Challenges of Contemporary Tax Law

Jubilee Book Dedicated to

Professor Włodzimierz Nykiel

volume II

edited by

Ziemowit Kukulski

Małgorzata Sęk

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Ziemowit Kukulski (ORCID: 0000-0003-2843-8170)
Małgorzata Sęk (ORCID: 0000-0002-6251-2031) – University of Lodz
Faculty of Law and Administration, Department of Tax Law, Kopcińskiego St. 8/12, 90-232 Lodz

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Contents

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Preface

Professor Włodzimierz Nykiel celebrated his seventieth birthday in 2021. This is a perfect opportunity to thank the Jubilarian for his scientific and academic activities to date. The Editors of this jubilee book – Professor's long-term associates at the Tax Law Department of the Faculty of Law and Administration of the University of Lodz, the Centre of Tax Documentation and Studies and the Foundation Centre of Tax Documentation and Studies – also have their own personal reasons to be grateful to the Jubilarian.

The scientific and academic biography of Professor Włodzimierz Nykiel is very rich, and international cooperation is an extremely important element thereof. The Jubilarian has always highly valued contacts with other centers and scientific circles, which allowed to build an international reputation of the Lodz school of tax law including the Tax Law Department and the Centre. For these reasons, as the Editors of the book, we decided that it should be divided into two volumes. The authors of the first part are eminent representatives of the Polish tax and financial law academia and practice. The second volume consists of studies prepared by foreign friends and colleagues of the Jubilarian – outstanding representatives of tax law academia and practice from other countries.

The book was born in turbulent times: of the COVID-19 pandemic and the war in Ukraine, just beyond Poland's eastern border. Although most of the texts were submitted in 2021, editorial and publishing works could not be completed before the Professor's seventieth birthday, therefore some of the observations made by the Authors may have slightly lost their topicality. In the meantime, the Professor's seventieth birthday (December 2021) coincided with the twenty-fifth anniversary of the Centre of Tax Documentation and Studies, founded and headed by the Professor

(December 2022), and the fiftieth scientific work anniversary of the Professor (October 2023).

We hope that this book, finally submitted for printing in 2023 and thus associated with three jubilees important for Professor Nykiel, will be a source of scientific inspirations for its Readers.

Editors

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Prof. Hab. Dr. Włodzimierz Nykiel, Dr. h.c.

Włodzimierz Nykiel was born in 1951 in Lodz, Poland. His parents: Mieczysław i Klara, were entrepreneurs. In 1969 he graduated from XXVI High School in Lodz and undertook legal studies at the Faculty of Law and Administration of the University of Lodz. In 1973, after receiving a Master of Law degree, he started working as an assistant at the Financial Law Department of the Faculty of Law and Administration of the University of Lodz. In the years 1978–1981 he studied comparative law at the International Faculty of Comparative Law (Faculté Internationale de Droit Comparé) in Strasbourg, France and received *Diplôme Supérieur de Droit Comparé*. In 1980 he received a Doctor of Law degree. His doctoral thesis *Budgetary act in socialist countries* was prepared under the supervision of Prof. Natalia Gajl. Based on the assessment of scientific achievements and the dissertation on the role of revenue in balancing local budgets (*Rola dochodów w równoważeniu budżetów lokalnych* [*The role of income in balancing local budgets*]) in 1993 he received a Habilitated Doctor of Law degree. In 1996 he was granted the position of Associate University Professor (*Professor Extraordinarius*). In 2002 he received the academic title of Professor of Law (State Professor) and in 2006 – the post of Full Professor of Law (*Professor Ordinarius*).

In 2016, he received an honorary doctorate from the University of Wrocław. The reviewers in the procedure for granting this title were Prof. Bogumił Brzeziński, Prof. Jerzy Małecki and Prof. Antonio Uricchio, Rector of the University of Bari Aldo Moro (Università degli Studi di Bari Aldo Moro) in Italy. In his review, Prof. Bogumił Brzeziński wrote that "[…] it will not be an exaggeration to say that Prof. Włodzimierz Nykiel is currently the most recognizable figure of the Polish tax law academia in the world". Similarly, Prof. Jerzy Małecki called Prof. W. Nykiel "a real ambassador of the Polish tax legal science". Also Prof. Antonio Uricchio wrote about the international activity and recognition enjoyed by Prof. Nykiel.

During over 50 years of work, Prof. Nykiel held various administrative functions at the University of Lodz. In the years 1994–1996 he was the Vice-Dean, and in the years 1996–2002 – the Dean of the Faculty of Law and Administration. In 2008 and 2012 he was elected Rector of the University of Lodz. He held this position until 2016.

In 2008 and 2012 he was elected Chairman of the Conference of Rectors of Public Universities in Lodz. From 2012, he was the Vice-Chairman of the Conference of Rectors of Polish Universities, a member of the Presidium of the Conference of Rectors of Academic Schools in Poland (CRASP) and the Chairman of the Committee for International Cooperation of CRASP.

In the years 2007–2022, he headed the Department of Substantive Tax Law, renamed in 2017 to the Department of Tax Law, at the Faculty of Law and Administration of the University of Lodz. Previously, he was the Head of the Substantive Tax Law Sub-Department at the Department of Financial Law. He also heads the Postgraduate Tax Law Studies, run continuously since 1995. In the years 2011–2019 he also headed the E-learning Postgraduate Tax Law Studies, and in the years 2003–2006 three editions of the Postgraduate European Union Tax Law Studies.

Włodzimierz Nykiel is the creator (1997) and long-term head (until 2022) of the Centre of Tax Documentation and Studies at the University of Lodz – the only research institution of this kind in Poland, cooperating with leading foreign centers, especially the International Bureau of Fiscal Documentation in Amsterdam (Netherlands). During the period when he headed the Centre, 154 nationwide tax conferences and seminars as well as several international conferences were organized, including: "Corporate Income Tax" (Cracow, 2007), "Taxpayer Protection. Tax Policy" (Lodz, 2008), "Tax Aspects of Research and Development – Towards More Sustainable Development in the EU" (Lodz, 2011), "Banking System – Current Issues at the Interface of Economy, Finance and Taxation" (Lodz, 2012), "Tax Treaties Application in Norway, Poland and Sweden" (Lodz, 2013), "Tax Legislation: Legal Standards, Trends, Challenges" (Lodz, 2013), "The Transformation of Tax Systems in the CEE and BRICS Countries – 25 Years of Experience and Future Challenges" (Lodz, 2015), "Informality, Taxation and Economic Development" (Tirana, Albania, 2016), "Tax Treaties Application Recent Developments in the Czech Republic, Hungary, Poland and Slovakia" (Lodz, 2016), "EATLP 2017 Congress: Corporate Tax Residence and Mobility" (Lodz, 2017), "The Third International Tax Seminar on Special Tax Zones" (Lodz, 2018), "The First Polish-Chinese Conference on the Recent Developments in Public Finance, Economy and Taxation in Poland and China" (Lodz, 2018), and "The Second

Chinese-Polish Conference on the Challenges of the Digital Economy and Possible Solutions" (Shanghai, China, 2019).

The achievements of the Centre of Tax Documentation and Studies, headed by Him, include the publication of over 70 issues of the only strictly scientific journal on the Polish publishing market devoted to tax law – "Kwartalnik Prawa Podatkowego" ["Tax Law Quarterly"], numerous tax scientific monographs supported or promoted by the Centre, three international research projects initiated and lead by the Centre, seven international research projects with the participation of the Centre, three research projects financed under grants from the State Committee for Scientific Research, numerous expert opinions on planned legislation, research projects on tax problems of local governments and three branches of the economy, a series of three reports on the state of tax law in Poland (2000, 2005, 2010), twenty four editions of the student competition in the field of tax law, two editions of doctoral workshops (2010, 2015), one edition of the competition for the best doctoral thesis in the field of tax law (2013), twenty eight editions of Postgraduate Tax Law Studies, eight editions of E-learning Postgraduate Tax Law Studies, three editions of Postgraduate European Union Tax Law Studies, participation in three international educational projects, including one cyclical, four cycles of trainings for foreign tax administrations.

Thanks to Prof. Nykiel's efforts the Centre's tax library was created, being the largest specialist tax library in Central and Eastern Europe with a book collection of over 5,000 items, a significant part of which are foreign publications.

Over 25 years of its existence, the Centre of Tax Documentation and Studies has become a leading academic center in Poland and Central Europe specializing in Polish, international, EU and comparative tax law. The undoubted international success of the Centre led by Prof. Nykiel was the organization in 2017 at the Faculty of Law and Administration of the University of Lodz of the Annual Congress of the European Association of Tax Law Professors (EATLP) – the most prestigious cyclical event in the world of tax law science. The Lodz EATLP Congress was not only the most important scientific tax event in Europe in 2017, but also the largest international tax event organized in Poland so far.

Another equally important event on an international scale was the organization in 2012 of the jubilee 20th EUCOTAX seminar at the Faculty of Law and Administration of the University of Lodz. EUCOTAX (European Universities COoperating on TAXes) is a joint initiative of renowned European universities and Georgetown University in Washington (United States), established in 1993 by an agreement between professors of tax law and aimed at conducting joint educational activities and research in the field of international, European, and comparative aspects of tax law. In 2009, Prof. Włodzimierz Nykiel was invited to join the initiative, and thereby students of the University of Lodz gained the opportunity to participate in the unique, internationally prestigious project Eucotax Wintercourse. Currently the following institutions participate in this initiative: Tilburg University (Netherlands) as coordinating institution, Vienna University of Economics and Business (Austria), Catholic University of Leuven (Belgium), Paris 1 Panthéon-Sorbonne University in Paris (France), University of Valencia (Spain), Osnabrück University (Germany), Georgetown University in Washington (United States), University of Zurich (Switzerland), University of St. Gallen (Switzerland), Uppsala University (Sweden), Loránd Eötvös University in Budapest (Hungary), Guido Carli Free International University of Social Studies in Rome (Italy), and the University of Lodz and the University of Warsaw. Since 2010, thirty-five students of the Faculty of Law and Administration of the University of Lodz have participated in thirteen editions of the project. This contributed to building the reputation of the University of Lodz and the Faculty of Law and Administration as a leading Polish center of research and teaching of tax law, cooperating with leading foreign centers.

In 2003, the Foundation Centre of Tax Documentation and Studies was established, the aim of which is to stimulate the development of tax law research, as well as to disseminate knowledge about taxes and tax law. The Foundation supports the activities of the Centre and other organizational units of the Faculty of Law and Administration of the University of Lodz. Its founders include i.a. the University of Lodz, Bank PEKAO S.A. and the International Bureau of Fiscal Documentation in Amsterdam, and Professor Nykiel is its president.

Professor Nykiel's scientific interests lie mainly in the issues of tax law, including its international, EU and comparative aspects, and initially also budgetary law and finances of local government units. He is a sole author of three books (*Ustawa budżetowa* [*Budgetary act*], Lodz 1987; *Rola dochodów w równoważeniu budżetów lokalnych* [*The role of income in balancing local budgets*], Lodz 1993; *Ulgi i zwolnienia w konstrukcji prawnej podatku* [*Reliefs and exemptions as elements of the legal structure of tax*], Warsaw 2002) and four editions of a commentary (*Ustawa o podatku dochodowym od osób fizycznych – Komentarz* [*Personal Income Tax Act – Commentary*], Warsaw 1997, 1998, 1999 and 2001), co-author of five books and four commentaries (two published once, one published twice, and one published nine times), as well as editor and co-editor of twenty six books, commentaries and academic textbooks, including five books in English and one in Chinese. He has written or co-authored more than 140 articles, chapters, and other studies, including several in English, and also in French, Spanish, Russian and Italian.

Several research areas of Prof. Nykiel can be identified. Both before and after obtaining the academic degree of habilitated doctor of law (1993), his research focused on the issues of budgetary law, banking law and local government finance. The results were presented in the monograph *Ustawa budżetowa* [*Budgetary act*] (Lodz 1987) based on the doctoral dissertation defended in 1980 and entitled *Ustawa budżetowa w krajach socjalistycznych* [*Budgetary act in socialist countries*], and numerous articles. During this period, Prof. Nykiel also undertook legal and comparative studies on the finances of local government units, with particular emphasis on the importance of local taxes in the context of the financial independence of municipalities. They resulted in numerous publications, including i.a. *Zakres samodzielności budżetowej gmin w świetle rozwiązań prawnych w latach 1973–1981* [*The scope of budgetary independence of municipalities in the light of legal solutions in the years 1973–1981*], "Problemy Rad Narodowych" 1981, No. 51 (co-author T. Austyniak-Górna); *Gospodarka finansowa w systemie rad terenowych* [*Financial management in the system of local councils*], [in:] *System terenowych organów władzy i administracji państwowej w europejskich państwach socjalistycznych*, ed. B. Zawadzka, Wrocław–Warszawa–Kraków–Gdańsk–Lodz 1985 (co-authors: N. Gajl, F. Sochacka-Krysiak); *Les dépenses des budgets territoriaux* [*Expenditure of territorial budgets*], "Acta Universitatis Lodziensis. Folia Iuridica" 1985, No. 20 (co-author: T. Augustyniak-Górna); *Dochody budżetów terenowych* [*Income of local budgets*], Lodz 1990; *Podatki lokalne – aspekty prawno-porównawcze* [*Local taxes – legal and comparative aspects*], "Acta Universitatis Lodziensis. Folia Iuridica" 1992, No. 54; *Dochody samorządu terytorialnego* [*Income of local government*], "Zeszyty Naukowe Akademii Ekonomicznej w Poznaniu" 1992, No. 203; *Budget and Taxes in Poland 1993*, "European Taxation" 1993, No. 9. The crowning achievement of the scientific work on the issues of finances of local government units is the habilitation thesis on the role of income in balancing local budgets (*Rola dochodów w równoważeniu budżetów lokalnych* [*The role of income in balancing local budgets*], Lodz 1993), which still remains a key position in Polish literature on the subject.

The second area of scientific interests of Prof. Nykiel is certainly the issue of tax reliefs and exemptions. The research on the construction of the tax conducted in this area resulted in numerous studies, both in the form of articles and chapters in monographs, as well as the monograph on reliefs and exemptions in the construction of tax (*Ulgi i zwolnienia w konstrukcji podatku* [*Reliefs and exemptions in the construction of tax*], Warsaw 2002). This monograph became the basis for conferring the academic title of professor of legal sciences on 18 November 2002 by the President of the Republic of Poland.

The third area of the Professor's scientific research concerns selected issues in the field of specific, as well as general tax law. Professor Nykiel is the author (co-author) and editor of many editions of commentaries on tax acts: the Personal Income Tax Act, the Corporate Income Tax Act, the Inheritance and Donation Tax Act, as well as the Tax Advisory Act. His scientific achievements in this area also include monographs on the issue of tax deductible costs prepared in co-authorship or under his editorship (*Leksykon kosztów uzyskania przychodów w podatku dochodowym od osób prawnych z uwzględnieniem regulacji prawa bilansowego* [*Lexicon of tax deductible costs in corporate income tax, taking into account the regulations of the balance sheet law*], Gdańsk 2007, co-authors: A. Mariański, D. Strzelec, E. Walińska, W. Bojanowski, A. Wencel) and related entities and transfer pricing (*Podmioty powiązane. Ceny transferowe. Dokumentacja podatkowa* [*Related entities. Transfer pricing. Tax documentation*], Warsaw 2014, co-editor D. Strzelec, co-authors: D. Strzelec, Z. Kukulski, A. Nowak-Piechota, S. Rzymkowska, M. Sęk, M. Wilk, T. Wojdal, Z. Wójcik), as well as chapters in monographs and articles on the issues of value added tax (with particular emphasis on the right to deduct input tax and the issue of good faith). His scientific achievements also include a multi-author monograph on general issues of tax law (*Zagadnienia ogólne prawa podatkowego* [*General issues of tax law*], Lodz 2014, co-edited with M. Wilk and co-authored) and a monograph prepared in co-authorship with Wojciech Chróścielewski on tax proceedings in the light of the Tax Ordinance (*Postępowanie podatkowe w świetle Ordynacji podatkowej* [*Tax proceedings in the light of the Tax Ordinance*], Warsaw 2000). His achievements also include numerous chapters and articles on tax principles, autonomy and the interpretation of tax law and the general anti avoidance clause.

Research on international, EU and comparative tax law holds a special place in the scientific research of Prof. Nykiel. Together with Hubert Hamaekers, Kevin Holmes, Jan Głuchowski and Tomasz Kardach, Prof. Nykiel is the co-author of the first study on international tax law published in Poland and entitled *Wprowadzenie do międzynarodowego prawa podatkowego* [*Introduction to International Tax Law*] (Warsaw 2006). Together with Adam Zalasiński, he co-edited a multi-author commentary on the jurisprudence of the Court of Justice of the European Union, which is publication still very unique in Poland (*Orzecznictwo Trybunału Sprawiedliwości Unii Europejskiej. Komentarz* [*Judicial practice of the Court of Justice of the European Union. Commentary*], Warsaw 2014). He is the co-author and co-editor of several internationally recognized monographs, including *Protection of Taxpayers' Rights. European, International and Domestic Tax Law Perspective* (Warsaw 2009, co-edited with Małgorzata Sęk and co-authored), *Tax Aspects of Research and Development within the European Union* (Warsaw 2014, co-edited with

Adam Zalasiński), *Tax Legislation. Standards, Trends and Challenges* (Warsaw 2015, co-edited with Małgorzata Sęk and co-authored) and *Transformation of Tax Systems in the CEE and BRICS Countries – 25 Years of Experience and Future Challenges* (Lodz 2018, co-edited with Ziemowit Kukulski and co-authored). Professor Nykiel also co-edited with Michał Wilk a multi-author monograph entitled *Polish Tax System. Business Opportunities and Challenges* (Warsaw 2017), which was also published in Chinese translated by Dr. Tan Yusen: 波兰税制 商业机会和挑战=*Polish Tax System. Business Opportunities and Challenges* (Shanghai 2019).

Professor Nykiel is also the author and co-author of several national and general reports presented at international scientific conferences or resulting from comparative tax law research and published in collective works and journals. These are: *Confidentiality and the Law of Taxation*, [in:] *Rapports polonais présentés au quinzième Congrès International de Droit Comparé* (Lodz 1998); *Budgetary Decentralization: Balance of Interests and Contradictions*, [in:] *Rapports polonais présentés au seizième Congrès International de Droit Comparé* (Lodz 2002); *Restricting the Legislative Power to Taxes*, [in:] *Rapports polonais présentés au XVIIe Congrès International de Droit Comparé* (Lodz 2006; co-author Z. Kukulski); *Poland-National Report. 17th Congress of the International Academy of Comparative Law Utrecht 2006. Tax Law Session*, "Michigan State Journal of International Law" 2007, No. 15, (co-author Z. Kukulski); *Raport generalny dotyczący ochrony praw podatnika* [*General report on the protection of taxpayer's rights*], "Kwartalnik Prawa Podatkowego" 2008, No. 2, (co-author M. Sęk); *Polish equity and debt financing regime in the light of neutrality principle, EC tax law and ECJ case-law*, "European Tax Studies" 2010, No. 1 (co-authors Z. Kukulski, M. Wilk)[1]; *Standardy, trendy i wyzwania legislacji podatkowej. Raport generalny konferencji „Tax Legislation: Legal Standards, Trends and Challenges"* [*Standards, trends and challenges of tax legislation. General report of the conference "Tax Legislation: Legal Standards, Trends and Challenges"*], "Kwartalnik Prawa Podatkowego" 2013, No. 4 (co-author M. Sęk); *Raport generalny – transformacja systemów podatkowych w państwach BRICS – 25 lat doświadczeń oraz wyzwania na przyszłość – cz. I* [*General report – transformation of tax systems in the BRICS countries – 25 years of experience and future challenges – part I*], "Kwartalnik Prawa Podatkowego" 2017, No. 2 (co-author Z. Kukulski); *Raport generalny – Transformacja systemów podatkowych w państwach Europy Środkowo-Wschodniej – 25 lat doświadczeń oraz wyzwania*

[1] This text has also been published in Italian and Spanish: *Il regime polacco dei finanziamenti a debito ed in conto capitale alla luce del principo di neutralita, normative fiscale comunitaria e giurisprudenza della Corte di Giustizia*, "Studi Tributari Europei" 2010, No. 1 (co-authors Z. Kukulski, M. Wilk); *Regimen polaco de financion por deudas y por acciones a la luz del principio de neutralidad y del Derecho y la jurisprudencia comunitarios*, "Estudios Tributarios Europeos" 2010, No. 1 (co-authors Z. Kukulski, M. Wilk).

na przyszłość cz. II [*General Report – Transformation of tax systems in Central and Eastern Europe – 25 years of experience and future challenges – part II*], "Kwartalnik Prawa Podatkowego" 2017, No. 3 (co-author Z. Kukulski).

Research on the protection of taxpayers' rights, initiated in 2008, has been an important and currently is the main area of the Professor's scientific interests. An international research project *Protection of Taxpayers' Rights, European, International and Domestic Tax Law Perspective* initiated and led by Prof. Nykiel and Dr. Sęk played a major role in the development of the worldwide scientific discourse on the protection of taxpayers' rights. The monograph presenting the results of the research (*Protection of Taxpayers' Rights, European, International and Domestic Tax Law Perspective*, Warsaw 2009, co-edited with M. Sęk and co-authored) has become an important position in the international literature on the protection of taxpayers' rights, as evidenced by numerous references by eminent members of the global tax academia. An international research project devoted to standards, trends and challenges of tax legislation, including the issues of protection of taxpayers' rights, also played an important role at the international level (see *Tax Legislation, Standards, Trends and Challenges*, Warsaw 2015, co-edited with M. Sęk and co-authored). The results of research in this area are also included in numerous articles and chapters in monographs, but above all the draft *Taxpayer's Rights Charter* must be mentioned, developed in co-authorship with Małgorzata Sęk, twice submitted to the Sejm as a parliamentary bill, and the monograph entitled *Karta Praw Podatnika. Nowy instrument ochrony prawa polskiego podatnika* [*Taxpayer's Rights Charter. A new instrument to protect the rights of the Polish taxpayer*] (Lodz 2022), co-authored with Małgorzata Sęk.

Professor Nykiel also published reviews of monographs by: Hanna Litwińczuk: *Prawo podatkowe przedsiębiorców* [*Tax Law of Entrepreneurs*] (Warsaw 2001), Antoni Hanusz: *Podstawa faktyczna rozstrzygnięcia podatkowego* [*The factual basis of a tax settlement*] (Cracow 2006), Bogumił Brzeziński (ed.), Marek Kalinowski (ed.), Adam Zalasiński, Ewa Prejs, Krzysztof Lasiński-Sulecki: *Prawo podatkowe Wspólnoty Europejskiej* [*European Community tax law*] (Gdańsk 2006), Adam Zalasiński: *Zakaz dyskryminacji w sferze podatków bezpośrednich w prawie podatkowym Wspólnoty Europejskiej* [*Prohibition of direct tax discrimination in the European Community tax law*] (Warsaw 2006), and Bogumił Brzeziński: *Zasady wykładni prawa podatkowego w krajach anglosaskich* [*Principles of interpretation of tax law in Anglo-Saxon countries*] (Warsaw 2007).

He has participated as a speaker and discussant in many domestic and international conferences. In 1985 he was a visiting researcher in Vienna and Salzburg (Austria). Since 1992 he has regularly held study visits at the International Bureau of Fiscal Documentation (IBFD) in Amsterdam (the Netherlands).

Professor Nykiel is regularly lecturing tax law, including international and European tax law (in both Polish and English). Earlier he has also been lecturing financial law. Thanks to his efforts and contacts with the International Bureau of Fiscal Documentation in Amsterdam, he was the first in Poland to deliver (co-deliver) a lecture *Międzynarodowe i europejskie prawo podatkowe* [*International and European Tax Law*] at the Faculty of Law and Administration of the University of Lodz. He has given lectures as a visiting professor at various foreign universities (Bari, Bologna and Taranto in Italy; Grenoble and Tours in France; Vienna in Austria). He delivered a series of lectures on Polish tax law to tax advisors in Nuremberg, Germany and to Members of the Slovak Parliament and high officials of the tax administration in Bratislava, Slovakia. He has also delivered lectures at universities in Denton (USA), Sofia (Bulgaria), Tirana (Albania), as well as Shanghai and Tianjin (China).

Worth mentioning are also the academic textbooks of tax law, which have been created at the initiative of and edited by Prof. Nykiel (*Polskie prawo podatkowe* [*Polish Tax Law*], Warsaw 2003, 2006, 2011 and 2015, and then *Prawo podatkowe w Polsce* [*Tax Law in Poland*], Warsaw 2018). The Professor is the author and co-author of extensive fragments of subsequent versions and editions of the textbook, and the team of authors also included staff members of the Faculty of Law and Administration of the University of Lodz invited by him (W. Chróścielewski, K. Koperkiewicz-Mordel, Z. Kukulski, M. Sęk, M. Wilk).

During over 50 years of work at the University of Lodz, he has supervised over 170 master theses in the field of law and in the field of administration and 18 doctoral theses in the field of law. He was a reviewer in 12 doctoral and 4 habilitation proceedings. He was appointed as a reviewer in 4 proceedings for the academic title of professor of law. He was a promoter in the proceedings for the award of honorary doctorates of the University of Lodz to Hubert Hamaekers and Bogumił Brzeziński. Several of the Professor's students worked and still work as university professors or as assistant professors at the Department of Tax Law of the University of Lodz.

Many times he has chaired and has been a member of the jury of student competitions in the field of tax law.

Professor Włodzimierz Nykiel belongs to a close and small group of eminent experts in tax law in Poland, widely appreciated abroad. He has held many important positions in Poland and abroad. Among others, he was a consultant of the International City Management Association in Washington (the United States) (1991–1992), an expert of the Joint Commission of the Government and Local Government (1995, 1996), a parliamentary tax expert (an expert of the Office of Studies and Expertise of the Chancellery of the Sejm) (1995–1997), a member of the Council for Systemic Reforms of the State to the Prime Minister (1998, 1999), a judge of the State Tribunal of the Republic of Poland (1997–2001), a member of the Economic and Social Advisory Council to the Minister of Finance (2003–2004), a member of the Social Treasury Council to the Minister of Finance (2004, 2005), a member of the State Examination Commission for Tax Advisors (1997–2010; its president in the years 2002–2007), a member and vice-president of the Advisory Council for Tax Law to the Minister of Finance (2014–2016), a member of the Scientific Council to the National Chamber of Tax Advisors (2018–2022) and a member of the Legislative Council to the Prime Minister's Office (2006–2010).

He is a member of a number of scientific societies, both international and national. Since 2000, he has been a member of the European Association of Tax Law Professors (in the years 2000–2005 he was on the EATLP Academic Committee). He joined the International Fiscal Association in 2002 and was elected to the Executive Committee at the 2005 Buenos Aires Congress (he was reelected in 2007 at the Kioto Congress and in 2009 at the Vancouver Congress and vacated the position in 2011). He was a member of the Advisory Council of the International Bureau of Fiscal Documentation in Amsterdam (2003–2008) and since 2008 he has been a member of the IBFD Board of Trustees. He is also a member of the Lodz Scientific Association.

Professor Nykiel is the editor-in-chief of "Kwartalnik Prawa Podatkowego" ["Tax Law Quarterly"] and he has been a member of programme boards of "Przegląd Podatkowy" ["Tax Review"], "Prawo i Podatki" ["Law and Taxes"], "Przegląd Legislacyjny" ["Legislative Review"], "Kwartalnik Doradcy Podatkowego" ["Quarterly of Tax Advisor"], advisory board of "EC Tax Review" and editorial board of "Central European Business Review".

In the years 1998–2004, together with Prof. T. Pajor, he run a law firm "Interlex", and later, until 2008, an individual law firm.

In 2015, he took part in the parliamentary elections in the Lodz constituency as the leader of the electoral list of Platforma Obywatelska. He was elected to the Sejm of the 8th term, receiving 21,708 votes. He was a member of the Parliamentary Education, Science and Youth Committee and the Public Finance Committee, he was the Chairman of the Permanent Subcommittee for Science and Higher Education.

Professor Włodzimierz Nykiel was awarded, among others: the Knight's Cross of the Order of Polonia Restituta (2011) and the Pro Ecclesia et Pontifice Cross (2012). All these numerous functions and honors, as well as being twice elected Rector of the University of Lodz, prove that the Professor's ethical and social attitude is rated as high as his professional achievements.

He is married – his wife Alina is a solicitor. He has two married daughters: Anna and Agata (Anna's husband is Jose Manuel Mateo Goyet, Agata's husband is Jakub Baraniak) and three grandchildren: Franciszek, Esteban and Klara.

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Hubert Hamaekers[1]

Prof. Wlodzimierz Nykiel 70: From Cooperation to Friendship

It was Spring 1994. Two prominent academics from Poland visited the IBFD in Amsterdam. Prof. Michal Sewerynski was rector of the University of Lodz, prof. Wlodzimierz Nykiel was professor of tax law at the Faculty of Law and Administration of that university. Apparently Prof. Jan Gluchowski, the IBFD contact person in Poland, and Anna Bardadin, a Polish librarian in the IBFD, had successfully promoted the treasure of tax information and opportunities for researchers in the IBFD.

In his discipline of social and labour law Prof. Sewerynski had already been very active in Europe and Prof. Nykiel took a special interest in European tax law, both anticipating a Polish membership of the European Community.

Our guests were clearly impressed by IBFD's library, tax databases and teaching programmes. The tour of the office with introductions to members

[1] Before joining the International Bureau of Fiscal Documentation (IBFD) in 1985 Hubert Hamaekers has been head of an international department and deputy director of legislation in the Ministry of Finance of The Netherlands and also chairman of the OECD Working Party on Transfer Pricing and Multinational Enterprises. He has been CEO of the IBFD from 1985 to 2004. Other functions included co-founder and Executive-Secretary of the European Association of Tax Professors, member of the Permanent Scientific Committe of the International Fiscal Association and member of the Consultative Committe of the Commissioner of Taxation of the People's Republic of China. During his academic career he has been professor of European Taxation at the Catholic University (now Radboud University) of Nijmegen, professor of International Tax Law at Jönköping University and visiting professor/lecturer at the Universities of Amsterdam (VU), Budapest (Eötvös Loranc), Cambridge, Leiden, Leuven, Lodz, Vienna (Wirtschaftsuniversität) and Stellenbosch (S.A.). From 1997 to 2011 he has been chairman of the Centre for Tax Documentation and Studies of the University of Lodz. In 2002 he received an honorary doctoral degree of the latter university. Hubert Hamaekers is a Commander of the Order of Oranje Nassau, an honorary member of the International Fiscal Association and an honorary fellow of the Chartered Institute of Taxation (UK).

of the research department from various countries including not only Europe but also the USA, Canada, Argentina, China and Japan, resulted in an interesting exchange of information. At the pleasant dinner with our Polish guests ideas for cooperation came up, in particular sending doctoral students to IBFD's library to be tutored by reasearch staff members. The Médoc wine served also contributed to the emerging spirit of cooperation. At the end of the visit Rector Sewerynski invited me to Lodz.

Gladly accepting the invitation, I went to Poland in September 1994. I had learned that the trip from Warsaw airport to Lodz was somewhat difficult. The options of taking the train from Warsaw Central Station (several hours) or taking a taxi to cover 140 kilometers of mostly two lane narrow roads through various towns and villages did not seem attractive. I was therefore happily surprised to see the Rector's driver waiting for me at the airport. The driver was very experienced meaning that he could overtake carts drawn by horses at maximum speed without hitting oncoming trucks. Only a couple of crossing cats did not survive the encounter.

The arrival in Lodz was surprising. After the narrow roads in the countryside a cityscape with six-lane circular roads emerged. The driver spoke some German and explained that I would stay in the "Sewerynski Marriott". That turned out to be the recently opened conference centre and hotel founded by Rector Sewerynski. The nickname "Marriott" was a little bit overstated, but my room was spacious and clean. Moreover, it hinted to an entrepreneurial spirit of my host.

After a four-kilometer stroll along Piotrkowska street marked with amazing 19th century palaces I met my hosts in a traditional restaurant located in a former bank building. I could not foresee that the place would become the scene of many pleasant and productive gatherings.

The food was good and the wine excellent. Apparenly my hosts had assumed that Médoc was my favourite beverage, a thought that I did not dispute. It turned out my hosts had already made ample preparations for future cooperation. An entity within the law faculty would be set up with a separate budget, two staff members and an office. The next day I already met the two candidates for the staff positions concerned and saw the premises to be occupied.

I was impressed by the drive shown by my hosts and the keen interest in cooperation with the IBFD. Not only did they arrange staff and office space but also a sponsorship by Bank Pekao S.A. The large office was located above eight flights of stairs on the fourth floor of an old university building. In the absence of an elevator regular visitors would probably become extremely fit (looking at the future head of the department, Prof. Nykiel, and myself at the time that would have been a collateral advantage of the new venture!).

Before I returned to Amsterdam a cooperation agreement between the University of Lodz and the IBFD was signed. In addition to a financial sponsorship the IBFD made lecturers on European and international tax law available, along with tutoring at the IBFD of doctoral students from Lodz and providing books and databases to the future library.

During that first visit I found Lodz, then the second largest city in Poland, amazing. From the mid 19th century to the Second World War its textile industry had been the largest in continental Europe. The former factories and the adjacent palace-like dwellings of the owners make a ring around the city centre. The red brick Poznanski complex and palace are striking examples. The prosperity of that era is shown by the large number of beautiful fin-de-siecle houses at Piotrkowska Street. After the Second World War the Lodz filmschool and industry became internationally renowned. Movie directors Andrzej Wajda and Roman Polanski are film giants connected with Lodz that bears the nickname of Lollywood.

During its first two years cooperation materialized rapidly. IBFD staff lectured in Lodz for an increasing audience of master and postgraduate students. I had the pleasure of introducing the topic of transfer pricing in Poland. Tax lecturers and Ph.D-students from Lodz made good use of the IBFD library facilities and a vanload of tax books arrived at the new tax library in Lodz.

A major development, however, was that prof. Nykiel became dean of the law faculty enabling him to structure the cooperation with IBFD in a more concrete way. Consequently in 1997 the Centre for Tax Documentation and Studies (CTD&S) was founded as a joint venture of the law faculty and the IBFD. Some years later the Centre became an independent foundation with Prof. Nykiel as managing director and the CEO of the IBFD as chairman of the Council of the Foundation.

Owing to Wlodzimierz Nykiel's organizational, promotional and educational talents and its dedicated staff the Centre had rapidly acquired the position of first provider of tax courses in Poland to both the government and the business sector. Every year seminars on Polish and European taxation are organised attracting an increasing number of practitioners and master students. English language seminars started to become relevant also to foreign tax administrators and tax managers from various companies.

Primary lecturer Prof. Nykiel was assisted by tax professors from other Polish universities, in particular Prof. Bogumil Brzezinski, and foreign universities. The cooperation with the IBFD was enhanced by the appoinment of Jan de Goede, head of the research department of the IBFD, as a member of the council of CTD&S and professor of international tax law at the faculty. Very able and loyal staff members, including the two editors of this liber amicorum, Dr. Malgorzata Sęk and Prof. Ziemowit Kukulski, greatly helped Prof. Nykiel in making the CTD&S a success.

Since the late nineties the annual National Students Conferences have been extremely useful for tax students from various universities, making the Centre the pivot of tax education in Poland. Other main events with more than 100 participants from various countries had a European focus such as the 1998 conference on taxpayer protection and the 2013 conference on trends in tax legislation with prominent speakers from 17 countries including the United States and China.

I felt very honoured when my relationship with the University of Lodz became even closer by receiving an honorary Ph.D with Prof. Nykiel as promotor. The fact that the other honorary doctor in 2002 was Andrzej Wajda offered me a unique opportunity for a pleasant conversation with this famous movie director.

The development of the Centre went hand in hand with the development of Poland and the city of Lodz, in particular after the accession to the European Union in 2004. The infrastructure improved enormously, a modern motorway made Lodz much better accessible from the capital city and Warsaw international airport (unfortunately only after my retirement from the Council of the Centre). In Lodz the former Poznanski complex became a world-class shopping mall cum hotel.

Prof. Nykiel's managerial skills and his international network did not remain unnoticed. In 2008 he was appointed Rector of the University of Lodz, a position he held for two terms until 2016. One of the perks of the job was the Biedermann palace serving as the office of the Rector.

With a Minister of Education, Prof. Michal Sewerynski, coming from the Lodz law faculty, and an entrepreneurial dean and subsequently rector like Prof. Nykiel, it was not surprising that the accommodation of the faculty and the Centre would be improved. A real surprise was the new faculty building itself. I could not believe my eyes when I saw the building for the first time in 2008: probably the most modern and sophisticated law faculty in the world, aptly built in the form of a paragraph! The good people connected with the CTD&S were very pleased with the spacious library, comfortable offices and adjacent lecture-theaters. Since that time the facilities have been utilized by Prof. Nykiel and his staff to further develop the Centre into the main tax research and study hub in Central Europe.

Dear Wlodek!

I have followed your career for almost thirty years. You have successfully combined the very demanding position of rector of a large university with that of director of the Centre. You have also served on several judicial, governmental and parlementary committees, the latter as a member of the Sejm. Not to mention the influencial books and articles written by you (unfortunately, I was not able to read the great majority of them). One could say that tax in Poland has been, and still is, personified by Wlodzimierz Nykiel, also from an international perspective.

One of the most pleasant aspects of my own career has been the relationship since 1994 with you in particular and the good people surrounding you in Lodz. Coming to Lodz, discussing your plans for the Centre during enjoyable dinners in the former bank at Piotrkowska and more officially in the Centre's council meetings, lecturing on transfer pricing for very interested audiences, meeting your family, it felt like coming home.

During my Amsterdam years you have been a frequent and very welcome visitor of the IBFD, many times accompanied by Bogumil. After my retirement from IBFD you became a member of IBFD's Board of Trustees and several times our guest in our hometown Wageningen. Please carry on with that, Médoc will always be waiting for you!

Wishing you all the best for the future, I thank you for the excellent cooperation and warm friendship.

Hubert

Abstract

The article describes the early days and the founding of the Centre for Tax Documentation and Studies by the University of Lodz and the International Bureau of Fiscal Documentation in the nineties and its development in later years. In particular due to its director Prof. Nykiel and its able and dedicated staff the Centre has become a leading tax research and training institute in Central Europe. Courses not only include programmes for master students but also for tax administrators and practitioners from various countries. Special attention goes to international and European tax topics, including the important topic of transfer pricing.

Keywords: Centrer of Tax Documentation and Studies, Prof. Nykiel, tax courses

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Vladimír Babčák[1]

Parallels of the Development of Tax Law in Slovakia

Laudation for Professor Włodzimierz Nykiel

I have known Professor Włodzimierz Nykiel for more than 40 years. We have been regularly meeting at different academic events in Poland and Slovakia. Especially in the past, our lively professional discussion was concerned with the emancipation of tax law from financial law and its development towards a separate branch of law. In our professional work, we have been defending the notion that tax law is indeed a separate branch of law, I in Slovakia and Professor Nykiel in Poland. I am still convinced that the current development of tax law cannot be stopped. Therefore, I still firmly hold to the same views as before, which, in my opinion, have been confirmed by social changes in both countries since 1989.

1. Introductory thoughts[2]

At the beginning of 2021, almost three decades had passed since the start of the tax reform, in Slovakia, which we may call the first reform. In 1992, in which the work on tax reforms began, we witnessed the increased attention of the public and scientific community to matters relating to taxation. The

[1] Prof. h.c. Prof. JUDr. Vladimír Babčák, CSc., Professor Financial and Tax Law (2002), Head of the Department of Financial Law, Tax Law and Economics at the Law Faculty of Pavol Jozef Šafárik University in Košice (Slovakia).

[2] This work was supported by the Slovak Research and Development Agency under Contract No. APVV-19-0124.

number of changes that were implemented through the tax reform of 1992 we have not since seen – maybe except for the year 2004. The year 2004 is inseparably connected with Slovakia joining the European Union (EU). Nevertheless, we believe that the quality of change that happened in 1992 in comparison to 2004 was greater.

In 1992, new tax law institutions that mark the beginning of independent tax law were introduced. After the reform of 1992, all previous tax laws were abrogated. The tax law became one of the most dynamically developing branches of the Slovak legal order. Moreover, many changes in the system of taxes were made. Beginning in 1993, the former taxes were all replaced by new ones that, although resembling the former taxes on objects of taxation (business income, ownership of property), widely differ in their legal construction to the extent that their similarities are only peripheral. After all, currently there exists no tax that has the same designation/name as any of the taxes that were imposed before 1992.

Many new tax law institutions were introduced (e.g., tax execution, tax advisors, new remedies, etc.).[3] In addition, we could mention one fact that is often overlooked. After 1992, the whole system of taxes was generally set out by the Law on the Tax System.[4] In that period, the Law on the Tax System was the "basic norm" of the tax law or the "tax law constitution" providing that no other taxes could be imposed except the ones directly stipulated in this law.[5] It contributed to one of the major principles of the tax law, namely, legal certainty for taxable entities. This legal certainty was based on the guarantees that no other taxes than those mentioned in this law would have been imposed. This could have effectively limited government spending, which could not rely on the possibility of introducing new taxes. Over time, this important principle was forgotten. Sadly, the Law on the Tax System was derogated on 1 September 1992. This opened the way for the government and parliament to introduce several new taxes. It could serve as an example of how the economic interests of certain ruling groups, even the personal interests of politicians, adapt and in some cases warp the general principle of taxation widely accepted by tax law theory.[6]

[3] Concerning the impact of tax reform on forming independent tax law, see: V. Babčák, *Slovenské daňové právo*, EPOS, Bratislava 2012, p. 42.

[4] SK, Law of 15 April 1992 on System of Taxes [*Zákon o sústave daní*], Collection of Laws 1992, No. 212, amended.

[5] See: V. Babčák, *Daňové právo a príprava daňovej reformy v Slovenskej republike*, "Acta Universitatis Carolinae: Iuridica" 2003, No. 3–4, pp. 9–26.

[6] See: V. Babčák, *The Public Financial Interest in Slovak Republic (Certain Reflections)*, [in:] E. Lotko, U.K. Zawadzka-Pąk, M. Radvan (eds), *Optimization of Organization and Legal Solutions Concerning Public Revenues and Expenditures in Public Interest*, Temida 2, Białystok 2018, pp. 25–37.

Changes in normative areas themselves could not guarantee the forming of an independent status of tax law as a separate branch of law. In addition, this development was the object of many discussions in the academic community and members of the public. For a typical person, it is not overly important whether tax law is or is not an independent branch of law. On the other hand, many questions related to taxation have become more visible in the public eye through the years following the tax reform of 1992. Immediately after 1992, tax justice and the impact of taxation on business started to be widely discussed in public. This discussion only intensified with the passing of time. The public sometimes subconsciously started to realize the importance of tax regulation and its impact on the existence and development of society. It must be openly admitted that the independent status of tax law was challenged by some members of the academic community – who held conservative views in the mould of "what once was must remain the same" – therefore the academic community has been rejecting this qualitative and fundamental change of Slovak legal order. In our opinion, the change in the position of tax law was created (and proved necessary) by the evolution of the society and economic relations along with the complex evolution of the legal order.

The process of creating tax law as an independent branch of Slovak law was justified and necessary. It was part of Slovakia's preparation for joining the European Union, which happened on 1 May 2004. This work led to the introduction of several new concepts into national taxation. Moreover, it confronted tax law with new requirements that have not been wholly accepted due to the fear of a loss of tax sovereignty constituting state sovereignty.

Although important from a political-economic perspective, EU membership for Slovakia did not carry the significant or revolutionary change for tax law the 1992 reform held. It follows from the fact that even before joining the EU, Slovakia was required to adapt its national legislation in accordance with EU law (both material and procedural norms of tax law). Therefore, new legislation concerning harmonized indirect taxes[7] was introduced half a year before joining the EU in 2004. Moreover, that year witnessed the introduction of fiscal decentralization also with the introduction of local taxes and a new basis for the system of local duties (more precisely, the number of local duties was limited). Although these changes were significant, they did not exceed the importance of the tax reform of 1992.

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[7] Former value added tax and excise tax(es) of 1992 significantly differ in their actual legal construction from the current taxation instruments known under this name today.

2. Present state of the Slovak tax law

Especially due to tax reform performed in the years 1992 and 1993, the tax law has exceeded the boundaries of financial law. It can be viewed as a natural, necessary, and irreversible development.[8] Professor Suchoža, one of the leading lawyers and academics in commercial law in Slovakia, noted: "the development of law in Slovak Republic provides enough reasons to believe that the traditional criteria by which the legal order (and legal theory) was measured including the creation and systematization of legal branches have been overcome."[9] We consider the outward (phenomenological) structure of the legal order and the relationships between its structural parts still to be an important academic topic. Sadly, broader academic discussions concerning these matters are currently lacking and we believe that it is our academic duty to pose these questions. Only an exchange of different opinions can provide an incentive for the future development of legal science and the science of tax law.

It takes roughly ten years until an independent body of norms that constitutes the tax law has been formed. This process was in our opinion finalized by the introduction of the Law on Tax Organs in 2001.[10] The law as a first competence legislation introduced the notion of "tax organ" (until then the notion of local financial organs was used). Moreover, the law introduced the term "tax proceedings" for a kind of procedure in which tax organs act and decide. Until then, no legislation used similar terms. In addition to that, the law began to distinguish between tax proceedings and administrative proceedings.[11] Unfortunately, the legislator later stopped using the term "tax organs" and, according to current legislation, this notion was replaced by the notion "organs of financial administration."[12]

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[8] See: V. Babčák, *Daňové právo na Slovensku a v EÚ*, EPOS, Bratislava 2019, pp. 57–85; *idem*, *Nalogovoje pravo Slovakii*, [in:] *Nalogovoje pravo stran vostočnoj Evropy*, Wolters Kluwer, Moscow 2009, pp. 196–243; *idem*, *Tax Law Creation as a Result of Partial Atomization of Financial Law in Slovakia*, [in:] M. Radvan (ed.), *System of Financial Law. System of Tax Law*, Masaryk University Press, Brno 2015, pp. 29–44.

[9] J. Suchoža, *Hraničné problémy finančného práva a práva hospodárskeho*, [in:] M. Štrkolec (ed.), *Aktuálne otázky finančného práva a daňového práva v Českej republike a na Slovensku*, UPJŠ, Košice 2004, p. 11.

[10] SK, Law of 6 April 2001 on Tax Organs [*Zákon o daňových orgánoch*], Collection of Laws 2001, No. 150, amended.

[11] See: Paras. 4(3)(c) and 4(3)(d) SK, Law of 6 April 2001 on Tax Organs [*Zákon o daňových orgánoch*], Collection of Laws 2001, No. 150, amended.

[12] Para. 2(2) of SK, Law of 5 December 2018 on Financial Administration [*Zákon o finančnej správe*], Collection of Laws 2019, No. 35, amended.

At the first glance, it could seem like we are discussing some unimportant questions concerning tax law, at least for a reader who is not acquainted with the problem at hand. It is important to realize that tax proceedings were regulated by general administrative rules until the end of 1993. With that in mind, the importance of the regulation of tax proceedings suddenly started to be significant. Still, there are those who believe that tax proceedings are a special type of administrative procedure.[13] It could only be viewed as a relic of the conservative approach of certain representatives of administrative law. Certainly, it is less difficult to adhere to the old-fashioned views about certain structural and systematic questions concerning legal order than to start thinking about new changes of law that result from socio-political and economic development. Without a new way of thinking, we would still be stuck with the opinions that belong to the beginning of the previous century.

In a practical sense, the development of procedural regulations of tax law in Slovakia has taken a different course of action. The Law on Tax Administration of 1992[14] excluded the application of general administrative procedural rules (e.g., Law No. 71/1967 Coll. on Administrative Proceedings[15]) regarding tax proceedings.[16] This approach was also adopted by the current procedural legislation, i.e., the Tax Procedure Code of 2012.[17] The procedural norms of tax law, in our opinion, played an important role, even a decisive role, in the separation of tax law from the scope of financial law (and further in history from administrative law). Through these new procedural norms, the material norms governing tax rights and obligations have started to be fully realized.

We can ask to what extent legislative organs contribute to the increase of the importance of tax law and whether it was caused by other factors. At first glance, it is more theoretical in the sense that it does not offer an exact answer. In my opinion, we cannot make a strict distinction between the role of legislative organs and of other factors influencing the constitution of an independent tax law. One of these other factors is accepting an independent tax law as a separate legal branch, as supported by public

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[13] See: V. Babčák, *K podstate daňového konania a jeho vzťahu k správnemu konaniu*, "Justičná revue" 2000, No. 8–9, pp. 914–925; *idem*, *Úvahy o vzťahu daňového, finančného a správneho práva*, [in:] M. Kiovská (ed.), *Pocta profesorovi Gašparovi*, UPJŠ, Košice 2008, pp. 11–20.

[14] SK, Law of 30 September 1992 on Tax administration of taxes and fees [*Zákon o správe daní a poplatkov*], Collection of Laws 1992, No. 511, amended.

[15] SK, Law of 29 June 1967 on Administrative Proceedings [*Zákon o správnom konaní (správny poriadok)*], Collection of Laws 1967, No. 71, amended.

[16] See: Para. 101 of SK, Law of 30 September 1992 on Tax administration of taxes and fees [*Zákon o správe daní a poplatkov*], Collection of Laws 1992, No. 511, amended.

[17] See: Para. 163 of SK, Law of 1 December 2009 on Tax Procedure Code [*Zákon o správe daní (daňový poriadok)*], Collection of Laws 2009, No. 563, amended.

opinion surveys. This opinion concerning tax norms hugely differs from the view held in the past. The change in public opinion resulted from the transfer of personal responsibility for material and financial well-being of an individual away from the state and shifting this responsibility to the individuals who at the same time play the role of bearers of new tax obligations. These new tax obligations include an obligation to register for a tax, an obligation to fill out a tax return, and so on. Although several of the procedural obligations did exist in the previous regime, the level of sophistication and difficulty of these legal relationships between taxable entities and the state or municipalities has become much higher. These relationships had to adapt to the requirements of new means of communication and information technology.

On the other hand, the option of creating one unified taxation instrument concerning natural and legal persons became possible (e.g., in the case of income taxation, the specific taxes such as tax on income from employment, tax on income from literary and art activities, tax on income of citizens, and tax on income from agriculture have been transformed into one tax on income; a similar situation happened in relation to the tax on income of legal persons).[18]

An important factor determining changes in tax matters has been changes in the system of government and planning. The transformation into a market economy, later joining the EU common market with distinct freedoms, led to an increase in Slovak legislative activity and contributed to the establishment of the principles and rules on which the current state tax policy is based (although these principles and rules are not codified). It is worth mentioning that a new rule has come into effect according to which new tax laws may come into effect and become binding only as of 1 January of a calendar year. As Art. 8(9) of the Legislative Rules of the Government of SR stipulates:[19] "In the case of law that regulates taxes or duties, it is required to set the date when the law comes into force on 1 January and a sufficient *vacatio legis* period shall be provided." We have stressed the importance of the introduction of such a rule several times in the past.[20]

[18] Contributions to the state budget (contributions on employment income, regulatory and price contributions), pensionary tax, agricultural tax.

[19] SK, Government resolution of 4 May 2016 on Legislative Rules of the Government of Slovak Republic [*Legislatívne pravidlá vlády Slovenskej republiky*], No. 164, amended.

[20] See: V. Babčák, *Úvahy o možnostiach daňového práva ovplyvňovať podnikateľské vzťahy najmä pri zdaňovaní príjmov*, [in:] J. Suchoža. J. Husár, R. Hučková (eds), *Právo, obchod, ekonomika VI*, UPJŠ, Košice 2016, pp. 8–34; *idem*, *Zamyslenie sa nad daňovou politikou (Slovenska/EÚ) z hľadiska jej vplyvu na daňové subjekty*, [in:] V. Babčák, A. Popovič, J. Sábo (eds), *3. slovensko-české dni daňového práva. Pozitívna a negatívna stimulácia štátu v oblasti zdaňovania*, UPJŠ, Košice 2019, pp. 11–41.

After the tax reform of 1993, tax law got rid of the high quantities of bylaws. Seldom does tax law employ government ordinances, especially in the case that certain provisions of tax law need to be more specified without directly impacting the rights of individuals. The SR Constitution[21] is clear on that issue and Para. 13(1) requires that an obligation be imposed only by law or on the basis of a law, within its limits, and while complying with basic rights and freedoms, by an international treaty or by a government ordinance. Government ordinances are adopted also when exceptions from a certain rule are provided, for example, regarding the extinction of tax arrears (which cannot be considered as going against the rights of taxable entities).[22] The Tax Code[23] states that the Government of the Slovak Republic shall lay down the conditions of extinction of tax arrears and cases in which tax arrears corresponding to an unsettled sanction pertaining to this tax shall become extinct for taxable entities who settled at least the tax within the period specified in the regulation.

In the area of tax law, decrees are rarely used except for excise taxes and income taxes. Every decree needs to have a statutory base for its adoption. The function of these decrees is to specify in more detail the rights and duties of legal subjects, for instance, when conditions for labelling of control stamps used on alcohol packaging, tobacco products, or duties concerning notification and publication of data or requisites for denaturing alcohol, and requirements for standards of mineral oil loss or tax return forms are set out (including the method of calculation), etc. In the case of income tax, decrees of Slovakia's Ministry of Finance are sporadically issued. Such decrees include, for example, methods for marking a tax payment, details concerning the verification of financial accounts, or they are used for issuing a binding opinion.

[21] SK, Constitution of Slovak Republic of 1 September 1992 [*Ústava Slovenskej republiky*], Collection of Laws 1992, No. 460, amended.

[22] E.g., SK, Government Ordinance of 14 September 2005 on Arrears on unpaid tax sanctions [*Nariadenie Vlády o zániku daňového nedoplatku zodpovedajúceho nezaplatenej sankcii prislúchajúcej k zaplatenej dani*], Collection of Laws 2005, No. 450 or SK, Government Ordinance of 7 June 2006 on Tax Arrears on unpaid sanctions imposed along the inheritance tax and tax on transaction of property [*Nariadenie Vlády o zániku daňového nedoplatku zodpovedajúceho nezaplatenej sankcii prislúchajúcej k zaplatenej dani z dedičstva, dani z darovania a dani z prevodu a prechodu nehnuteľností*], Collection of Laws 2006, No. 418 or SK, Government Ordinance of 15 April 2015 on Tax Arrears on unpaid sanctions imposed alongside value added tax [*Nariadenie Vlády o zániku daňového nedoplatku zodpovedajúceho nezaplatenej sankcii prislúchajúcej k zaplatenej dani z pridanej hodnoty*], Collection of Laws 2015, No. 90.

[23] SK, Law of 1 December 2009 on Tax Procedure Code [*Zákon o správe daní (daňový poriadok)*], Collection of Laws 2009, No. 563, amended.

Before 1989, by-laws were often used instead of laws in tax practice. This was most striking in the case of procedural regulations. The Ordinance on Tax and Fee Proceedings of 1962[24] had been in force for three decades. At the present time, it would be inconceivable that legislation of a lesser legal force should oblige taxable persons to perform such procedural duties, e.g., such as filing a tax return. Moreover, it is currently unthinkable that the tax law would confer to the government a power to adjust the percentages of tax rates as it seems fit to the government, especially when the observance of legality and legal certainty of tax subjects is to be respected.

Frequent changes in tax laws in Slovakia cause serious problems in the field of knowledge, implementation, and application of tax law. Therefore, tax law as a part of Slovak law is characterized by significant instability. Frequent amendments of tax regulations diminish the value of legal certainty[25], and at the same time, cause deviation from the clarity requirement of tax legislation.

Frequent changes in tax legislation were justified at the beginning of Slovakia's membership in the EU given that Slovakia had to adapt to different tax rules. Even with the best effort, such adaptation to the new legal tax framework took some time. Tax administrators were also confronted with frequent changes in procedural tax law. For example, The Act on the Administration of Taxes and Fees of 1992[26] used to be modified at least three times each year, not to mention its indirect amendments. Along with these changes, new laws on excise duties, a new law on income tax of 2003, along with a new law on local taxes were introduced at the end of 2004.

Thus, tax administrators and the entire tax system faced a challenge of how to implement these new rules into everyday practice.

3. Perspectives of Slovak tax law

A new quality level of tax law can be detected after 1 May 2004. Until then, the tax law was primarily concerned with domestic regulation of the rights and obligations of taxable persons (with the exception of issues

[24] SK, By-law of Ministry of Finance of 15 February 1962 on Proceedings concerning taxes and fees [*Vyhláška Ministerstva Financií o konaní vo veciach daní a poplatkov*], Collection of Laws 1962, No. 16, amended.

[25] See: Para. 22(2) of SK, Law of 11 December 1952 on Tax on income from employment [*Zákon o dani zo mzdy*], Collection of Laws 1952, No. 76, amended.

[26] SK, Law of 30 September 1992 on Tax administration of taxes and fees [*Zákon o správe daní a poplatkov*], Collection of Laws 1992, No. 511, amended.

concerning international double taxation). In the previous period, as a sovereign state Slovakia freely decided the questions concerning the weight of the tax burden that was imposed on taxable persons or tax rules governing its tax system.

Significant shift in these circumstances occurred after 1 May 2004. Suddenly, national tax legislation had to adhere to the rules of EU law, mainly regarding indirect taxes and partially direct taxation.

Development of the tax law – in a normative and a scientific sense – was affected in two ways:

1) close interconnection between EU law and Slovak law,
2) greater influence of EU law and international law on fundamental aspects of tax law.

Both factors naturally have their roots in EU membership. On the other hand, these factors could create great legal uncertainty for tax residents and non-residents performing their business activities in Slovakia. This uncertainty was rooted in frequent changes of tax legislation which Slovak businesses were not accustomed to in the past. It is not surprising that certain business circles are sceptical about the suitability of certain decisions on the part of EU institutions regarding taxes and to measures that have been adopted by the government during the past 10–12 years.

The Slovak economy faces a great number of cases of tax avoidance and evasion. The latter are mainly related to VAT, in respect to which it is simpler (at least at first glance) to evaluate the tax gap than in the case of income tax. We believe that from a quantification standpoint, the negative effects of tax avoidance and evasion in respect to indirect taxation (including cases of tax fraud) are comparable to the effect that tax avoidance and evasion have on income taxation. It is easier to quantify the missing VAT than relatively accurately estimate the unpaid amount of corporate income tax.

Despite the introduction of various new prevention mechanisms, tax evasion has not been eliminated. For example, over time Slovakia has shown a great tax gap on value added tax – the estimated difference between the potential tax revenue that is to be expected to be collected, providing taxable persons adhere to the tax norms, and the actual collected tax. This corresponds to the data of the Institute of Financial Policy of the Ministry of Finance. According to the preliminary estimate, the tax gap on VAT in 2008 reached 26.9%. In nominal terms, the difference between potential and actual collected tax revenue from VAT was estimated at EUR 2.3 billion for 2018 (2.6% of the GDP).[27]

[27] See: Institute Financial Policy of the SK Ministry of Finance, *Tax gap in case of VAT*, Bratislava, May 2009.

In recent years, various measures for combating tax fraud on VAT were introduced. We could mention several measures that cause a major upheaval, especially between businesses. One example is the obligation to provide a guarantee before registration as a VAT taxpayer. Although the directive on VAT[28] gives Member States the power to introduce measures for the proper collection of VAT, it does not stipulate specifically the measure in question.

The tax guarantee on VAT was introduced in 2012[29] and it was abrogated in 2019.[30] The amount of guarantee required for a period of 12 months was between EUR 1,000 and EUR 500,000 depending on the risk of tax abuse posed by the registrant. The embarrassment caused by this measure led to its derogation. According to the explanatory memorandum[31] on the novelization of the Law on VAT[32], the guarantee was abolished since it had fulfilled its goal – to eliminate tax fraud caused by newly registered taxpayers. Considering the troubles that continue to stem from VAT tax fraud, this explanation sounds comical as well as absurd. We believe that the guarantee should never have been introduced into Slovak legal system since it complicated the circumstances for business activities even more. In addition to that, it undermined the tax certainty of businesses. This conclusion is illustrated by vague terms governing the discretional power of the tax authority regarding guarantees: "the tax administrator shall take into account the risk of VAT fraud." The cited procedural norm does not provide any sufficient reasons on how to justify the amount of tax guarantee required from a taxpayer in a certain situation (even for a person that is not accustomed to the tax law, it sounds vague at best).[33]

A reverse-charge mechanism introduced in respect to the commodities that most often are used in a fraudulent transaction, the introduction

[28] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Official Journal EU L 347, 11 December 2006, p. 1, amended.

[29] SK, Law of 26 July 2012 on Amending of Law on Value Added Tax [*Zákon ktorým sa mení a dopĺňa zákon č. 222/2004 Z. z. o dani z pridanej hodnoty*], Collection of Laws 2012, No. 246.

[30] SK, Law of 29 November 2018 on Amending of Law on Value Added Tax [*Zákon ktorým sa mení a dopĺňa zákon č. 222/2004 Z. z. o dani z pridanej hodnoty*], Collection of Laws 2018, No. 369.

[31] See: Explanatory memorandum on SK, Law of 29 November 2018 on Amendment of Law on Value Added Tax [*Zákon ktorým sa mení a dopĺňa zákon č. 222/2004 Z. z. o dani z pridanej hodnoty*], Collection of Laws 2018, No. 369, p. 21.

[32] SK, Law of 6 April 2004 on Value Added Tax [*Zákon o dani z pridanej hodnoty*], Collection of Laws 2004, No. 222, amended.

[33] See: V. Babčák, *Daňové právo verzus podnikateľské prostredie*, [in:] P. Mrkývka, J. Gliniecka, E. Tomášková, E. Juchniewicz, T. Sowiński, M. Radvan (eds), *The Financial Law towards Challenges of the XXI Century*, Masaryk University Press, Brno 2020, pp. 301–326.

of a VAT control report and an institution of VAT collateral[34] are other measures aiming to tackle VAT fraud.

Similar tendencies could be observed in relation to tax evasion on corporate income tax. Corporate income tax revenues also suffer from many tax evasion and avoidance practices in the form of unlawful modification of a tax base, hiding of taxable income, failure to fill out a tax return, and due to relocation of the seat of a company abroad. According to the data provided by the consulting company Bisnode, the number of companies with seats located abroad was 4,113 in 2014 and since then this number increased to 5,298 as of 2020.[35]

One could suppose that the pandemic would have slowed down the speed by which companies relocated their seats to other countries commonly designated as tax havens. However, the opposite is true. The number of companies with their seats in the United States increased although it was a country heavily affected by the pandemic. As of today, the total number of companies with Slovak ownership that have their seats in the US is 1,406[36] (which is an increase of 178 companies).[37] Why this is the case? The reason for this situation is a long-term underestimation of an increase in the severity of tax legislation and its adverse effects on businesses by state authorities. The severity of tax legislation might be justified. Besides, tax laws also show an increase in difficulty and ambiguity of tax norms whose interpretation is problematic even for tax authorities. In addition, there are systematic failures in the form of introduction and soon cancelation of new tax institutions, without proper explanation from the state. One of such institutions was the tax licence, which also contributed to the current situation of many businesses relocating their seats, even ceasing to exist altogether. The tax license constituted an obligation to pay minimal tax for every registered business company. The tax license was introduced in 2004 and after three years it was abrogated by novelization of the law on income tax.

The relocation of companies to so-called tax havens is one of the major factors that are used by state authorities for justification of the increase in the severity of tax regulation. Businesses understand this trend as a breach

[34] See: M. Štrkolec, *Zabezpečovacie inštitúty pri správe daní*, UPJŠ, Košice 2017, p. 164.

[35] http://www.bisnode.sk/wp-content/uploads/2013/11/Tlac_raje_Q3.pdf (accessed: 5.03.2021).

[36] *Ibidem*.

[37] FinReport, *Počet slovenských firiem so sídlom v daňových rajoch rastie aj počas krízy*, 2020, https://www.finreport.sk/financie/pocet-slovenskych-firiem-so-sidlom-v-danovych-rajoch-rastie-aj-pocas-krizy/ (accessed: 22.11.2022); TASR, *Analýza: V daňových rajoch je viac ako 5000 slovenských firiem*, https://www.teraz.sk/najnovsie/analyza-v-danovych-rajoch-je-viac-ak/525193-clanok.htm (accessed: 22.11.2022).

of their freedom to conduct business, which is guaranteed under national and EU law. Similar trends could be also identified with respect to VAT (for example, in the case of the introduction of VAT guarantee or additional conditions for VAT registration).[38]

Besides relocation, a great number of companies were dissolved. We think that the reason for the increase in the number of dissolved companies cannot be justified solely by the pandemic, but also was caused by several other factors. This conclusion is supported by data collected since 2012:[39]

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Number of dissolved companies	4,822	4,912	7,255	8,964	8,883	8,915	5,249	4,099	4,154	608

We believe that the tax system of every state shall support and not hinder the economic growth of that state. In that respect, the tax system in a broader sense (taxes, system of tax authorities, and mechanisms of tax administration) must be stable. The stability of the tax system depends upon economic, social, and legal relationships that exist in the economy. For the stability of the tax system, the government along with the Parliament and other state organs, each within its own capacity, are responsible.[40]

A stable tax system should respect certain criteria and be built upon certain principles which reflect the tax policy of a certain state. They should not be affected by political changes recurring after election victory of some political parties.

Stability must be granted for the whole system of legal norms (both material and procedural) that constitute tax law. We believe that requirements for stability of tax law in Slovakia are as follows:

1) legal certainty shall be guaranteed for taxable entities and be based upon longevity of tax rules;

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[38] SK, Law of 26 July 2012 on Amending of Law on Value Added Tax [*Zákon ktorým sa mení a dopĺňa zákon č. 222/2004 Z. z. o dani z pridanej hodnoty*], Collection of Laws 2012, No. 246.

[39] *Štatistika vzniku a zániku firiem a živnostníkov*, 2023, https://finstat.sk/analyzy/statistika-poctu-vzniknutych-a-zaniknutych-firiem (accessed: 5.03.2021). Number of dissolved companies include: limited liability companies, joint stock companies, co-operatives, societas europaea, general commercial partnerships and limited partnerships. From the chart it is evident that the number of dissolved companies culminated in the years 2017–2019. This situation was caused by the introduction of tax licences in 2013, which was effectively abolished as of 1 January 2018. Since then the number of companies returned to the level of 2014.

[40] E.g., it shows an effort to relocate the seat of a company or part of the business.

2) only one date per year shall be set for all tax legislation to come into force or be changed – currently this date is 1 January of a year;

3) all indirect changes of tax laws through other legislation shall not be permitted;

4) the tax system shall be simple and easy to understand;

5) increase in severity of tax laws shall be avoided – otherwise tax legislation would be prompting taxable persons to bypass tax laws that prove to be too strict.

Stability in the tax system contributes to the elimination of injustice and discrimination in taxation. Multinational companies are often present with better conditions for taxation than local businesses. Such a case constitutes an unjust privilege for multinational companies by the state.[41] Stability in tax law promotes the idea of tax prevention. In that respect, we share the belief that prevention requires less economic and administrative costs than ex-post therapy. This view is true for all forms of tax prevention (tax audit, forfeit of certain goods, etc.). What is particularly dangerous is the very low level of awareness about legal matters existing in Slovak society (understandable in its own right).

4. Instead of conclusion

Slovakia's entry into the EU required tax authorities to implement new tax mechanisms. The differences between Slovak's legislation and European legislation are:

1. Some of the EU legal acts are directly applicable in Slovakia.
2. Some of the EU legal acts (mainly directives[42]) contain provisions that must be implemented by the acts of the Slovak Parliament into a national legal order.
3. Some tools and mechanisms set out in the legal acts of the EU are facultative in the sense that it is up to the Parliament whether, when, and in what form they would be implemented into tax practice. Such national measures may never conflict with EU law. There were several occasions when the Slovak Parliament employed facultative measures of EU law, for

[41] Slovakia ceased to be considered a state with a preferential tax regime according to academic papers and the press. See: L. Leservoisier, *Daňové ráje*, HZ, Prague 1996, p. 9. See: E. Burák, *Daňová prevencia – v príkladoch z praxe*, Ján Šindléry – TESFO, Ružomberok 2014, p. 32.

[42] See: J. Sábo, *Smernica o úrokoch a licenčných poplatkoch v práve Českej republiky a Slovenskej republiky*, "Acta Universitatis Carolinae: Iuridica" 2018, No. 1, p. 145.

example we could mention the poorly framed introduction of guarantee on VAT based upon Art. 273 of the Directive 2006/122/EC.

State power in Slovakia should be promoting a balanced approach and the adoption of long-term tax policy in Slovakia. It follows from Para. 3(1)(a) the Law on Financial Administration[43] according to which the Ministry of Finance, is a central authority for the administration of taxes, duties, and customs, and prepares strategy for taxes and duties. The strategy shall find its expression in the text of concrete tax laws notwithstanding the nature of the law. From the recent past, one of the more renowned documents is *For a Modern and Successful Slovakia*,[44] which was prepared by the Ministry of Finance in 2020. This document includes provisions named *Fiscal reform*. However, it seems the document did not obtain the necessary support in the governing coalition.

According to the document, one of the main goals in the area of taxation is the promotion of tax discipline. The document stresses the importance of tax reform based on the increase of property taxation and environmental taxation along with the abrogation of taxes that are harmful for the economy. The document is a proclamation on the importance of the introduction of a mix of several taxes,[45] which could guarantee economic growth. Tax reform that was repeatedly publicly announced has not been implemented. The government justifies this inaction with the COVID-19 pandemic.

Finally, I would like to highlight certain open challenges that presently stand before the tax law and before the academic community in Slovakia. These challenges are systemic in nature. They are not secondary problems in the tax law that could be simply removed via small changes in tax legislation.

Challenges posted by the EU and the European Commission we leave omitted, which is wholly understandable. They represent long-term unresolved tax issues and several of them are not on the EU's current agenda due to the ongoing pandemic. Several other issues of EU taxation that had been proposed in the past 10–15 years ended up in failure. Often the failure was caused by the lack of a clear logical goal of the proposed changes. These problems were often recognized by the academic community that was often able to better evaluate the quality of the proposed measures than politicians. The EU tax policy often misjudges the response

[43] SK, Law of 5 December 2018 on Financial Administration [*Zákon o finančnej správe*], Collection of Laws 2018, No. 35, amended.

[44] *Moderné a úspešné Slovensko*, n.d., https://www.mfsr.sk/files/archiv/8/MaUS_NIRP2.pdf (accessed: 5.03.2021).

[45] *Ibidem*, p. 7.

on the part of national political representation to the proposed measures, which are often refused because of fear of infringement of national tax sovereignty of Member States. We could ask ourselves whether it is due to the stubbornness of Member States or due to the inability of the EU that precludes reaching an overreaching political consensus in tax matters. As an example, it could serve the case of indirect taxation (not only for the application problems that the tax system currently is facing),[46] but also for the lack of significant progress in the reform of indirect taxation.[47] Another example is the cases concerning CCCTB and CCTB[48] that were proposed, but their adoption had not come to fruition. In addition, we could mention a great number of cases of tax abuse and tax avoidance in harmonized taxes. Other cases worth mentioning (in our opinion useless and unsuccessful) is the fight against so-called tax havens – especially when in this regard the EU itself does not apply the same criteria to all Member States pretending that among EU Member States there does not exist any tax havens.

We could highlight the following problems with respect to the normative and application circumstances of Slovak tax law.

First, the current tax system is not flexible enough to be able to adapt to long-term development of the global (and European) economies and to face the challenges posed by globalization. In the past, the boundaries ceased to be a problem for conducting business. Relationships between states, international organizations, and different regions were virtually without borders. Therefore, the boundaries could no longer stop the development of international commerce. As well, taxes should not serve as a tool for slowing down economic development, but on the contrary, their aim should be to promote economic growth. In that respect, Slovak tax legislation and its tax system do not adapt well in a changing world and therefore cannot cope with international tax competition.

Second, against the background of the ongoing industrial revolution (Industry 4.0), Slovakia is not able to evaluate whether certain tax optimalization reached the level that it should be considered as tax evasion. It is often the case with respect to the new technological means employed

[46] See: V. Babčák, *Daňové právo na Slovensku…*, p. 141.

[47] L. Hrabčák, *Reforma systému DPH v Európskej únii – Revolúcia alebo Evolúcia?*, [in:] V. Babčák, A. Popovič, J. Sábo (eds), *3. slovensko-české dni daňového práva. Pozitívna a negatívna stimulácia štátu v oblasti zdaňovania*, UPJŠ, Košice 2019, pp. 63–175.

[48] See: European Commission, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)*, COM(2011)121 final, 16 March 2011; European Commission, *Proposal for a Council Directive on a Common Corporate Tax Base*, COM(2016)685 final, 25 October 2016; European Commission, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)*, COM(2016)683 final, 25 October 2016.

in the digitalization of goods and services markets across the global economy, international cooperation, and harmonization of international taxation rules.[49] Today, Slovakia is sadly not able to eliminate the tax gap caused by tax avoidance on income tax.

Third, there is a necessity to prepare a tax reform that would fulfil these conditions:

1) the tax system should be based on a combination of direct and indirect taxation, with a higher tax burden imposed on consumption and property, while reducing the tax burden for businesses;

2) the gradual introduction of robotization in several industries that will cause a decrease in human work force should prompt Slovakia to consider the introduction of specific levies imposed on robots that could serve as a source of tax revenue in the future for the state pension system;[50]

3) differences between big businesses and small and medium businesses should be abandoned;

4) exact legal conditions for granting tax exceptions should be adopted to ensure big international companies do not move to another country just before their special tax status is about to expire; each agreement concerning tax obligations conducted between the state and international companies should be publicly accessible (for example, via the Slovak government and Ministry of Finance websites);

5) introduction of a 0% VAT rate for goods deemed a basic need for people;

6) reduction of the high number of tax exceptions in the common system of VAT and direct taxes;

7) broadening the digitalization of the tax administration, including the introduction of automatic exchange of information between tax authorities and other relevant agencies such as the Cadastre Register, the Social Insurance Agency, and employment offices.

Fourth, since 2008, the Slovak Ministry of Finance has kept promising to undertake reform of the collection of taxes, customs, and social contributions.[51] This problem is addressed in a document *Concept of reforms in tax and customs administration towards the introduction of a unified system of collection of taxes, customs, and social contributions*[52] – which is known as *Programme UNITAS* and later as *UNITAS II*. Based on *UNITAS II*, a later

[49] See: V. Babčák, M. Štrkolec, A. Vartašová, *Daňové úniky, ich vznik a eliminácia*, UPJŠ, Košice 2020, pp. 114–115.

[50] See: V. Babčák, *Úvahy o možnostiach daňového práva*…, pp. 8–34.

[51] On page 27, the document *For a Modern and Successful Slovakia* addresses the vision to unify compulsory payments in Slovakia.

[52] *Program UNITAS*, n.d., https://www.mfsr.sk/sk/dane-cla-uctovnictvo/programy/program-unitas/ (accessed: 5.03.2021).

document under the name *Strategy of development of financial administration for the years 2014–2020*[53] was adopted. The name of this document suggests it was adopted with the programme period of the EU financial framework in mind. The document was adopted in direct relation to the document *Europe 2020: A European strategy for smart, sustainable, and inclusive growth*.[54] Slovakia has succeeded in attaining several goals set up in the European strategy. One of the most prominent successes was the unification of tax authorities and customs authorities into one system under the name the Financial Administration. On the other hand, the places for collection of taxes, customs, and social contributions remain fragmented. In a way, this is mainly due to the sectoral fragmentation of the collection of compulsory payments as a whole. This is caused by the high number of compulsory payments (with different calculation bases and different rates) currently collected in Slovakia. This leads to an inappropriate administrative burden for businesses, which must at the same time cope with different legal rules for the collection of taxes, customs, and social contributions. Therefore, we believe that the call for unification (approximation) of the bases of calculation of mandatory contributions is fully justified.[55]

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[53] *Ibidem*.

[54] European Commission, *Communication from the Commission Europe 2020. A strategy for smart, sustainable, and inclusive growth*, COM(2010)2020, Brussels, 3 March 2010.

[55] V. Babčák, *Daňové právo ako forma a nástroj pôsobenia štátu na ekonomické vzťahy*, [in:] J. Suchoža. J. Husár, R. Hučková (eds), *Právo, obchod, ekonomika VI*, UPJŠ, Košice 2016, pp. 9–26.

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Abstract

The author presents a short historical look at the development of tax law in Slovakia after November 1989. The main focus of the article concerns questions about the status of tax law in the legal order and the distinct periods of its development. The discussion of this topic is related to the different time periods that form the circumstances of development of tax law within Slovak legal order. In the conclusions, the author points out the major challenges for the legislation and academic study of tax law that have been caused by globalization, Europeanisation, and the global pandemic.

Keywords: tax law, development of tax law

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Philip Baker[1]

Polish Tax Cases before the European Court of Human Rights

1. Introduction

It is a great pleasure to be invited to contribute a chapter to the Jubilee Book dedicated to Professor Włodzimierz Nykiel on his 70th birthday. Professor Nykiel, perhaps more than any other tax academic in Poland, has established links with other tax academics elsewhere in the European Union and in Third States, and has done much to advance cooperation between Polish tax academics and those elsewhere in the world. This short chapter is intended to acknowledge Professor Nykiel's contribution to the issue of legal protection of taxpayers' rights, and particularly the protection of taxpayers' rights under the European Convention on Human Rights (ECHR).[2]

In May 2008 Professor Nykiel convened one of the first conferences anywhere in Europe on the protection of taxpayers' rights, at the Biedermann Palace of the University of Lodz. Personally, it was a tremendous honour to be invited to attend and speak at that conference, and to visit for the first time the area of Poland from where my grandmother originated. The first day of the conference was dedicated to the topic of Taxpayer Protection, and resulted in an excellent book entitled *Protection of Taxpayer's Rights – European, International and Domestic Tax Law Perspective*.[3]

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[1] Philip Baker, Queen's Counsel, Field Court Tax Chambers, Gray's Inn, London; Visiting Professor, Oxford University.

[2] Council of Europe, Convention for the Protection of Human Rights and Fundamental Freedoms, 4 November 1950, as amended.

[3] W. Nykiel, M. Sęk (eds), *Protection of Taxpayer's Rights – European, International and Domestic Tax Law Perspective*, Oficyna, Warszawa 2009.

The book contains national reports on taxpayer protection in a number of countries in Europe and the rest of the world. It also contains a number of topical chapters dealing with specific issues, including the enforcement of taxpayers' rights under European Union law, the ECHR and taxpayer protection, and several issues concerning taxpayers' rights protection in Poland. At the time it was published, there were perhaps no more than half a dozen books in total on the protection of taxpayers' rights, so this was a major addition to the literature and to the development of interest in the whole question of protecting the rights of taxpayers.

This chapter considers the cases that have been decided by the European Court of Human Rights (ECtHR) emanating from Poland. By "tax cases" a broad approach is taken, and any cases that have tax issues at their core are regarded as falling within this classification. Thus, as will be seen, one of the cases discussed here concerns the freedom of expression of journalists writing about the motivation behind changes in tax law.

While it is difficult to be comprehensive, a search of the database of cases at the ECtHR[4] identified only five reported cases that might be regarded as tax cases and that have involved Poland. That is a relatively small number, even taking into account the fact that Poland only ratified the ECHR in 1993. One might easily find a much larger number of tax cases from other countries, such as Bulgaria, that ratified the Convention around the same time. It is a matter of pure speculation why there are so few cases that have derived from Poland. One possibility is that Polish tax law and Polish tax administration respect taxpayers' rights to such an extent that no cases have arisen. That is a very attractive thought, but virtually every tax system gives rise to issues of protection of taxpayers' rights, and it is hard to see why fewer issues would have arisen in Poland. A second possible explanation is that knowledge of the provisions of the European Convention are not well-known amongst tax practitioners in Poland: again that explanation is unlikely, particularly given that there seem to be a relatively large number of non-tax cases lodged before the ECtHR from Poland.[5] Another possibility, which may perhaps be a better explanation, is that there are several levels of courts and tribunals in Poland that can hear cases concerning taxpayers' rights, including the Constitutional Court. Not only is the requirement of exhausting domestic remedies likely to prevent many cases from being brought, but the different levels of adjudication create the possibility that a remedy will have been granted before the case might reach the

[4] The HUDOCS database.

[5] The country profile for Poland produced by the ECtHR, lists 1,721 applications concerning Poland lodged during 2020.

stage where it could be referred to the ECtHR in Strasbourg. Whatever the explanation, the fact that there are only five cases allows some discussion of each of them.

2. *Lewandowski* v. *Poland* (application No. 43457/98, decision of 15 June 1999)[6]

Lewandowski is not only the earliest case dealing with tax-related matters that came to the ECtHR from Poland, but it is also one of the strangest. On 29 January 1996, two bailiffs and an employee of a private security agency visited the applicant's flat in Gryfino in Poland with a warrant alleging that the applicant had failed to pay social security contributions in respect of his small business. The applicant was not at home, but his wife telephoned him and he informed the bailiffs that all outstanding social security contributions had been paid. The bailiffs and security agents left the flat. The next day the applicant went to the Gryfino Tax Office and presented a receipt showing that he had paid the social security contributions, and the employee responsible for his account admitted that the warrant had been issued erroneously and apologised to him. A day later the applicant complained to the District Prosecutor that the behaviour of the bailiffs had been such a threatening manner that the state of the health of his wife had deteriorated (one of the bailiffs had been armed). On 25 February (that is less than four weeks after the visit of the bailiffs), the applicant's wife died: he informed the District Prosecutor that in his opinion his wife's death had been caused by the stress resulting from the actions of the bailiffs. There then followed a series of actions by the District Prosecutor and by other officials. These included obtaining expert reports from medical experts who, in their opinion, concluded that it was impossible to establish the existence of a causal link between the bailiffs' action and the death of the applicant's wife. As a result, any investigation was ultimately dropped. The applicant complained through the hierarchy of prosecutors to the Prosecutor General, but the investigation was discontinued. At that point the applicant lodged a complaint before the ECtHR in Strasbourg alleging breach of Art. 2 ECHR (the right to life) as well as Art. 6 (right to a fair trial) arising from the investigation of the complaints by the prosecution.

The ECtHR dealt with the matter relatively briefly. Expert opinion delivered by two professors of medicine and a doctor established that it had

[6] ECtHR, decision, 15 June 1999, *Lewandowski* v. *Poland*, No. 43457/98.

been impossible to show a causal link between the visit of the bailiffs and the death of the applicant's wife less than a month later. The ECtHR very rarely makes its own findings of fact, and was constrained here by the evidence collected in the course of the investigation by the prosecutors showing no causal link between the actions of the bailiffs and the death of the applicant's wife. On that basis, the Court concluded there was no appearance of a violation of Art. 2. Article 6 was also not applicable because the case did not concern the determination of the applicant's civil rights and obligations, or a criminal charge. The Court declared the application inadmissible.

At this remove of time, it is impossible to determine exactly what did happen when the bailiffs and the security agent visited the applicant's flat. Clearly the applicant considered that the bailiffs had behaved in a threatening manner, and he objected to the fact that one of them was armed (apparently bailiffs were always armed with gas pistols during the execution of warrants). The applicant clearly considered that the action of the bailiffs had significantly contributed to his wife's death, and pursued the matter through various procedures in Poland. At the end of the day, however, medical evidence failed to support any causal link between the visit of the bailiffs and the wife's death.[7]

3. *WS* v. *Poland* (application No. 37607/97, decision of 15 June 1999)[8]

This case (and the one that follows) establish a rather more significant, general principle with regard to the ECHR. The applicant was a bookkeeper; in 1996 she was found liable for a "tax offence" by the Tax Office in that a) she had made book-keeping errors on behalf of a client for which she was liable to a penalty of PLN 300 (or 30 days imprisonment in default) and b) a penalty of PLN 100 (or 10 days imprisonment in default) for incorrectly calculating the value of a deduction for VAT purposes. She appealed against this to the Tax Chamber who dismissed her appeal, and then complained to the Minister of Finance who failed to answer the

[7] While it does not relate to Poland, there has been a disturbing increase in the number of cases reported before the ECtHR involving high-handed or threatening behaviour on behalf of the tax police, primarily in parts of Eastern Europe that were formerly part of the Soviet Union. It is purely speculative, however, to consider that similar conduct might have been involved in this case.

[8] ECtHR, decision, 15 June 1999, *WS* v. *Poland*, No. 37607/97. Interesting to note that this decision was issued on the same day by an identical Court to the *Lewandowski* case.

complaint. She then filed an application with the ECtHR alleging a breach of Art. 6 (right to a fair trial) on grounds that she had no access to a court to challenge the fine imposed against her.

Stopping there, the case involved relatively small fines but with potential serious consequences for the applicant. Aside from the fact that there was the possibility of going to prison in default of payment of the fine, there was also the reputational damage. Despite that, there was no possibility of access to a court. In terms of the ECHR, the question was whether she faced a criminal charge and, consequently, had a right to a court. The ECtHR on this point had already developed a three-factor test. The first factor was whether the offence was regarded as belonging to the criminal law within the law of the country concerned. In Poland, the tax offence was regarded as a fiscal offence, and certain provisions of the Criminal Code were applicable. That, however, was not the only factor. The second factor concerned the nature of the offence which, in this case, was of a technical and not of a criminal character. It did not require any criminal intent and was regarded as a tax offence and not a tax crime. In terms of the severity of the penalty, which was the third criterion, the pecuniary penalty was relatively low, and the offence was not punishable by imprisonment. Putting these points together, the ECtHR concluded that the applicant was not charged with a criminal offence and so did not fall within the scope of Art. 6.

This case is, of course, relevant for a much broader range of matters other than just tax matters. In many situations, regulatory fines are imposed without the possibility of an appeal to a court. Usually there will be some form of review, perhaps by an administrative committee (driving offences are an example). It is important in those cases to determine whether or not the matter involves a criminal charge, and this case is an example of the approach taken in connection with tax matters. It is highly instructive to compare this case with the next one discussed here.

4. *Szott-Medyńska* and others v. *Poland* (application No. 47414/99, decision of 9 October 2003[9]

The opportunity to review the decision in *WS* v. *Poland* arose some four years later in this case. The three applicants ran a small family business and the Tax Office found them guilty of a fiscal offence in failing to pay

[9] ECtHR, decision, 9 October 2003, *Szott-Medyńska* and others v. *Poland*, No. 47414/99. Two of the judges who sat in the *WS* v. *Poland* case also sat in this case.

a monthly income tax advance on wages. They were each made liable to a pecuniary penalty of PLN 250 (with 17 days imprisonment in default). They appealed to the Tax Chamber which dismissed their appeal: no further appeal was permitted. Once again, they complained under Art. 6 that no appeal to a court lay against the decision of the Tax Chamber.

The applicants sought to distinguish this case from *WS* v. *Poland* on the basis that the offence could be punishable by imprisonment (in default of payment). In fact, as explained, that was also a possibility in the *WS* v. *Poland* case.

The ECtHR applied the same three criteria as they had applied in *WS* v. *Poland*. In terms of the first criteria, the tax offence again belonged to the sphere of criminal law. In terms of the nature of the offence, the ECtHR took a different view and considered that the offence related to liability which was of general application to all citizens and not only to a particular group possessing a special status. Finally, in regard to the third criterion, the severity of the penalty, the Court noted that the penalty was quite small but it could be substituted by up to 30 days imprisonment in default of payment. On that basis, the ECtHR concluded that the penalties had a punitive character; they were sufficiently severe to conclude that they could be characterised as criminal. In contra-distinction to the decision in *WS* v. *Poland*, the ECtHR concluded that the applicants were charged with a criminal offence and that Art. 6 was, therefore, applicable.

There was, however, another aspect to the case. The Polish Government had argued that, even if there was no appeal to a court from the decision of the Tax Chamber, there was the possibility for the applicants to bring a constitutional complaint before the Polish Constitutional Court. The applicants had failed to bring such a complaint. The ECtHR concluded that, in failing to bring such a complaint, the applicants had failed to exhaust all domestic procedures. On that basis, therefore, their application was inadmissible.

There are two comments that one might make on this case. First, it seems very hard to distinguish this case from the case of *WS* v. *Poland*, except with regard to the second of the criteria based on the nature of the offence. In the *WS* case, the ECtHR concluded that the offence was of a technical nature and applied specifically to bookkeepers who had made mistakes with regard to their clients. In this case, the ECtHR concluded that it was a general offence applicable to all taxpayers who had employees and failed to make a payment of tax. It is hard to distinguish the case on the basis of the punishment, given that it appears to have been similar in both cases.

The second comment one might make is that the requirement to exhaust domestic remedies by making a constitutional complaint to the

Constitutional Court may well explain why so few tax cases have proceeded from Poland to the ECtHR in Strasbourg. The ECtHR acknowledged the somewhat limited competence of the Constitutional Court, but nevertheless concluded that a constitutional complaint is necessary to exhaust domestic remedies. That, of itself, is likely to deter many cases from proceeding to the ECtHR.

5. *Stankiewicz* and others v. *Poland* (No. 2) (application No. 48053/11, decision of 3 November 2015)[10]

In some respects this case is a little remote from the discussion of tax cases, but it does have a tax issue at its heart. The application was brought by three people: a journalist, the editor in chief, and the publisher of a daily newspaper entitled "Rzeczpospolita". In 2005, the newspaper ran a series of articles about a change to the Polish Tax Ordinance Act[11] which provided that evidence collected in criminal proceedings could be used as evidence in tax proceedings, but only after the criminal proceedings had been concluded. The articles alleged that this change was of substantial benefit to criminal groups, particularly "the petrol mafia", since criminal investigations for tax evasion could drag on many years, and the evidence could not be used in a tax case in the meantime. The amendment to the law had been advised by Ms DS who had given evidence before the Parliamentary Finance Committee and who was a well-known expert on tax law and a former senior civil servant. Claiming that the articles in the newspaper had damaged her reputation, she lodged a claim for the protection of personal rights against the three applicants. After various hearings in the Polish courts, her claim was upheld, and the three applicants were required to publish an apology to her and pay PLN 20,000 to a charity. The three applicants then brought a claim in Strasbourg alleging a breach of Art. 10 (the freedom of expression).

The case is essentially on the freedom of expression of journalists rather than on any content that is specific to tax matters. It was relevant that Ms DS was a former senior civil servant and involved in the legislative process, so she was a public figure who therefore knowingly exposed

[10] ECtHR, judgement, 3 November 2015, *Stankiewicz* and others v. *Poland* (No. 2), No. 48053/11.

[11] PL, Act of 29 August 1997 Tax Ordinance [*Ustawa z dnia 29 sierpnia 1997 r. Ordynacja podatkowa*], Official Gazette [*Dziennik Ustaw*] of 1997, No. 137, item 926, amended.

herself to public scrutiny. However, the ECtHR concluded that the Polish courts, including the Supreme Court, had not given sufficient weight to the role of the press as the "public watchdog", and therefore did not carry out a sufficiently careful balancing exercise between the right to impart information on the one hand and the protection of the reputation of others on the other. On that basis, the ECtHR found that there had been a violation of Art. 10 and ordered compensation equal to the amount paid to charity, plus an amount for non-pecuniary damage to each of the applicants for violation of their convention rights.

This case is an important one on the freedom of expression, and particularly the rights of journalists. It is not specifically a tax case, but it illustrates how tax issues can be seen in the wider context and give rise to decisions of the ECtHR establishing general principles. Of the tax cases relating to Poland before the ECtHR, this is the only case that has been held to be admissible and in respect of which an award was made in favour of the applicants.

6. *Formela* v. *Poland* (application No. 31651/08, decision of 5 February 2019)[12]

With the *Formela* case, the discussion returns very much to the core of tax issues. The applicant ran a business and was registered as a taxpayer for VAT purposes. During the early 2000s, he purchased goods from company K, which provided invoices which the applicant paid in full. The applicant claimed an input tax deduction in respect of the VAT shown on those invoices. Unfortunately, the copies of the invoices held by company K were stolen; company K promised to reconstruct the missing paperwork but failed to do so. Subsequently, the applicant also purchased services from company S, which supplied invoices showing an amount of VAT which the applicant paid. However, company S was not at the time registered as a VAT payer: it subsequently rectified that, voluntarily filed its outstanding VAT forms, and paid the VAT amount to the Tax Office.

In 2004, the applicant was subject to a tax audit which disclosed that company K no longer retained copies of the invoices (and had not

[12] ECtHR, judgement, 5 February 2019, *Formela* v. *Poland*, No. 31651/08. There is a small point to note here that the application was lodged with the ECtHR in June 2008, but the judgement was not given until February 2019. There is no obvious explanation for the long delay.

reconstructed the documentation) and that company S was not registered for VAT. As a consequence, the applicant was denied the VAT input tax deduction and required to pay over the VAT that he had wrongly deducted. The applicant appealed against the tax assessment decisions, but the assessments were upheld. It was noted that the applicant might have the possibility of a civil action against the suppliers for failing to comply with their VAT obligations as a consequence of which the applicant was unable to deduct the input tax.

The issue of restrictions on the deduction of input tax, and the denial of input tax deduction to VAT-registered taxpayers who have otherwise complied with their VAT obligations, has been the subject matter of other case law before the ECtHR and also the European Court of Justice.[13] Before the ECtHR the leading case on this was the case of *Bulves* v. *Bulgaria*.[14] As in those other cases, the applicant complained that the refusal to allow him to deduct input tax, despite the fact that he had complied with all his own VAT obligations, was a breach of Art. 1 of Protocol No. 1 of the ECHR (the right to enjoyment of possessions). He contended that the right to deduct input tax was a possession which had been denied through no fault of his own.

In this area, the ECtHR has gradually moved away from its judgment in *Bulves*. With regard to company S, the Court noted that there was a relatively straightforward verification mechanism by which the applicant could have found out that company S did not have a valid VAT registration at the time. The applicant had failed to use that verification mechanism and was, consequently, not able to claim that he had a legitimate expectation of the right to deduct input VAT.

With regard to company K, where the duplicate documentation had been stolen but not reconstructed by the company, the ECtHR carried out a lengthier analysis of the problem of input VAT deduction and the margin of appreciation enjoyed by states in implementing a tax system to prevent fraud or abuse. In particular, the ECtHR observed that the applicant had a civil remedy against company K for failure to reconstruct the documentation: the existence of that action sufficed to allow the ECtHR to conclude that the legislation maintained a fair balance between the protection of the applicant's rights to deduction and the demands of the general interest. On that basis, the ECtHR found that the claim under Art. 1 of the Protocol No. 1 was manifestly unfounded.

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[13] See, for example, from the EU, CJEU, judgement, 4 June 2020, *CF*, C-430/19 as one of the most recent cases discussing this issue.

[14] ECtHR, judgment, 22 January 2009, *Bulves* v. *Bulgaria*, No. 3991/03. Other cases include *Nazarev* and others v. *Bulgaria* (ECtHR, judgement, 25 January 2011, No. 26553/05); *Atev* v. *Bulgaria* (ECtHR, judgement, 18 March 2014, No. 39689/05); and *Euromak Metal Doo* v. *Former Yugoslav Republic of Macedonia* (ECtHR, judgement, 14 June 2018, No. 16839/14).

This judgement is in line with the more recent cases involving the denial of the deduction of input VAT. The Court seems to be well aware of the problems of missing trader fraud, and the concerns that governments have about the deduction of input tax. In essence, the question becomes whether the innocent trader should be required to bring an action against the supplier who has failed to comply with its VAT obligations, or whether the state should allow the deduction of input VAT (even if all conditions have not been satisfied) because the trader is otherwise innocent. In recent cases, the balance seems to have swung more in favour of denying the input tax deduction to the innocent trader, and requiring that trader to bring a remedy against the supplier who has failed to comply with VAT obligations. This case from Poland is an example of this trend in the ECtHR jurisprudence.

7. Concluding comments

An examination of the tax cases that have proceeded from Poland to the ECtHR in Strasbourg has provided an interesting opportunity to review a small number of cases, but ones that touch upon a number of different issues. The cases include a very unusual case on Art. 2 (the right to life), two contrasting cases on the limits of the scope of a criminal charge for the purposes of Art. 6, a case on Art. 10 and the freedom of expression of financial journalists with respect to reporting on a technical tax change, and finally a case in relation to the right to enjoyment of possessions and the deduction of input tax. Several of the cases have contributed to the development of ECtHR jurisprudence. Of the cases, the applicant was successful in only one of them – *Stankiewicz* – and that case has in many respects the least contact with the Polish tax system. The other cases demonstrate perhaps a rather draconian tax system with fines (and imprisonment for non-payment of those fines) for relatively minor errors in relation to tax compliance, and a strict VAT input deduction rule. However, in none of those cases was the applicant successful, so in none of those cases had the Polish tax legislation overstepped the limits set by the ECHR. That does not suggest in any way that there should be complacency about the protection of taxpayers' rights: the divergent results in connection with the imposition of small penalties for errors in completing tax returns suggests that a government should not sail too close to the wind on these matters.

Most of these cases date back to the time before Poland joined the European Union or soon afterwards. They mostly date before the conference on taxpayer protection which Professor Nykiel organized at the University of Lodz in 2008. It would be nice to speculate that the small number of cases that have proceeded to Strasbourg from Poland might reflect a growing recognition of the rights of taxpayers and the need to respect those rights which Professor Nykiel championed by organizing that conference in 2008.

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Abstract

This chapter considers the cases that have been decided by the European Court of Human Rights emanating from Poland. By "tax cases" a broad approach is taken, and any cases that have tax issues at their core are regarded as falling within this classification. Thus, as will be seen, one of the cases discussed concerns the freedom of expression of journalists writing about the motivation behind changes in tax law.

Keywords: protection of taxpayers' rights, tax cases, the European Convention on Human Rights, the European Court of Human Rights

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María Cruz Barreiro Carril[1]

Problems Raised by DAC 6 concerning Taxpayer's Rights and Fundamental Freedoms. Particular Reference to DAC 6 Implementation in the Spanish Legal Order

1. Introduction

DAC 6 makes reference to the fifth amendment to the *Directive on Administrative Cooperation* (DAC),[2] that is, the one undertaken by the Directive 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements. DAC 6 basically establishes the obligation on "tax intermediaries" (in some cases, on taxpayers) to inform (national) tax authorities about certain cross-border arrangements with a potential risk of tax avoidance, followed by the obligation on those tax authorities to automatically exchange that information to be used in the frame of tax risk management processes.

The Directive is rooted in the BEPS' Action 12 which provides recommendations for the design of rules to require taxpayers and advisors to disclose aggressive tax planning arrangements.[3] According to the OECD "Mandatory disclosure regimes should be clear and easy to understand, should balance additional compliance costs to taxpayers with the benefits

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[1] Prof. Dr. María Cruz Barreiro Carril, PhD in law (2010), Associate Professor of Tax Law, Faculty of Legal and Labour Sciences, University of Vigo (Spain). This work was submitted for publication in 2021.

[2] EU, Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, OJ L 347 of 3 December 2011, pp. 1–12.

[3] Action 12 Mandatory Disclosure Rules, Inclusive Framework on BEPS, OECD, *Action 12 Mandatory Disclosure Rules*, n.d., oecd.org/tax/beps/beps-actions/action12/ (accessed: 5.05.2021).

obtained by the tax administration, should be effective in achieving their objectives, should accurately identify the schemes to be disclosed, should be flexible and dynamic enough to allow the tax administration to adjust the system to respond to new risks (or carve-out obsolete risks), and should ensure that information collected is used effectively".[4]

However, the way in which the mandatory disclosure regime is articulated in the Directive leads one to conclude that this regime is far from exhibiting the features that the OECD deems to be desirable. Very much to the contrary, the mandatory disclosure regime laid down in DAC 6 raises serious issues both concerning legal certainty for taxpayers (and, more generally, taxpayer's rights) and efficiency for tax administrations. This work focuses on the first group of issues, pointing out some of them and referring to some aspects of the DAC 6 implementation into the Spanish legal order, which took place through the incorporation[5] of an additional provision (number 23) in the General Tax Law,[6] which endorses the cross-border arrangement reporting obligation. This regulation was completed with the content incorporated through a modification of the Royal Decree 1065/2007[7] by the recently adopted Royal Decree 243/2021 of 6 April. This implementation shows that the Spanish legislature, rather than using the room to manoeuvre that it was given in transposing the Directive to reduce the problems raised by the Directive as regards taxpayer's rights, transposed the Directive in a way that overall enhances those problems. The work ends with some general comments on the problem that the Directive raises for taxpayer's rights from a broader perspective: one related to the Directive's legal bases. This perspective helps to understand why DAC 6 raises also issues concerning fundamental freedoms.

2. Problems raised by DAC 6 concerning taxpayers' rights. Selected issues

Many scholars have been severely criticizing the problems that DAC 6 raises concerning taxpayer's rights.[8] This section focuses on some of those

[4] OECD, *Mandatory Disclosure Rules, Action 12 – 2015 Final Report*, OECD Publishing, Paris 2015, p. 9, http://dx.doi.org/10.1787/9789264241442-en (accessed: 5.05.2021).

[5] This incorporation took place through the Law 19/2020, 29 December.

[6] ES, Law 58/2003, of December 17, General Tax Law.

[7] ES, Royal Decree 1065/2007 setting general regulations on tax procedures and detailed implementation regulations on assessment.

[8] See, for instance, N. Cicin-Savin, *New Mandatory Rules for Tax Intermediaries and Taxpayers in the European Union- Another 'Bite' into the Rights of the Taxpayers*, "World Tax

issues related to the vagueness in the definition of both persons obliged to report the arrangements and the arrangements themselves, and on those related with the rules on penalties for non-reporting that this Directive requires Member States to lay down.

2.1. Persons subject to the reporting obligation

Concerning persons subject to the reporting obligation, they will be those (individual or entities) included in the concept of "intermediary", as defined by the Directive, even if in certain cases the obligation is shifted to the "relevant taxpayer".

The Directive uses a very broad concept of intermediary as this concept includes those scholars call "promoters" of the arrangement (or "principal intermediaries"), and the so-called "service providers" (or "auxiliary intermediaries").[9] The first group of intermediaries includes "any person that designs, markets, organises or makes available for implementation or manages the implementation of a reportable cross-border arrangement".[10] The second group includes "any person that, having regard to the relevant facts and circumstances and based on available information and the relevant expertise and understanding required to provide such services, knows or could be reasonably expected to know that they have undertaken to provide, directly or by means of other persons, aid, assistance or advice with respect to designing, marketing, organising, making available for implementation or managing the implementation of a reportable cross-border arrangement".[11] Scholars refer to the intermediaries included in this second group as those meeting the "knowledge test".[12] In connection with this the Directive states that "[a]ny person shall have the right to provide evidence that such person did not know and could not reasonably be expected to know that that person was involved in a reportable cross-border arrangement", and that "[f]or this purpose, that person may refer to all relevant facts and circumstances as well as available information and

Journal" 2019, Vol. 11, No. 1; D. Blum, A. Langer, *At a Crossroads: Mandatory Disclosure under DAC-6 and EU Primary Law – Part 2*, "European Taxation" 2019, Vol. 59, No. 7.

[9] See, for instance, J. Malherbe, S. Braun, *The European Union Directive (DAC6) Compelling Advisors to Report Transnational Tax Schemes*, "Tax Management International Journal" 2020, No. 3, p. 6.

[10] DAC 6, Art. 1(1)(b).21, Para. 1.

[11] DAC 6, Art. 1(1)(b).21, Para. 2.

[12] S. Moreno González, *La Directiva sobre revelación de mecanismos transfronterizos de planificación fiscal agresiva y su transposición en España: Transparencia, certeza jurídica y derechos fundamentales*, "Nueva Fiscalidad" 2019, No. 2, p. 47.

their relevant expertise and understanding".[13] Therefore, it is incumbent upon the auxiliary intermediary to prove unawareness of the arrangement. According to Rodríguez Márquez, the words used by the Directive at this point may lead to conclude that it does not impose auxiliary intermediaries an enhanced due diligence,[14] even if, as stressed by Moreno González, the vagueness in the words prevents from clearly identifying the requirements for triggering the reporting obligation. The Spanish legislator, when implementing the Directive into the domestic legal order, did not contribute to reduce this uncertainty, and when establishing the persons subject to the reporting obligations simply reproduces the definition and kinds of "intermediary" included in the Directive without providing any further clarification on the conditions triggering the reporting obligation for auxiliary intermediaries.[15]

As noted, the reporting obligation is, in certain cases, shifted to the "relevant taxpayer". This takes place in the case where there is no intermediary because the taxpayer designs and implements a scheme in-house and, in the case, when the intermediary is exempt from this obligation due to a legal professional privilege. DAC 6 establishes a far-reaching concept of "relevant taxpayer", including "any person to whom a reportable cross-border arrangement is made available for implementation, or who is ready to implement a reportable cross-border arrangement or has implemented the first step of such an arrangement".[16] The Spanish legislature transposed this concept in a very similar way, being the only peculiarity to be taken into account the fact that, as very recently explained by the Spanish legislature,[17] the Directive uses a concept of "taxpayer" (*contribuyente* in the Spanish version) which goes beyond the concept of *contribuyente* enshrined in our domestic tax system. That is why the domestic legislator opted to use the term *obligado tributario interesado* to refer to the term *contribuyente interesado* adopted by the Directive.

The author agrees with Moreno González that the far-reaching approach in the definition of the concepts of "intermediary" and "relevant taxpayer" may render it difficult to determine the person subject to the reporting obligation with the risk of duplicate reporting by more than one intermediary (or relevant taxpayer), increasing the compliance cost for taxable persons. As emphasized by that author, it should be noted that, at

[13] DAC 6, Art. 1(1)(b).21, Para. 2.

[14] J. Rodríguez Márquez, *Revelación de esquemas de planificación fiscal agresiva: directiva de intermediarios fiscales*, Lefebvre-El Derecho, Madrid 2018, pp. 48–49.

[15] S. Moreno González, *La Directiva…*, p. 48.

[16] DAC 6, Article 1(1)(b).22.

[17] ES, Royal Decree 243/2021, 6 April, Preamble, II, Para. 6.

least, the domestic provision of the Regulation[18] implementing the DAC 6 clarifies that, in cases of multiple reporting obligations, the filling of the declaration by one of them exempts the rest from such an obligation?[19]

As stated, it is possible that intermediaries are exempt from their reporting obligation due to a legal professional privilege, since the Directive establishes that "[e]ach Member State may take the necessary measures to give intermediaries the right to a waiver from filing information on a reportable cross-border arrangement where the reporting obligation would breach the legal professional privilege under the national law of that Member State".[20] Since the task of defining the scope of legal professional privilege is a matter for domestic legislators, many authors have stressed the risk that domestic regulations on the matter may become pool factors for aggressive tax planning arrangements, leading to a scenario where Member States would be in competition with each other when seeking to attract those arrangements to their jurisdictions. That is why Rodríguez Márquez understands that it would have been better if the Directive had followed the approach undertaken by the Anti-Money Laundering Directive,[21] which itself establishes the reporting obligations on lawyers.[22] The radically different approach adopted by DAC 6 renders the regulation of the professional privilege by each Member State crucial.

In the case of Spain, Additional Provision 23 of the General Tax Law exempts from the obligation to report cross-border tax arrangements due to the duty of *professional secrecy* (which is how is known in our country "the legal privilege protection offered in relation to lawyer-client communications")[23] those who are intermediaries (according to the

[18] ES, Art. 42(4).2º of the Royal Decree 1065/2007 setting general regulations on tax procedures and detailed implementation regulations on assessment.

[19] S. Moreno González, *La Directiva...*, pp. 49–50.

[20] DAC 6, Art. 8ab.5.

[21] EU, Council Directive 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No. 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (Text with EEA relevance), OJ EUT L 141 of 5 June 2015, pp. 73–117.

[22] J. Rodríguez Márquez, *El secreto profesional y la transposición de la DAC 6*, "ELDERECHO.COM", Lefevbre, 2 June 2020, section 1, https://elderecho.com/secreto-profesional-la-trasposicion-la-dac-6 (accessed: 5.05.2021).

[23] A. Benalal, M. Fuentes, *Legal privilege, confidentiality and professional secrecy Q&A: Spain*, 2021, https://www.twobirds.com/~/media/disputes-plus/files/pdfs/various-qas--april-2020/legal-privilege-confidentiality-and-professional-secrecy-qanda-spain.pdf (accessed: 5.05.2021). As the authors note, "professional secrecy is conceptualised as a right and duty of lawyers, by which they are exempt from disclosure to third parties (mainly the public administration and judges) of communications maintained with their clients,

Directive), regardless of the activity performed, and have provided advice with respect to designing, marketing, organizing, making available for implementation or managing of the implementation of a reportable cross-border arrangement, *with the sole aim of evaluating the arrangement's compliance with applicable legislation* and *without seeking or facilitating its implementation*. According to this provision, the duty of professional secrecy in Spain, as regards this obligation, only concerns persons who undertake the so-called "neutral advice", that is, the one *with the sole aim of evaluating the arrangement's compliance with applicable legislation* and *without seeking or facilitating its implementation*. This means that the only task covered by the duty of professional secrecy is, as stressed by Rodríguez Márquez, the one consisting of establishing the taxpayer's legal position by analysing whether the arrangement under the reporting obligation is compliant with the law.[24] Intermediaries who undertake an active position concerning the arrangement, by performing tasks consisting of designing, marketing, organizing, making available for implementation or managing of the implementation of the reportable cross-border arrangement may never invoke professional secrecy.[25] This has been severely criticized by Spanish scholars and, specially, by the Spanish Association of Tax Advisors, which further emphasizes that intermediaries who evaluate the arrangement's compliance with applicable legislation will not be covered by professional secrecy if "they seek or facilitate its implementation". As a conclusion, this association states that the Spanish legal treatment of professional secret concerning the reporting obligation is more restrictive than the one granted by the Directive and warned about the difficulties of reconciling the domestic provision implementing the DAC 6 regarding professional secrecy, with its regulation by both the Spanish Constitution and the domestic legal framework.[26]

In relation with this, one needs to bear in mind that the abovementioned domestic provision acknowledges professional secrecy of those with the status of intermediary "regardless of the activity performed". Therefore, as explained by Rodríguez Márquez, the legal privilege does not only cover lawyers, but also any person having the status of intermediary (such

counterparties or other lawyers involved by reason of their profession". They emphasize that "this concept differs from the common law concept of 'legal privilege', which is a right of the client. Professional secrecy is rather a duty (and right) of the lawyer".

[24] J. Rodríguez Márquez, *El secreto profesional…*, section 4.

[25] *Ibidem*.

[26] Europapress, *Aedaf avisa de "importantes problemas" de seguridad jurídica por la transposición de la directiva 'DAC 6'*, 25 May 2020, https://www.europapress.es/economia/fiscal-00347/noticia-aedaf-avisa-importantes-problemas-seguridad-juridica-transposicion-directiva-dac-20200525191030.html (accessed: 5.05.2021).

as advisors) according to the Directive. By contrast, in Spain professional secrecy, conceived as a right-duty, was so far limited to lawyers. Indeed, as remarked by that author, this right-duty of professional secret, in the field which is relevant for the purpose of this work, is linked to the fundamental right of defence, enshrined in Art. 24.2 of the Spanish Constitution, which states that "[…] all persons have the right […] to the defence and assistance of a *lawyer*". Next, this provision establishes that "the law shall determine the cases in which, for reasons of family relationship or professional secrecy, it shall not be compulsory to make statements regarding alleged criminal offences". Given that the right of defence is a fundamental right, its legal development (including its delineation in relation to other legal interests that are constitutionally recognized) must be undertaken through an Organic Law. This Law is the Organic Law 6/1985 of the Judicial Power, of 1 July, whose Art. 542(3) establishes that "*Lawyers* shall keep secret all facts or information that have been confided to them through any of the facets of their professional activity and may not be obliged to give evidence thereon". Being clear that professional secrecy in Spain is only recognized by Organic Law of the Judicial Power to lawyers, its extension to other persons covered by the term "intermediary", within the meaning of DAC 6, should have been carried out by a legal instrument with status of organic law. This is the opinion of Rodríguez Márquez, who criticises that the extension of the subjective scope of professional secrecy to other persons who are not lawyers has been carried out through an ordinary law.[27] The Spanish General Tax Law, which is an ordinary law, basically reproduces the content of the Directive regarding this issue.

2.2. Content of the reporting obligation

The content of the reporting obligation includes the cross-border arrangements potentially aggressive which fulfilled the conditions established by the Directive.[28] Given that "Aggressive tax-planning arrangements have evolved over the years to become increasingly more complex and are always subject to constant modifications and adjustments as a reaction to defensive countermeasures by the tax authorities",[29] the European legislature understands that " it would be more effective to endeavour to capture potentially aggressive tax-planning arrangements

[27] J. Rodríguez Márquez, *El secreto profesional…*, section 4.

[28] It should be noted that the reporting obligation only arises regarding potentially aggressive arrangements covered by the objective scope of the Directive 2011/16/EU.

[29] DAC 6, Preamble, IX.

through the compiling of a list of the features and elements of transactions that present a strong indication of tax avoidance or abuse rather than to define the concept of aggressive tax planning".[30] The Directive refers to these indicators as "hallmarks"[31] (included in Annex IV of the Directive) being a hallmark defined as "a characteristic or feature of a cross-border arrangement that presents an indication of a potential risk of tax avoidance, as listed in Annex IV".[32] Consequently a "reportable cross-border arrangement" means any cross-border arrangement that contains at least one of the hallmarks set out in Annex IV".[33]

It is important to note that those hallmarks just indicate a potential risk of tax avoidance. The presence of one or several hallmarks in an arrangement does not render it abusive.[34] Certain hallmarks, such as the one relating to transfer pricing transactions, even refer to genuine transactions not linked with potentially abusive transactions. This remark leads Calderón Carrero to conclude that the scope of application of those hallmarks goes beyond what is necessary to attaint their objectives, especially if one takes into account that those transactions are already subject to specific documentation and reporting obligations.[35]

Also, it is important to note that certain hallmarks may only be taken into account where they fulfil the "main benefit test". "That test will be satisfied if it can be established that the main benefit or one of the main benefits which, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage".[36] This test is broader than the one included in the GAAR of the Anti-Tax Avoidance Directive[37] (ATAD) and is articulated in a more objective way since it uses the term "benefit" instead of the term "purpose". As explained by Moreno González, the Spanish transposing provision adopted a very similar definition of the test, even if with some variations which,[38] in that author's

[30] *Ibidem*.

[31] *Ibidem*.

[32] DAC 6, Art. 1(1)(b).20.

[33] DAC 6, Art. 1(1)(b).19.

[34] J.M. Calderón, *El nuevo marco de transparencia sobre esquemas transfronterizos sujetos a declaración por intermediarios fiscales y contribuyentes: las "EU tax disclosure rules" y sus implicaciones*, "Quincena Fiscal" 2018, No. 10, p. 13.

[35] *Ibidem*, p. 18.

[36] DAC 6, Annex IV, Part I.

[37] EU, Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193 of 19 July 2016, pp. 1–14.

[38] The Spanish provision instead of using the term "main benefit", adopts the term "main effect", and instead of the term "main benefit", it uses the term "tax saving". S. Moreno González, *La Directiva*..., pp. 35–36.

view, aim to articulate the test in even more objective terms and to clarify its material scope. However, as expressed by Moreno González, the Spanish provision does not succeed in eradicating subjectivity and uncertainty, since, among other things, makes it necessary to determine whether the tax benefit is the main effect or one of the main effects of the arrangement.

2.3. When must the information must be transmitted?

One of the most controversial issues regarding the reporting obligation is the moment when the relevant information must be provided.

According to Art. 8ab.1 of the Directive "Each Member State shall take the necessary measures to require intermediaries to file information that is within their knowledge, possession or control on reportable cross-border arrangements with the competent authorities within 30 days beginning:

1) on the day after the reportable cross-border arrangement is made available for implementation; or

2) on the day after the reportable cross-border arrangement is ready for implementation; or

3) when the first step in the implementation of the reportable cross-border arrangement has been made,

whichever occurs first".

This regulation shows that the Directive applies, as put forward by Malherbe and Braun, to "prior intellectual activity", and that is why these authors conclude that the Directive "would probably find its place better in Aldous Huxley's 'Brave New World' than in legislation".[39]

2.4. Consequences of failure to comply with the reporting obligation

According to Art. 25a of the Directive, "Member States shall lay down the rules on penalties applicable to infringements of national provisions adopted pursuant to this Directive and concerning Arts. 8aa and 8ab, and shall take all measures necessary to ensure that they are implemented. The penalties provided for shall be effective, proportionate and dissuasive."

The way in which DAC 6 addresses the matter of penalties raises, at least, two issues. First, the fact that designing those penalties lies within the competence of domestic legislators, without any minimal

[39] J. Malherbe, S. Braun, *The European Union Directive…*, p. 10.

harmonizing framework established by the Directive, may lead to similar competition issues as those raised by the approach undertaken by the Directive regarding the legal privilege. Second, the fact that penalties will be imposed as a consequence of failure to comply with an obligation which is designed on the basis of very broad and unclear concepts raises obvious problems concerning the essential general principles of criminal law, such as the principles of legality, characterization, and legal certainty. Once again, the transposition of the Directive into the Spanish legislation, did not help to reduce the problems of legal uncertainty, and raises issues regarding the proportionality principle claimed by the Directive. The rules on infringement and penalties laid down by the Spanish legislature had been severely criticized by the Spanish Association of Tax Advisors who stressed that the domestic provision remains silent on the impossibility of sanctioning behaviours performed before its entry into force and held that the amount of penalties runs against the proportionality principle.[40]

3. Final comments: The controversial legal bases of DAC 6 as the root of the problems regarding taxpayer's rights and fundamental freedoms

It is clear that DAC 6 raises issues regarding taxpayers' rights, and that the Spanish legislation transposing the Directive does not succeed in solving those issues. The Directive shows two interests at stake: Member States' interest in fighting aggressive tax planning and (constitutional fundamental) taxpayers' rights. If the Directive tried to find a balance between them, it clearly chose to enhance the first interest to the detriment of taxpayers' rights. Moreover, the mandatory disclosure regime laid down in the Directive shows problems of incompatibility with the EU legal order. Echoing this concern, Blum and Langer stress that the justification for the restriction of fundamental freedoms[41] that mandatory disclosure rules involve is difficult to find regarding certain hallmarks. Those authors point out that while the necessity of ensuring effective fiscal supervision might justify certain elements of the DAC 6 that aim to ensure the efficient enforcement of existing tax rules – as happens also through the rules of the DAC on the exchange of information upon request – it seems at best

[40] Europapress, *Aedaf avisa de "importantes problemas"*...

[41] The reporting obligation – with its correlated administrative costs – arises in cross-border situations.

doubtful that such justification can be applicable regarding "mandatory disclosure rules obliging taxpayers to report legal, but politically undesirable, structures".[42]

In my view, the very problem surrounding these issues, and in particular, the difficulties in finding a justification for the restriction to the fundamental freedoms that certain hallmarks clearly involve, lays on the legal bases (Arts. 113 and 115 TFEU) on which the DAC 6 was adopted. Problems arising from the adoption of Art. 115 TFEU (legal basis for the harmonization of direct taxes) are even more obvious than those arising from Art. 113 TFEU (legal basis for the harmonization of indirect taxes).[43] Article 115 TFEU empowers the Council to unanimously adopt "directives for the approximation of the laws […] of the Member States as directly affect the establishment or functioning of the internal market". Article 115 TFEU therefore allows the adoption of directives which harmonize Member States' legislations when *those legislations* directly affect the functioning of the internal market. As I have stressed in other work,[44] it is essential to note that Art. 115 does not address *taxpayers' practices or behaviours*, but rather *national domestic laws*. The problem with the DAC 6 is that it does not address national domestic laws but taxpayers' practices or behaviours, that is, aggressive tax planning. I have expressed analogous considerations regarding the ATAD. With the aim to protect Member States' tax bases from erosion caused by increasing sophisticated tax-planning structures, DAC 6 articulates a reporting obligation that enable Member States to close loopholes by, *inter alia* enacting legislation which discourages taxpayers to use them. However, in my view, "if the existing domestic laws are inappropriate at the global level and allow taxpayers to exploit disparities for their benefit, and to the detriment of Member States' tax collection interests", leading to, for instance, a situation of double non-taxation, these States should take action and adopt consistent harmonizing directives that eliminate both situations of double non-taxation as well as double taxation situations to which those disparities might lead as well.[45] "Avoidance", the idea inspiring the ATAD, and also the DAC 6, "is a concept focused on

[42] D. Blum, A. Langer, *At a Crossroads: Mandatory Disclosure under DAC-6 and EU Primary Law – Part 1*, "European Taxation" 2019, Vol. 59, No. 6, p. 289.

[43] For a complete analysis of both provisions (Arts. 113 and 115 TFEU) as the legal bases of DAC 6 see: D. Blum, A. Langer, *At a Crossroads Mandatory Disclosure under DAC-6 and EU Primary Law – Part 1*, pp. 284–290.

[44] M.C. Barreiro Carril, *La controvertida base jurídica de la Directiva antielusión fiscal. Un análisis a la luz de reglas de vinculación*, "Revista de Derecho Comunitario Europeo" 2019, Vol. 62, p. 171. See also: *idem*, *The controversial legal basis of the anti-tax avoidance directive. An analysis in the light of its linking rules*, "Tijdschrift voor Fiscaal Recht" 2021, Vol. 19, No. 611, pp. 971–972.

[45] *Ibidem*.

the behaviour of the taxpayer and not on the inadequacy of existing rules", as pointed out by Dourado.[46] As I stated in another work, "The fact that the existing rules are inadequate should not lead to responses by EU law which adversely affect taxpayers that undertake legal mismatch arrangements by taking advantage of such inadequacy".[47] In this regard, in my opinion, it is shocking that the Council states that "tax-planning structures often take advantage of the increased mobility of both capital and persons within the internal market",[48] while no real concern seems to emerge from the Council regarding tax obstacles created by disparities in Member States' legislations. For instance, the Common Consolidated Corporate Tax Base, which would provide for consistent harmonization by removing obstacles jeopardizing the exercise of fundamental freedoms, has been set aside for a later time. Further still, I agree with Weber that the utilization by taxpayers of the most advantageous legal systems is in line with the objective of the internal market.[49] Therefore, if Member States want to prevent taxpayers from making use of disparities or loopholes, they should truly harmonize domestic legislations, for example, through a consistent directive from the perspective of the internal market, in the terms outlined.

Regarding its legal basis, DAC 6 raises the same essential problems as the ATAD. The DAC 6 is arguably even more problematic than the ATAD, since, as expressed by Malherbe and Braun, while the second one applies to transactions which have been already performed, DAC 6 "addresses prior intellectual activity.[50]

As a final conclusion, it should be stressed that both the ATAD and the DAC 6 focus on aggressive tax planning behaviours rather than (domestic) legislations. However, in order for the Council to enforce Directives in the field of direct taxation, what is needed is domestic legislations, not taxpayers' behaviours, to affect the internal market. Member States are of

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[46] A.P. Dourado, *The meaning of aggressive tax planning and avoidance in the European Union and the OECD: An example of legal pluralism in International Tax Law*, [in:] J. Englisch (ed.), *International Tax Law: New Challenges to and from Constitutional and Legal Pluralism*, IBFD, Amsterdam 2016, p. 264.

[47] M.C. Barreiro Carril, *The controversial legal basis of the anti-tax avoidance directive*…, p. 972.

[48] DAC 6, Preamble, II. As expressed in a great way by Blum and Langer that statement "essentially claims that the internal market and the associated free flow of goods and services was "too" successful, since it has become too easy to receive sophisticated and comprehensive tax advice within the European Union. In other words, the internal market has to be protected from being a victim of its own success" (D. Blum, A. Langer, *At a Crossroads: Mandatory Disclosure under DAC-6 and EU Primary Law – Part 1*, p. 286).

[49] D. Weber, *Tax avoidance and the EC Treaty freedoms*, Kluwer Law International, Alpheen aan den Rijn 2016, p. 33.

[50] J. Malherbe, S. Braun, *The European Union Directive*…, p. 10.

course entitled to fight those behaviours and protect their tax bases as long as tax avoidance domestic legislations fulfil the conditions arising from fundamental freedoms, as set up by the CJEU.[51] This is all the more justified if one bears in mind that aggressive tax planning behaviours, are, among other things, incompatible with the principle of equity. They can do so unilaterally or inspired by the BEPS Project, but cannot use a directive based on Art. 115 TFEU (at least with the content of the ATAD or the DAC 6) for the sole purpose of fighting against legal tax-planning arrangements, even if all of them agree to do so, by fulfilling the requirement of unanimity, which so far was very difficult to attain in the field of direct taxation. As I expressed regarding the ATAD, an objective (i.e.: such as fighting tax avoidance) does not acquire (priority) European status only because it appears as such in a directive: the fight against tax evasion is not, in my opinion, an objective to be achieved through a directive, at least in the way the ATAD has attempted to achieve it.[52] If Member States decide to use a Directive to fight aggressive tax planning in the field of direct taxes, they can only do so through one which eliminates disparities in domestic legislations, pursuing not only the objective of eradicating aggressive tax planning practices, but also the removal of tax obstacles to the internal market.

Article 115 TFEU is, in my view, conceived, from a taxation perspective, to contribute to improving the conditions in which taxpayers exercise their fundamental freedoms within the EU. True harmonization may serve that purpose. Both the ATAD and DAC 6 are not real harmonising directives. This work shows how the inappropriate use of a legal (harmonizing) basis – Art. 115 TFEU – for goals other than building a real internal market, may be the true cause of problems for taxpayers, both from the perspective of fundamental rights and fundamental freedoms.

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[51] CJEU, judgment, 12 September 2006, *Cadbury Schweppes*, C-196/04.

[52] M.C. Barreiro Carril, *Commentary on Chapter 16: Does the Anti-Tax Avoidance Directive Involve a Positive Step Towards the Completion of the Internal Market? Some Reflections in the Light of Linking Rules Addressing Hybrid Mismatches*, [in:] P. Pistone (ed.), *European Tax Integration: Law, Policy and Politics*, IBFD, Amsterdam 2018, pp. 640–641.

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Abstract

This work aims to identify some of the problems that the Directive 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (DAC 6) and its implementation into the Spanish legal order, raise as regards taxpayers' rights and fundamental freedoms. By describing the basic content of this reporting obligation, the author emphasizes the vagueness in which that content is defined both in the Directive and in the domestic legislation implementing the Directive, which raises issues as regards the principles of legality, characterization, and legal certainty. Furthermore, the author stressed that the mandatory disclosure regime laid down in the Directive, and in the domestic legislation, shows problems of incompatibility with the EU legal order. The work ends with some general comments on the problem that the Directive raises for taxpayers' rights from a broader perspective: the one related to the Directive's legal bases. This perspective helps to understand why, in the author's opinion, DAC 6 raises also issues concerning fundamental freedoms.

Keywords: reporting obligation of cross-border arrangements, aggressive tax planning, DAC 6, legal basis for the adoption of harmonizing directives, taxpayers' rights

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Radu Bufan[1]

Natalia Șvidchi[2]

Some Considerations about the Practical Importance of CJEU Judgements

1. Introduction

As partisans of the full harmonization of the EU tax system, the purpose of the paper, based on two recent judgements of the CJEU, is to emphasize the possibility to extend some of the solutions to the field of direct taxation (see section 2) but also, to show the risks of the preliminary rulings, especially when the Advocate General and the Court are exceeding their role (see section 3).

2. The need of an extended application of the CJEU case-law in the field of non-harmonized direct taxation

The full harmonization of tax legislation at the EU level remains a desire, as the Common Consolidated Corporate Tax Base (CCCTB) project has not been completed yet and its future is uncertain. The indirect harmonization in the field of direct taxation via the CJEU case-law is another direction by

[1] Prof. Dr. Radu Bufan, PhD in Law (1998), Professor, Faculty of Law, West University of Timisoara (Romania).

[2] Dr. Natalia Șvidchi, PhD in Law (2014), Research Assistant, Faculty of Law, West University of Timisoara (Romania).

which progress is made in this area, through the TFEU provisions on fundamental freedoms.[3]

The proponents of the broadest application of EU law can identify other solutions for the "exploitation" of the CJEU judgements, where they use as arguments certain principles formulated by the Court, especially if national law does not expressly resist or, better, where national law provides the right framework for such an extension. In particular, we refer to judgements of the CJEU in the field of VAT which have the potential to be used in direct taxation, from the perspective of the principles they enshrine.

Such a possibility has emerged in Romanian tax law, under the judgement delivered by CJEU in case *Zabrus Siret*.[4]

In this case, a Romanian company tried to correct its VAT returns after it has been subjected to a tax inspection, because it had identified, after the inspection, certain supporting documents which it had not found at the time of the inspection, being within the five-year limitation period provided by the Romanian Fiscal Procedure Code[5] in Art. 91.

However, the tax administration has denied the company the right to correct its VAT returns by invoking the provisions of Art. 84 in conjunction with Art. 105 of the Romanian Fiscal Procedure Code and with the provisions of Annex No. 1 to the Order approving the Guidelines for correcting clerical errors in value added tax returns.[6]

The Romanian court of last degree invested with the resolution of the company's request (Suceava Court of Appeal) has asked the CJEU to provide the necessary guidance to solve the conflict between the taxpayer and the Romanian tax administration, asking CJEU whether the provisions of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (VAT Directive)[7] "preclude a national legislation which, by way of derogation from the five-year limitation period imposed by national law for the correction of VAT returns, prevents […] a taxable person from making such a correction in order to claim his right of

[3] R. Bufan, J. Malherbe, M. Buliga, N. Șvidchi, *Tratat de Drept Fiscal*, Vol. 2: *Drept fiscal al Uniunii Europene*, Hamangiu, Bucharest 2018, pp. 310–384.

[4] CJEU, judgement, 26 April 2018, *Zabrus Siret*, C-81/17.

[5] RO, Government Ordinance No. 92 of 24 December 2003 establishing the Fiscal Procedure Code [*Codul de procedură fiscală*], Official Gazette, Part I, No. 863 of 26 September 2005, repealed by Law No. 207 of 20 July 2015 establishing the Fiscal Procedure Code [*Codul de procedură fiscală*], Official Gazette, Part I, No. 547 of 23 July 2015.

[6] RO, Order No. 179 of 14 May 2007 approving the Guidelines for correcting clerical errors in value added tax returns [*Ordin pentru aprobarea instrucțiunilor de corectare a erorilor materiale din deconturile de taxă pe valoarea adăugată*], Official Gazette, Part I, No. 347 of 22 May 2007.

[7] EU, Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Official Journal EU L 347, 11 December 2006, p. 1, amended.

deduction on the sole ground that that correction relates to a period that has already been the subject of a tax inspection."

Interestingly, the Romanian tax administration invoked in defence of the restrictive interpretation of the Romanian Fiscal Procedure provisions two principles, namely the principle of the unity of tax inspections, but also the principle of legal certainty, as mentioned by the Court in Para. 39 of the judgement.

The Court's solution was to consider that preventing a taxpayer, within the legal limitation period, from correcting his tax returns for a certain period on the grounds that the period in question has already been subject to a tax inspection constitutes a violation of the principles of effectiveness, of fiscal neutrality and of proportionality, as argued in Paras. 40–44 of the judgement.

The principle of neutrality is expressly regulated in the Romanian Fiscal Code[8] in Art. 3(a) in the following wording: "The taxes and charges covered by this Code shall be based on the following principles: The neutrality of tax measures in relation to the different categories of investors and capital, with the form of ownership, ensuring equal conditions to investors, Romanian and foreign capital."

It should be noted that Art. 3 is found in Title I "General provisions", applicable (with certain exceptions) to all the taxes provided for in the Romanian Fiscal Code, including direct taxes such as the corporate tax and the income tax. As a result, the principle of fiscal neutrality, outlined in the *Zabrus Siret* case, could also be invoked before the Romanian courts in the case of a Romanian taxpayer who wishes to correct his corporate tax returns, after the period to which the returns relate has been the subject of a tax inspection.

Such an opportunity appeared to us in a case pending before a Romanian court in which a company had purchased some cooling equipment of high value and decided to depreciate it under the accelerated regime provided by the Romanian law. Under the provisions of Art. 24 of the Romanian Fiscal Code the taxpayer in question was entitled to deduct for tax purposes, within the first 12 months after putting into operation, a depreciation of 50% of the purchase value of such equipment. But, due to an accounting error, in the first 12 months after the purchase, the company did not deduct any tax depreciation for the equipment; instead, it deducted the 50% only in the 12 subsequent months (months 13–24 of the purchase). The error was acknowledged by the company only during the tax inspection, but the company was no longer able to submit a correcting

[8] RO, Law No. 571 of 22 December 2003 establishing the Fiscal Code [*Codul fiscal*], Official Gazette, Part I, No. 927 of 23 December 2003 repealed by Law No. 227 of 20 July 2015 establishing the Fiscal Code [*Codul fiscal*], Official Gazette, Part I, No. 547 of 23 July 2015.

tax return, considering the restriction imposed by the provisions of Art. 84 of the Romanian Fiscal Procedure Code.

During the proceedings before the court of first degree, the designated accounting expert identified this problem, pointing out that according to Art. 84 of the Fiscal Procedure Code, tax returns can be corrected by the taxpayer on its own initiative; however, it is not possible to correct tax returns for tax periods which have been subject to tax inspection or for which a tax inspection is in progress.

Under the same reasoning the court of first degree has rejected the legal action of the taxpayer in respect of the possibility to correct the tax return during the tax inspection.[9] It should be mentioned that the court of first degree judgement was delivered before the CJEU's judgement in *Zabrus Siret*.

The taxpayer appealed the judgement of the court of first degree, arguing, by relaying on the *Zabrus Siret* judgement, that the approach of the tax administration, confirmed by the court of first degree, violated the principle of neutrality provided by Art. 3(a) of the Romanian Fiscal Code. In the opinion of the taxpayer, the different treatment, applied solely on the ground that he has been subjected to a tax inspection before the expiration of the five-year limitation period, represents an unjustified violation of the principle of neutrality.

Considering the merits of the appeal made by both sides of the dispute, the court of appeal overturned the judgement of the first degree court and sent it for retrial to the same court.[10]

Regardless of the judgment to be given in this case, what should be noted from the foregoing is that, the general principles of the EU, relevant in the taxation field, can be invoked before the national courts in tax disputes in matters of non-harmonized taxes, especially if the "environment" offered by domestic law, the doctrine or national case-law allow or encourage such an extension.

3. What happens when the Advocate General and the CJEU are exceeding their role

It is an acknowledged fact that "although, in order to deliver its judgement, the Court necessarily takes into account the legal and factual context of the dispute in the main proceedings, as defined by the referring court

[9] RO, Timișoara Court of Appeal, judgement, No. 88/31.03.2016, file 1657/59/2014.

[10] RO, High Court of Cassation and Justice, judgement, No. 2275/22.04.2019, file 1657/59/2014.

or tribunal in its request for a preliminary ruling, it does not itself apply EU law to that dispute. When ruling on the interpretation or validity of EU law, the Court makes every effort to give a reply which will be of assistance in resolving the dispute in the main proceedings, but it is for the referring court or tribunal to draw case-specific conclusions, if necessary, by disapplying the rule of national law that has been held to be incompatible with EU law."[11]

In a Romanian case[12] it seems that CJEU's considerations regarding the factual aspects have been taken as such by the national court which made the request for a preliminary ruling and which, in the end, decided the case.

The questions referred to CJEU were raised in a tax case, in which the appellant, a university professor, practiced several liberal professions: chartered accountant, tax advisor, insolvency practitioner, and lawyer. Also, occasionally, the appellant derived copyright royalties from publishing activity.

The issue, however, was not necessarily related to the number of the liberal professions carried out by the appellant (although this contributed to the complexity of the case), but to the fact that the appellant, along with two other individual persons, owned an immovable property which was rented to two companies. The appellant held the majority of the shares in one of the companies and was one of its directors.

Following a tax inspection performed regarding the activity of the appellant, the tax inspectors considered that the income from the rental of the immovable property should be taken into consideration when calculating the turnover threshold provided under the Romanian legislation for the application of the special exemption scheme for small enterprises (RON 220,000 or EUR 65,000). Only by including the income from rental in the calculation of the threshold would the appellant exceed the threshold and would be obliged to register for VAT purposes and fulfil the related obligations. In the end, the tax inspectors registered retroactively, ex officio, the appellant for VAT purposes and calculated the VAT the appellant should have collected and paid since that moment and the related accessories.

The appellant was of the opinion that, from the VAT point of view, the rental of a co-owned personal immovable property, qualified as an ancillary transaction, both in the light of the CJEU pro rata deduction case-law in which this notion was analysed, and of the criteria regulated in the

[11] CJEU, *Recommendations to national courts and tribunals in relation to the initiation of preliminary ruling proceedings*, Official Journal EU C 380 of 8 November 2019, point 11.

[12] CJEU, judgement, 9 July 2020, *AJFP Caraş-Severin and DGRFP Timişoara*, C-716/18.

Romanian Implementing Rules of the Fiscal Code[13] provisions, elaborated based on the CJEU case law.

In this context, the national court of last degree decided to send CJEU three questions analysed both by the Advocate General and by the Luxembourg Court in case *AJFP Caraş-Severin and DGRFP Timişoara*.

In their analysis, the Advocate General[14] and the CJEU pointed out that the application of their interpretation of the VAT Directive provisions is the task of the national court. However, one cannot neglect the fact that these statements are preceded by some very strong specifications (especially in the opinion of the Advocate General, Paras. 50–53) which seem to deprive the national court of its right and the correlative task to apply the interpretation of the court in the light of the circumstances of the case; in our opinion, by reading the opinion of the Advocate General and the judgment of the CJEU one cannot escape the feeling that the case was actually decided in Luxembourg and that there is nothing else for the national court to do, but to comply, which actually seems to have happened.

By doing so, we consider that, in the end, the facts that represented the point of reference in the case were analysed superficially and taken as such, irrespective of their true representation in reality. Considering that the national court had set aside the arguments and the evidence in this regard provided by the appellant, there is a high probability for it to have been persuaded by the interpretation applied to the facts of the case by the Advocate General and by the CJEU.

As such, after stating that it is the task of the national court to apply the interpretation of the VAT Directive to the facts of the case, the Court listed the elements that should be considered in order to determine the existence of an ancillary transaction, namely the nature of the immovable property, the source of its financing, and its use.

Specifically, for the case at issue, in Para. 45 of the judgement, the Court listed a series of elements (outlined also by the Advocate General), all to the disadvantage of the appellant, followed by the specification that it is for the referring court to decide if they represent arguments that demonstrate that the renting activity under discussion in the case is related to the usual professional activity of the appellant (whereas the Advocate General already stated that such elements demonstrate such a relation, Paras. 50–53 of the opinion).

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[13] RO, Government decision No. 44 of 22 January 2004 approving the rules for implementing Law No. 571/2003 on the Fiscal Code [*Pentru aprobarea Normelor metodologice de aplicare a Legii nr. 571/2003 privind Codul fiscal*], Official Gazette, Part I, No. 112 of 6 February 2004.

[14] CJEU AG Kokott, opinion, 6 February 2020, *AJFP Caraş-Severin and DGRFP Timişoara*, C-716/18.

These elements are the following: the appellant declared that he performed his profession as a practitioner in collective proceedings at the address of the rented immovable property, the immovable property was partially let to a company of which the appellant is a shareholder and director, and which carries a similar (tax consultancy) activity to that of the appellant.

In our opinion, a close analysis of the elements pointed out by the CJEU does not reveal a strong connection of the renting activity with the professional activity of the appellant, as it results in a clear manner from reading the AG opinion and CJEU judgement.

As such, when it comes to the nature and the source of financing, the appellant argued, without being contradicted by the tax authorities, that the immovable property was represented by a house with a yard; its rooms were transformed into offices, but the transformation costs were entirely incurred by the tenants. Therefore, the appellant did not bear any costs in this regard. The only costs incurred by the appellant were those related to the partial price paid upon the acquisition and with the subsequent instalments for the bank loan contracted to finance the remaining price, the instalments being covered from the rent paid by the tenants.

It is important to mention that the appellant proved that the portion of the price paid upon the acquisition of the immovable property was not covered from income derived from the appellant's liberal professions, but from a private donation. For this reason, the immovable property was never included in his professional allocated assets, but maintained in his personal ownership.

As to the use of the immovable property, the national court argued that the direct link of the renting activity with the professional activity of the appellant results from the elements pointed out by the CJEU as necessary to be taken into account.

One of these elements is represented by the fact that the registered office of the appellant's insolvency practitioner profession was at the address where the immovable property in discussion was located. Both the Advocate General and the CJEU seem to disregard the fact that the registration was purely formal, as there was no indication that the appellant actually used that immovable property: it was a personal co-owned property, outside the professional allocated assets, and no costs were made/deducted by the appellant with the use of this property. The existence of the registered office does not imply automatically the fact that economic activities are carried out there. Moreover, the appellant showed that the economic activities related to all the liberal professions were carried out at the address which was declared as the registered address for the chartered accountant and tax advisory professions.

The other element that represented, in the opinion of the Advocate General and of the Court, an argument for the existence of a close and direct link, is the fact that, in one of the companies which rented the immovable property, the appellant was a shareholder and a director. Moreover, it was pointed out that the company in question carried similar activities to that of the appellant.

The aspects that were neglected in this regard are: the immovable property was only partially rented to the company in question, the appellant was not the only shareholder and director of that company, and the rental contract was concluded with this company not only by the appellant, but by the all co-owners, the other two owners having no holding and no position in the company at issue.

As to the arguments that the company carried out a similar activity with that of the appellant, it seems that the following aspects were considered as irrelevant: the fact that the tax consultancy was only one of the professions carried out by the appellant and this activity represented only a secondary object of activity of the company, not the main one.

However, most important is that, from a VAT point of view, the company in discussion represented a separate taxable person and it cannot be claimed that the economic activity of the company represents the economic (professional) activity of the appellant, regardless of the facts that the appellant is a shareholder and director in that company.

It is our opinion that the economic activity of the company and its nature could have been used as an argument only where the appellant could have been considered as acting as a taxable person in his capacities as shareholder and/or director. This conclusion results from the arguments of the CJEU, according to which an ancillary transaction must not be a direct, permanent and necessary link with the professional activity of a taxable person. It was demonstrated that the appellant did not act as a taxable person, neither in his relation with the company as shareholder, nor in his relation as director.

Thus, as director the appellant never received a payment from the company; an essential condition for a transaction to be included in the VAT scope is for it to be made for a consideration. Moreover, as director the appellant did not act independently, but in the name and on the account of the company,[15] the economic responsibility for his acts belonging to the company. Secondly, as shareholder, the appellant received occasionally dividends, and according to the CJEU case-law on this matter: "the mere acquisition, holding and sale of shares in a company do not, in themselves,

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[15] See: CJEU, judgement, 13 June 2019, *IO*, C-420/18; CJEU, judgement, 18 October 2007, *van der Steen*, C-355/06.

amount to an economic activity within the meaning of the Sixth Directive, since the mere acquisition of financial holdings in other undertakings does not amount to the exploitation of property for the purpose of obtaining income therefrom on a continuing basis. Any dividend yielded by that holding is merely the result of ownership of the property […] It is otherwise where the holding is accompanied by direct or indirect involvement in the management of the companies in which the holding has been acquired, if that entails carrying out transactions which are subject to VAT, such as the supply of administrative, financial, commercial and technical services […]".[16]

Accordingly, even if the appellant would have been actively involved in the management of the company, this involvement is not accompanied by the provision of management or other kinds of services for consideration. Therefore, it cannot be stated that the appellant acted as a taxable person in his capacity as shareholder in relation with the company.

Overall, one cannot state that the interpretation of the CJEU is wrong or that its reasoning departs from its case-law on ancillary transactions in the field of pro rata deduction. The issue is that the CJEU, given its prerogative to make references to the factual context of the case, actually dictated to the national court what elements to examine, there being no doubt regarding its opinion on the outcome of such an examination. It seems that the national court either was trapped by the findings of the CJEU or found in these findings enough to rely on without further examinations.

4. Conclusions

The EU harmonized law is constantly evolving by enshrining at the Union level the most appropriate principles and practices from the law of the Member States, in order to respond to the upcoming requirement, to which the national law of the most Member States, for various reasons, is not suited yet.

The superior quality of EU law, as it is "built" continuously by the CJEU, especially in terms of principles and rules that give expression, in tax matters, to broader demands of democracy and the rule of law, requires that it be applied on a large scale.

Thus, specialists and connoisseurs of EU law have the moral obligation to invoke principles extracted from EU law in purely internal situations in

[16] CJEU, judgment, 30 May 2013, *X*, C-651/11, Paras. 36 and 37.

non-harmonized tax fields, because court decisions of superior reasoning quality can be obtained, the scope of EU law is extended and, ultimately, more and more citizens are convinced of the advantages of harmonization in tax law and in legal matters in general.

This practical extension can be limited only by the consequences of the principle of procedural autonomy of the domestic law, which, from the Romanian experience, however, does not have a major impact, because the procedural rules are almost identical in tax matters.

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Bufan R., Malherbe J., Buliga M., Șvidchi N., *Tratat de Drept Fiscal*, Vol. 2: *Drept fiscal sl Uniunii Europene*, Hamangiu, Bucharest 2018.

Abstract

In this paper the authors analyse two CJEU judgments delivered as a result of preliminary questions in the VAT field sent by Romanian courts, with the purpose to outline the benefits of the preliminary ruling procedure, but also its drawbacks. It is the authors' opinion that some of the general principles governing indirect taxes, as developed by the CJEU, could be used successfully in the field of direct, unharmonized taxes, especially when there are strong reasons in this regard. The judgment in case *Zabrus Siret* is a good example in this sense. On the other hand, the authors question the CJEU's assessment of the facts of the case, considering the impact of such an assessment on the national referring court, by providing as example the judgement in case *AJFP Caraş-Severin and DGRFP Timişoara*.

Keywords: general principles of EU law, CJEU judgments, limits of CJEU's assessment

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Dániel Deák[1]

Release from the Pressure of the EU Competition Law

1. Subject of analysis

Although harmonisation in tax law is exceptional, this does not mean that the Member States should not consider developments in another Member State in light of the internal market's smooth functioning, following the principle of equivalence.[2] Not only is the Member States' taxation power limited by the principle of equivalence in general,[3] but the tax rules of the Member States are increasingly subject to

[1] Freelance researcher, Dsc, Hungarian Academy of Sciences.

[2] In the framework of the Single European Act adopted in Luxembourg on 9 September 1985, a declaration was made under Art. 100b of the Treaty establishing the European Economic Community (OJ L 169, 29 June 1987, p. 20). This article aims to draft the internal market principle, which has become known as the principle of equivalence. It is also called the principle of mutual recognition. The implementation of this principle is set out in the Commission Communication from the Commission to the Council and the European Parliament – *Management of the Mutual Recognition of National Rules after 1992 – Operational conclusions reached in the light of the inventory drawn up pursuant to Article 100b of the EC Treaty*, COM/93/669 final, 15 December 1993.

[3] In the EU, taxation is within the competence of Member States. However, they are obliged to exercise their taxation power consistently with the EU law. See: CJEU, judgement, 14 February 1995, *Schumacker*, C-279/93, Para. 21. Member States must thus not ignore the EU environment while exercising their power. It is another aspect of the Member State's taxation power that Member States can unilaterally determine the territorial application of their tax laws, although following the principles recognised by international law. See: E. Traversa, A. Pirlot, *Tax sovereignty and territoriality under siege: how far should the EU freedoms of movement impact on the territorial allocation of taxing powers between Member States?*, [in:] C. Brokelind (ed.), *Principles of law: function, status and impact in EU tax law*, IBFD, Amsterdam 2014, pp. 364–367.

EU competition law. Under such circumstances, tax matters are increasingly heard by the European Commission and, subsequently, by the European judicial authorities.

Meanwhile, competition law considerations are brought to the fore, which serve globalisation and are foreign to the tax law's internal logic. However, special sectoral taxes appear to be an exception to the general trend. In recent months, sales taxes hitting large companies have aroused particular attention.

Hungarian and Polish special sectoral taxes are peculiar, first because they apply to specific sectors. Furthermore, they are levied on sales. Finally, strangely enough, they have progressive rates.

In practice, these taxes target businesses with significant turnover. The addressees are typically businesses operating in Hungary (or Poland) but owned by persons settled down in the other Member States. Because of the suspicion of unlawful state aid, the European Commission, as the European competition authority, took action against these taxes. The Commission, however, was not successful in defending its position in the Court of Justice of the European Union (CJEU).[4]

As the literature has revealed the judgments' shortcomings, it is sufficient to refer to them below.[5] In what follows is to share some thoughts on how the Member States' tax law has developed and may develop in the future in an EU environment where special sectoral taxes are accepted. Concerning the tax law problem of special sectoral taxes, the appropriate case law of CJEU will be briefly presented.

[4] See the cases as follows: CJEU, judgement, 16 May 2019, *Poland* v. *European Commission*, joined cases T-836/16 and T-624/17; CJEU, judgement, 16 March 2021, *European Commission* v. *Poland*, C-562/19 P; CJEU, judgement, 27 June 2019, *Hungary* v. *European Commission*, T-20/17; CJEU, judgement, 16 March 2021, *European Commission* v. *Hungary*, C-596/19 P; CJEU, judgement, 3 March 2020, *Vodafone*, C-75/18; CJEU, judgment, 3 March 2020, *Tesco*, C-323/18.

[5] See, in particular, the most comprehensive critique of the respective judgments with R. Szudoczky, B. Károlyi, *The troubled story of the Hungarian advertisement tax: How (not) to design a progressive turnover tax*, "Intertax" 2020, No. 1. See also: B. Károlyi, *Progressive turnover-based taxes and their legal repercussions under EU law*, "EC Tax Review" 2020, No. 6. Furthermore: R. Mason, *What the CJEU's Hungarian cases mean for digital taxes*, "Tax Notes International" 2020, No. 2; P. Nicolaides, *Multi-rate turnover taxes and state aid: A prelude to taxes on company size* , "European State Aid Law Quarterly" 2019, No. 3; L. Parada, *How the Vodafone Magyarország opinion affects EU debate on turnover-based digital taxes?*, "Tax Notes International" 2019, No. 5; D. Stevanato, *Are turnover-based taxes a suitable way to target business profits?*, "European Taxation" 2019, No. 11; G. Kofler, J. Sinnig, *Equalization taxes and the EU's' Digital Services Tax*, "Intertax" 2019, No. 2; R. Mason, L. Parada, *Digital battlefront in the tax wars*, "Tax Notes International" 2018, No. 12.

2. Reference framework in the CJEU practice

The central question of the problem of prohibited state aid that may arise in connection with special sectoral taxes is determining the basis of comparison, i.e., a so-called frame of reference. It can be decided whether the examined tax measure can be classified as selective. As long as the European judicial authorities did not see any reason to find prohibited state aid concerning special sectoral taxes, they deviated from their previous practice or made an unconvincing distinction from previous cases.

They did not consider what the CJEU had already shown in *Humblot*[6] and much later in *Gibraltar*[7] that the legislative objective can be overridden if the effect of protectionism of the respective taxation can be shown. Moreover, the European judicial authorities deciding on special sectoral taxes have skipped discrimination, although it may well undermine the adequate protection of fundamental freedoms and discourage European solidarity.

In *Humblot*, a vehicle tax with steeply progressive rates provoked controversy. The tax was calibrated according to the vehicle's cylinder capacity, i.e., an objective criterion. The impact of this tax was to hit vehicles with a high cylinder capacity.

Such vehicles were only manufactured outside the Member State applying the restrictive tax rates. However, the tax application did not depend on whether the taxable product was of a domestic or foreign origin. The tax rule's effect was that imported products were subject to stricter taxation, a trade barrier. Such tax was therefore found discriminatory and protective.[8]

In *Gibraltar*, it could not be seen immediately that prohibited state aid occurred. It arose from a tax haven situation the offshore companies operating in Gibraltar could enjoy. No tax haven could be discovered from the respective regulatory system.

Offshore companies could avoid taxation because they did not have an employee or did not use commercial real estate to trigger taxation. The General Court did not identify a tax haven because it confined itself to examining the regulatory system. It missed disclosing the impact of regulation, however.

The CJEU criticised the General Court's judgment as follows: "The General Court's approach, based solely on a regard for the regulatory technique used by the proposed tax reform, does not allow the effects of

6 CJEU, judgement, 9 May 1985, *Humblot*, 112/84.

7 CJEU, judgement, 15 November 2011, *European Commission* and *Spain* v. *Gibraltar* and *the United Kingdom*, joined cases C-106/09 P and C-107/09 P.

8 See: CJEU, judgement, 9 May 1985, *Humblot*, 112/84, Para. 14.

the tax measure in question to be considered and excludes from the outset any possibility that the fact that no tax liability is incurred by offshore companies may be classified as a 'selective advantage'."[9]

Taxation depended on the size of the turnover and seemed objective, but one had to bear in mind that domestic companies did not achieve higher tax rates while companies operating in Poland or Hungary, respectively, but owned by persons from the other Member States had high turnover that immediately had to be taxed at the highest rate. Similarly to *Gibraltar*, the Hungarian legislature constructed taxation in full knowledge of the easily predictable situation that taxation affected businesses operated by persons from the other Member States negatively while unilaterally favouring competing domestic companies. Concerning the reference framework, it is necessary to consider the legal structure of taxation and the market conditions under which tax rules are expected to apply.

In C-385/12 *Hervis*,[10] CJEU found that the taxation of turnover based on highly progressive tax rates was linked to the rule on the aggregation of taxable turnover of affiliated undertakings. It was concluded that the taxpayers belonging to company groups were taxed based on a "fictitious" turnover. The *Vodafone* and *Tesco* cases are different from *Hervis* as, in the special telecom tax and the retail trade tax, respectively, there is no aggregation rule.[11] The CJEU, therefore, ruled that, for lack of a combination of a progressive tax and an aggregation rule, the problem identified in *Hervis* no longer existed.[12]

3. A conflict between the EU's and the Member States' competences

The uncertainty surrounding the law on prohibited state aid and the Commission's practice of prohibiting state aid lies in the fact that it is impossible to know precisely how competences are divided between the EU and the Member States. In principle, taxation is a Member State competence. However, if a Member State takes specific measures, the possibility of prohibited state aid may arise. If so, the EU competition authority must already act.

[9] See: CJEU, judgement, 15 November 2011, *European Commission* and *Spain* v. *Gibraltar* and *the United Kingdom*, joined cases C-106/09 P and C-107/09 P, Para. 88.

[10] CJEU, judgment, 5 February 2014, *Hervis*, C-385/12.

[11] Following the judgment in *Vodafone* and *Tesco*, the aggregation rule exists in the newly introduced retail trade tax, but taxpayers are now entitled to opt out. See: HU, Act XLV of 9 June 2020 on the retail trade tax.

[12] See: CJEU, judgement, 3 March 2020, *Vodafone*, C-75/18, Para. 55 and CJEU, judgment, 3 March 2020, *Tesco*, C-323/18, Para. 75.

There are two views on the future development of the EU state aid law: 1) inter-governmentalism: the masters of integration are the Member States, 2) neo-functionalism: the European authorities (above all the Commission) can act autonomously in the general interest of the Union. According to the literature, lawyers are more pro-independence and political scientists are, in turn, more pro-union.[13]

There may be no valid legal doctrine when a Member State measure is distortive, but no legal doctrine is required under Art. 107 TFEU to demonstrate a distortive effect. In practice, the mere identification of state aid is sufficient, which does not require a conceptual distinction between general and specific measures. In the absence of a general definition, the finding of prohibited state aid becomes a matter of discrimination, as the case law shows, for example, in the case of *Gibraltar*.

Due to neo-functionalism considerations, Cees Peters does not accept without reservations the tax lawyers' current view that, given the requirement of legal certainty, Member States can act autonomously in what constitutes prohibited state aid and harmful tax competition.[14] If the Member States do not agree on a harmonisation law to eliminate the state aid procedure's uncertainties, EU competence will inevitably increase as the Commission fills the gaps. In practice, high-taxing Member States may already be more robust in enforcing different EU tax harmonisation policies than the low-taxing Member States, which tend to apply tax competition to attract additional capital to the Member State.

On a global scale, the reality is that Member States' powers are being involuntarily eroded. It would be pointless for the Member States to insist on the critical requirement of legal certainty in tax law once multinational companies are interested in breaking down administrative barriers to cross-border competition as quickly and as entirely as possible. Then, the academic debate might be decided against the will of the Member States.

4. A lesson to be drawn: a gloomy future of tax law as a particular branch of law

The right to control state aid is part of competition law in the broadest sense. Prohibited state aid can be implemented through tax and non-tax means. In the former case, the EU authorities may examine taxes, now not

[13] C. Peters, *Tax policy convergence and EU fiscal state aid control: In search of rationality*, "EC Tax Review" 2019, No. 1, p. 9.

[14] *Ibidem*, p. 14.

for tax but for competition law purposes. The relevant EU authorities may want to determine whether the Member States' tax measures in question have a distorting effect on competition.

In any case, tax law as a particular branch of law has had to date a limited effect in the EU legal environment. On a global stage of capital movements, particular law branches tend to be pushed into the background. Such an event happened, e.g., in recent decades with the company law.

With the development of the digital economy and growing capital mobility, there is a need to simplify the regulatory environment of company law, resulting from the trend that national company law is becoming empty of meaning.[15] The underlying national company law is being replaced by restrictions of other legal branches, which are not tailored to its legal type but its size, and apply thresholds linked to turnover, staff, or other business features.

In such cases, tax law considerations are often subordinated to the interests of the freedom of global capital markets. In the field of tax regulation, global capital market movements require, for example, an extension of tax consolidation even to cross-border company groups[16] while devaluing traditional transaction-based transfer pricing methods.

Cooling of financial activity requires continuous regulatory oversight of capital market activity while regulators constantly adapt to changing markets. A tax instrument that can be used to curb financial market hyperactivity is, e.g., the imposition of a financial stability contribution on financial enterprises (this is the so-called "bank levy"), proposed by the IMF already in 2010.[17] Similarly, it is a chance to introduce a financial transaction tax in the European framework.[18]

A further difficulty for tax law is the frequent use of estimation when assessing financial performance or market judgment. Flexibility is needed in changing market conditions, but such a development makes it difficult to enforce legal certainty that is a crucial feature of tax law. The resilience of regulators is meaningful in economics, but it can hardly be coordinated with a legal system's stability.

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[15] European Commission, *Communication from the Commission on a simplified business environment for companies in the areas of company law, accounting and auditing*, Brussels, 10 July 2007, COM(2007)394 final. See, in particular, Para. 3.1.

[16] Proposal for a Council Directive on a Common Corporate Tax Base, Strasbourg, 25 October 2016, COM(2016)685 final (first step – common tax base); proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), Strasbourg, 25 October 2016, COM(2016)683 final (second step – unitary taxation).

[17] IMF, *A fair and substantial contribution by the financial sector. Final report for the G-20*, June 2010, https://www.imf.org/external/np/g20/pdf/062710b.pdf (accessed: 1.03.2021).

[18] Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax, Brussels, 14 February 2013 COM(2013)71 final.

Competition law considerations suggest measures to be taken on a global scale because a proper compass of the authorities' intervention is the global economic impact. In such an environment, legal doctrines are depreciated. Debates are constant, e.g., when looking for how the reference framework should be defined to establish selectivity while examining state aid. From a competition law point of view, a reference framework's choice could be extensive, which often seems unacceptable from a tax law perspective.[19]

Although freedom of competition is in the public interest, competition may dissolve itself because of the endless pursuit of profit individual actors seek. Heated competition law is a consequence of the emergence of global capital, against which the authorities endeavouring to enforce the obligations of national legal branches appear to act in the public interest. Nevertheless, the contradiction cannot be avoided because the nation-state's public interest is local, while the capital interested in breaking down the administrative barriers to freedom of competition is global. It is only possible to take the proper position on a case-by-case basis in whether the local public interest or the global private interest deserves priority.

From a competition law point of view, consolidated and non-consolidated companies operating in the same market are compared. Such a comparison is not appropriate because of the tax law regime developed to date. It is logical for the Commission, as a competition authority, to shape the reference framework for turnover tax in a way to provide for a flat-rate tax that does not allow exceptions while the Member States, in contrast to this aspiration, may wish to include redistributive logic in their tax legislation.

A lawyer can easily find that unreflected competition law may lead to fictions in the real world of the market imperfections. If this scepticism against market competition is well founded, then – but only then – progression in taxation can be included within a single frame of reference, even in the case of taxation levied on turnover. The question, then, is how far lawyers specialising in taxation can enforce their considerations while resisting global influence.

Global capital is sending a message through competition law, under the pressure of which the nation-state's legal toolbox often crashes. On a case-by-case basis, a balance should be struck between the free movement of capital and nation-state sovereignty, but the pendulum often transcends somewhere in this and somewhere in that direction. In the case of progressive taxes on turnover, for the time being, defenders of

[19] The General Court also ruled against the Commission's decision in the *Apple* case, finding that the Commission had failed to prove the existence of a tax advantage. This decision reflects growing doubts about the extension of EU competition law. CJEU, judgment, 15 July 2020, *Ireland* and *Others* v. *European Commission*, joined cases T-778/16 and T-892/16 (under appeal; see: *Ireland* v. *European Commission*, C-465/20 P).

nation-state sovereignty seem to gain against those who want to open up European capital markets and further harmonise the relevant regulations to remove administrative barriers from the freedom of capital.

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Abstract

What follows is to share some thoughts on how the Member States' tax law has developed and may develop in the future in an EU environment where special sectoral taxes are accepted. Tax law considerations are increasingly subordinated to the interests of the freedom of global capital markets. Flexibility is needed in changing market conditions, but such a development makes it difficult to enforce legal certainty, which is a crucial feature

of tax law. The resilience of regulators is meaningful in economics, but it can hardly be coordinated with a legal system's stability.

Concerning progressive taxes on turnover, for the time being, defenders of nation-state sovereignty seem to gain against those who want to open European capital markets and further harmonise the relevant regulations to remove administrative barriers from the freedom of capital. However, the future tells us how much national tax law systems can preserve their cohesion in the EU, an integral part of the global economy.

Keywords: progressive taxes on turnover, reference framework, legal certainty

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Caroline Docclo[1]

The Dissenting Interpretation of the Term "Immovable Property" in the Treaty of 1964 between Belgium and France and the Outcome of the Discussion in Their New Treaty

Foreign languages remain a stumbling block in international relationships. As a francophone, I expected to meet Professor Włodzimierz Nykiel for the first time in [Lots] when he invited me to attend a congress. A friend of mine who had Polish roots told me that I should pronounce [wutɕ] or [Wootch]. I managed to overcome the language barriers, landed in Łódź and met Professor Nykiel and his team.

In contrast, the Belgian and French authorities and judges seem to be unable to agree on the reading of their double tax treaty of 10 March 1964[2] although it is written in French, which is an official language of both countries. Let me illustrate this with the differences in interpretation of the term "immovable property" (*bien immobilier*) used in this treaty and the characterization of shares in French real estate companies for the purpose of the treaty.

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[1] Prof. Caroline Docclo is a professor of international tax law at the Université de Liège and the Université libre de Bruxelles, an invited professor at the Royal University of Law and Economics of Phnom Penh; an independent person of standing appointed by the Belgian government for the purposes of EU Arbitration Directive and Arbitration Convention; a member of the Permanent Scientific Committee of the International Fiscal Association; and a member of the Brussels Bar.

[2] Convention between Belgium and France for avoidance of double taxation and establishing rules for reciprocal administrative and legal assistance in matters of income tax (*Convention entre la Belgique et la France tendant à éviter les doubles impositions et à établir des règles d'assistance administrative et juridique réciproque en matière d'impôts sur les revenus*).

1. Introduction

The nature of shares in French real estate companies matters when determining the tax treatment under the treaty between Belgium and France of dividends or capital gains obtained by shareholders who reside in the Kingdom of Belgium. Although the income tax treaty of 1964 between Belgium and France was not patterned after the OECD Model Convention,[3] it contains similar rules expressed in a different order. The question whether such dividends or capital gains qualify as income from "immovable property" has been submitted to the supreme courts of both countries and has been answered differently in the two countries.

2. Shares in real estate companies are personal property under general law

Belgium adopted the French Civil Code of Napoleon. Although the code has evolved differently in the two countries, it has retained the same definition of personal and immovable property. Article 529 of the Napoleon's Civil Code provides that claims and rights relating to shares or interest in financial, commercial, or industrial companies are personal property by determination of the law, even though real estate belongs to the companies.[4] A distinction must be made between the assets owned by a company and the shares that the same company issues.[5] Under both French and Belgian laws, shares are personal property by determination of the law and the partners who hold them are not the owners of the land and buildings belonging to the company.

Nevertheless, the French legislator has given specific features of quasi-transparency to companies called *sociétés d'attribution* whose sole purpose is either the construction or acquisition of buildings with a view to their division into fractions intended to be allocated to their members, or the management of these buildings so divided. Their hybrid status can be justified by their ephemeral purpose which is the acquisition or the

[3] In its latest version: OECD, *Model Tax Convention on Income and on Capital 2017 (Full Version)*, OECD Publishing, Paris 2019 (2017 OCDE Model).

[4] Under the new Belgian Civil Code (in force since 1 September 2021), shares in comapnies remain personal property since they do not qualify as immovable property (Art. 3.46 to 3.49).

[5] FR *Conseil constitutionnel*, No. 2019-820 QPC, 17 January 2020, *Epoux K.*

construction of buildings. Those companies are intended to be dissolved as soon as their goal is achieved, and their partners' main purpose is not to share profits.[6]

3. Treatment of shareholdings in real estate companies under domestic income tax law

3.1. In Belgium

Under Belgian tax law, as a rule, an individual taxpayer is not taxable on the profits made by a company which is a separate legal entity.[7] However, any benefit received by a shareholder from such a company qualifies as a taxable dividend (Art. 18 of the income tax code (*Code des impôts sur les revenus 1992* – CIR 1992)). Individuals are not taxed on the gains that they realize upon the sale of shares unless the transaction exceeds the normal management of private wealth (Art. 90 CIR 1992).

The tax regime of income and capital gains derived by the shareholder is not determined by the nature of the company's assets. As a rule, the shareholders are not taxed on the company's income and they are not deemed to sell part of the company's real estate when they sell their participations. Under Belgian tax law, dividends and speculative gains on shares are the only taxable income that the shareholders can derive from a French real estate company.

3.2. In France

Under French tax law, real estate companies may be subject to different tax regimes.

A so-called *société d'attribution* is transparent for tax purposes. Its shareholders are regarded as if they had the rights and obligations of the company. Its shareholders are taxed on the company's income as if they received it themselves (Art. 1655 ter of the general tax code (*Code général des impôts* – CGI)).

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[6] See: FR the report of Councillor Dagneaux, *Report before FR Cass. (ass.), 2 October 2015*, "Bulletin d'Information, Cour de cassation", No. 837, p. 13.

[7] Except for the application of the Cayman tax or in the exceptional cases referred to in Arts. 24 and 29 CIR 1992.

The ordinary *société civile immobilière* (SCI) is semi-transparent. The SCI is a subject of tax law. French tax law does not consider the partners to be the owners of the SCI's assets. However, the tax on the SCI's income is collected from each shareholder in proportion to his shareholding and the computation of his tax liability depends on his own characteristics. When the shareholding in the SCI is a private investment, the SCI's income is taken into consideration as a real estate income in the shareholder's tax bill. This regime applies whether the company distributes its profit or accumulates it. Besides, the distribution of dividends by an SCI is not a taxable event. Under this semi-transparency regime, the partners pay tax on the company's profits, but they are not deemed to obtain the income of the SCI, which has a separate personality. The semi-transparency is a matter of tax collection only.

An SCI may opt for the corporate income tax regime. If it does, there is no semi-transparency: the company pays tax on its profits and its shareholders are taxed on the dividends that it distributes.

The regime of capital gains realized on shares in real estate companies depends on the circumstances.

The tax regime of a French resident who alienates shares in a real estate company that he held as a private investment depends on the tax regime of the company itself. If the real estate company is "semi-transparent", the net gains derived from the transfer are subject to the same tax regime as capital gains realized on the transfer of real property (Art. 150 UB CGI). If the company has opted for corporate income tax, the capital gain realized on the sale of the shares it issued is subject to tax as a capital gain on the sale of personal property (Art. 150 0 A CGI).

When the seller is not domiciled for tax purposes in France, on the contrary, no distinction is made depending on the tax regime chosen by the company whose shares are sold. If the company's assets are mainly composed of real estate (*société à prépondérance immobilière*), whether semi-transparent or subject to corporate income tax, the capital gain realized by a non-resident on the sale of his shares is in principle taxable according to the capital gains regime applicable to real property (Art. 244 bis A CGI). The concept of *société à prépondérance immobilière* is specific to tax law. If non-resident taxpayers are taxed in France on capital gains realized on shares in *sociétés à prépondérance immobilière*, it is because the CGI considers that these capital gains are derived from a French source (Art. 164 B CGI) but it does not qualify the shares transferred as real property.

The CGI does not qualify shares in *sociétés à prépondérance immobilière* as real property, even though the capital gains they generate are taxed as if they were capital gains on real estate in many circumstances. If this were the case, the shares of SCIs subject to corporate income tax would change in nature depending on whether they are disposed of by residents of France or by non-residents.[8]

4. Treatment of shareholdings in real estate companies under the double tax treaty

Article 3 of the treaty of 10 March 1964 between Belgium and France deals with income from immovable property. Income from such property is taxable only in the contracting state in which the property is situated (Art. 3 Para. 1).

The income referred to in Art. 3 is identified in two steps: Paras. 2 and 3 determine the property from which it arises; Para. 4 determines the manner in which the income referred to arises.

Article 3 defines the term "immovable property" by referring to the law of the contracting state in which the property is situated. It specifies that the term includes rights to which the provisions of general law concerning immovable property apply, usufruct of immovable property and rights to variable or fixed royalties for the exploitation of mineral deposits, sources, and other resources of the soil (Art. 3 Paras. 2 and 3).

Article 3 applies to income derived from the use, letting or exploitation from immovable property, on the one hand, and profits resulting from the alienation of immovable property, on the other hand (Art. 3 Para. 4).

In 1977, France made a reservation to Art. 6 of the OECD Model Convention that is equivalent to Art. 3 of the treaty between Belgium and France:[9] "France wishes to retain the possibility of applying the provisions in its domestic laws relative to the taxation of income from shares or rights, which are treated therein as income from immovable property." France did not include such a possibility in its treaty with Belgium and Art. 3 remained unchanged since 1964.

Before 2003, the OECD Model Convention did not include any provision that gains derived by a resident of one contracting state from the alienation of shares or other interests in an entity may be taxed by the other contracting state if these interests derive a significant part of their value from real property situated on the territory of that contracting state. The treaty between Belgium and France does not include such a provision

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8 See, however: FR, *Tribunal administratif de Montreuil* (TA), 7 June 2019, No. 1705505.

9 Paragraph 6 of the Commentary on Art. 6 of the 2017 OECD Model.

either. Belgium is not in favor of clauses such as Art. 13 Para. 4 of the OECD Model Convention as it reads since 2003. Accordingly, in 2005, Belgium made a reservation to this provision.[10] When Belgium agreed to include similar provisions in several treaties, it subjected their application to varying carve-outs. Belgium did not deviate from its policy when it signed and ratified the Multilateral Instrument (MLI).[11] When adopting Art. 9(1)(b) of the MLI, Belgium merely accepted to extend to interests in entities such as partnerships and trusts the scope of the existing provisions of the treaties it signed earlier and that were similar to Art. 13 Para. 4 of the OECD Model Convention.[12]

The only provision of the treaty between Belgium and France that alludes to a specific tax regime applicable to French real estate companies is point 2 of the protocol which supplements Art. 15 relating to dividends (Art. 15 of the treaty between Belgium and France is the equivalent of Art. 10 of the OECD Model Convention). Point 2 of the protocol covers *sociétés d'attribution* referred to in Art. 1655 ter CGI. As mentioned before, in France, these companies are transparent. Their shareholders are taxed on their income as if they had rights over the assets and operations of these companies. The protocol provides that Art. 15 does not prevent France from treating the shares of such companies as real property, but it also allows Belgium to tax its residents on the dividends derived from those shares as ordinary dividends. Point 2 of the protocol deviates from the above-mentioned Art. 15 only and does not concern the capital gains regime. However, in 1966, the Belgian administration had extended its application to capital gains on shares of *sociétés d'attribution* realized by Belgian residents, considering that France could tax them as well as Belgium.[13] In 1978, it revised its position and considered that France could tax them, while Belgium should exempt them.[14] The French Council of State (*Conseil d'Etat*), on the contrary, decided that point 2 of the protocol cannot be extended to capital gains on shares in real estate companies.[15]

[10] Paragraph 51 of the Commentary on Art. 13 of the 2017 OECD Model.

[11] Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, done at Paris on 24 November 2016.

[12] BE Bill of 4 February 2019 assenting to the Multilateral Convention for the implementation of measures relating to tax treaties to prevent the erosion of the tax base and the shifting of profits and to the Explanatory Note, made in Paris on 24 November 2016 [*Projet de loi du 4 février 2019 portant assentiment à la Convention multilatérale pour la mise en œuvre des mesures relatives aux conventions fiscales pour prévenir l'érosion de la base d'imposition et le transfert de bénéfices et à la Note explicative, faites à Paris le 24 novembre 2016*], Doc. parl., *Chambre* (2018–2019), 54-3510/001, p. 49.

[13] BE Circular 920 of 18 August 1966, No. 21.

[14] BE Circular Ci.R9F of 15 March 1978.

[15] FR, C.E., 24 February 2020, No. 436392.

5. Interpretation of the treaty term "immovable property"

If shares in a French real estate company qualified as immovable property for the purposes of Art. 3 of the treaty between Belgium and France, dividends paid on such shares to a Belgian resident and capital gains realized on such shares by a Belgian resident should be taxable in France "only".

To identify the scope of that provision, reference should be made to the general rules of treaty interpretation. Belgium ratified the Vienna Convention of 23 May 1969 on the Law of Treaties. It applies to treaties signed by Belgium since 1 October 1992. However, since it codifies customary international law, Belgian courts apply its rules to all treaties, regardless of their date or whether the treaty partner is a party to the Vienna Convention.[16] France never signed the Vienna Convention. Nevertheless, French courts draw on the principles of this convention to interpret international treaties. In particular, they apply the principle of literal interpretation and seek the ordinary meaning of words in their context and the common intention of the parties.[17]

It is stated that a double tax treaty cannot be a legal basis for taxation since it only limits the fiscal sovereignty of the contracting states. A treaty applies to prevent a taxation provided by domestic legislation.[18] In view of the different scopes of domestic tax law and tax treaties, the *Conseil d'Etat* of France has formally introduced a "principle of subsidiarity of treaties", according to which the national judge must first ascertain the legality of a tax under French law before verifying its compliance with a treaty signed by France.[19]

The treaty between Belgium and France defines the term "immovable property" by referring to the laws of the contracting state in which the property in question is situated (Art. 3 Para. 2). More specifically, it refers to the provisions of private law relating to the ownership of such property (Art. 3 Para. 3). The context seems to indicate that the definitions under private law would prevail. However, in view of its generality, the expression "the law of the contracting state" may be

[16] BE, Opinion of AG Delange, before Cass., 27 January 1977, *Pasicrisie*, 1977, I, p. 574.

[17] Ph. Martin, *L'interprétation des conventions fiscales internationales*, "Revue de droit fiscal" 2013, No. 24, p. 320.

[18] C. van Raad, *Five Fundamental Rules in Applying Tax Treaties*, [in:] L. Hinnekens, *Liber Amicorum Luc Hinnekens*, Bruylant, Bruxelles 2002, p. 588.

[19] See: FR CE (ass.), 28 June 2002, No. 232276, *Schneider Electric*. The French Surpeme Court [*Cour de Cassation*] does not apply this principle (see: FR Cass. (ass.), 2 October 2015).

interpreted as including both tax law and civil law. It is also agreed that tax definitions are preferred when they deviate from definitions given by other branches of law.[20]

On the other hand, Art. 22 of the treaty between Belgium and France (that is the equivalent of Art. 3 Para. 2 of the OECD Model Convention) refers to national tax laws to provide the definitions missing in the treaty. Unlike Art. 3, it does not specify that the law of the country in which a property is located would take precedence in qualifying the property. Besides, it requires ensuring that the national tax definition used does not conflict with the treaty context.

6. Characterization of dividends paid on shares in a real estate company

The Supreme Court (*Cour de Cassation*) of Belgium has been called to decide whether dividends received by an individual residing in the kingdom as a return on his private investment in a French ordinary SCI were taxable in Belgium according to the distributive rules of the treaty between Belgium and France. It is remarkable that in France, this question does not arise since French law simply does not provide for the taxation of such dividends.

In a decision of 2 December 2004, the *Cour de Cassation* of Belgium decided as follows (free translation):[21]

"The dispute relates to the taxation of income distributed to the plaintiff, resident in Belgium, by a *société civile immobilière* under French law whose purpose, according to the findings of the judgment, is the management and letting of buildings of which it is the owner and not the allocation of its buildings to its shareholders and which is, as such, an ordinary *société civile immobilière* within the meaning of French law.

[20] With regard to Art. 6 of the OECD Model Convention, similar to Art. 3 of the treaty between Belgium and France, see: K. Vogel, *Klaus Vogel On Double Taxation Conventions*, 3rd ed., Art. 6, No. 22, Kluwer, London 1997; Ph. Baker, *Double Taxation Agreements and International Tax Law*, Sweet & Maxwell, London 1991, p. 112 et seq.; B. Peeters, *Double Conventions préventives de la double imposition – Commentaire 1991*, Ced-Samson, Diegem 1991, p. 84.

[21] BE Cass., 2 December 2004, "Pasicrisie" 2004, No. 584; C. Docclo, *Les divergences de vues du Conseil d'Etat de France et de la Cour de cassation de Belgique sur la qualification des revenus de parts de sociétés civiles immobilières françaises* – comments on BE Cass., 2 December 2004, "Journal de droit fiscal" 2004, No. 6–7, p. 233 et seq.

Under French tax law, companies of this nature are subject to a so-called semi-transparency regime according to which the company is deemed not to exist separately from its members, the latter are treated as if they were direct owners of the real estate to which the shares they hold entitle them and the income from these shares is considered as real estate income when, as in this case, it is attributed to individual shareholders who have not invested the shares in a business.

The [criticized] judgment finds that the income from the shares held by the plaintiff in a *société civile immobilière* in France was taxed in France as income from immovable property.

Article 3.1 and 2, of the treaty of 10 March 1964 between Belgium and France […] provides that income from immovable property shall be taxable only in the contracting state in which such property is situated and that the concept of immovable property shall be determined in accordance with the laws of that state; […]

By deciding that the Belgian tax authorities could tax such income, the judgment violates the above-mentioned provisions of the treaty concluded between Belgium and France."

This decision of the *Cour de Cassation* of Belgium seems to have confused semi-transparency and transparency under French law and relied on the fact that the tax bills that the French tax authorities send to the shareholders of ordinary SCIs mention real property income with respect to the profits made by the SCI. It induced from this that under French law, the shareholders would be deemed to have direct rights over the company's real estate and the income it produces.

Based on this holding, shareholders of ordinary SCIs considered that the income earned by the SCI reached them without changing its nature when dividends were distributed, and they claimed that the dividend should be exempt in Belgium. Belgian courts considered that the Belgian tax authorities could not tax SCIs' income, even on the occasion of a dividend distribution, on the grounds that such income would qualify as income from real estate property in France. Some taxpayers even reported the profits of the SCIs in which they had interests even though they had not received any dividend and even though they were not requested to report SCIs income under Belgian law.[22]

The Belgian tax authorities kept contesting the Supreme Court's ruling. In 2016, the Belgian *Cour de Cassation* overturned the decision of the Court of Appeal of Brussels of 10 September 2013, which had held that dividends from a SCI were covered by Art. 3 of the treaty between

[22] See: C. Docclo, *Le mystère belge de la translucidité des SCI françaises* – comments on BE Ghent, 29 April 2014, "Tijdschrift voor fiscal recht" 2014, p. 694 et seq.

Belgium and France and, for this reason, were taxable in France only.[23] By doing so, the *Cour de cassation* also overturned its own decision of 2004.

The *Cour de cassation* restated that ordinary SCIs are semi-transparent under French tax law and that their members are subject to income tax on a portion of the company's profits, accumulated or distributed, corresponding to their rights in such companies. Under French law, the share of each individual member in the company's profits is deemed to represent income from real property. However, it does not follow from these rules that shares in SCIs, which have a separate legal and fiscal personality, qualify as immovable property for the purpose of Art. 3 Para. 1 of the treaty between Belgium and France. The *Cour de Cassation* held that the Court of Appeal of Brussels violated Art. 3 of the treaty by considering that dividends paid on such shares were income from immovable property taxable in France only. The *Cour de Cassation* dared to say that it relied on the French rules "in the interpretation that they receive in France". We will see below that the interpretation given by the *Conseil d'Etat* of France may not be the one expected by the *Cour de Cassation* of Belgium.

In any case, under Belgian law, company shares are personal property. The treaty between Belgium and France does not determine that shares in French SCIs are situated in France. They are normally located at the place where the shareholder manages his wealth, i.e., at his domicile. Under Art. 3 Para. 2 and Art. 22 of the treaty, one may therefore refer to Belgian law to determine whether shares in SCIs held by a Belgian resident fall within the notion of "immovable property".

7. Characterization of capital gains on shares in a real estate company

When a taxpayer sells his shares in a company, the company does not make profits and the issue is not whether the company's income is attributed to the shareholder. Only the seller realizes a gain. However, the issue of the legal nature of the property from which the income is derived is the

[23] BE Cass, 29 September 2016, "Journal de droit fiscal" 2017, p. 65; P. Glineur, *Le Beaujolais de Crésus et la transparence fiscal*, [in:] S. Douénias, P. Minne (eds), *Fiscalité internationale et patrimoniale – Mélanges Pascal Minne*, Bruylant, Bruxelles 2017, p. 281 et seq. See also: BE Cass, 21 September 2017, "Tijdschrift voor fiscal recht" 2019, p. 92; C. Docclo, *La jurisprudence de la Cour de cassation sur le traitement des revenus des SCI françaises* – comments on BE Cass., 21 September 2017, "Tijdschrift voor fiscal recht" 2019, No. 554, p. 92 et seq.

same when characterizing a gain realized on the shares of a company and a dividend paid by a company from its profits.

Under Art. 3 of the treaty between Belgium and France, profits resulting from the alienation of immovable property located in France by residents of Belgium are taxable in France. Under Art. 18 of the same treaty, other capital gains realized by residents of Belgium may be taxed in Belgium only.

In 2012, the French authorities released a commentary on the treaty between Belgium and France where they considered that the notion of "immovable property" is not defined by the treaty and that shares in French real estate companies should therefore be characterized according to French law. They further considered that above-mentioned point 2 of the protocol is not limited to the *sociétés d'attribution* covered by Art. 1655 ter CGI and that, under French law, the shares of a company whose assets are mainly composed of real estate located in France (*sociétés à prépondérance immobilière*) should be immovable property. The capital gains realized on the disposal of these shares should therefore be taxable in France, although the transaction does not involve land or buildings or rights to such property.[24] The French authorities had already drawn the same conclusion in an instruction of 6 May 1966.

In France, an administrative doctrine expressed in instructions or in answers to parliamentary questions has legal value unless case law overrules it.[25] A circular is binding on the French authorities, while a taxpayer may challenge it in courts or even request its annulment.

In one case, a resident of Belgium who had held, as a private investment, shares in a French real estate company owning real estate located in France, sold them. The French authorities relied on the administrative commentary mentioned above to tax him on the capital gain he realized. The taxpayer requested the annulment of this instruction, but the French *Conseil d'Etat* dismissed his petition in a decision of 24 February 2020.[26]

The *Conseil d'Etat* of France first restated that point 2 of the protocol cannot be extended to other companies than *sociétés d'attribution*. Further, it considered that, when determining whether a property is immovable, Art. 3 of the treaty between Belgium and France refers to the law of the

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[24] FR BOI-INT-CVB-BEL-10-10, "Bulletin officiel des finances publiques – impôts", 12 September 2012, 110 et seq.

[25] The basis of this rule is found in Art. 80 A of the FR Tax Procedure Book [*Livre des procédures fiscales*], which provides that when the taxpayer followed published instructions or circulars the authorities may not support a different interpretation.

[26] "Revue de droit fiscal", 2020/38, No. 374, with comments by C. Docclo, *Convention franco-belge – Définition des "biens immobiliers" selon le régime d'imposition en droit français des plus-values réalisées*, pp. 47–54.

state where the property is situated and, more particularly, to its tax law, unless the context requires a different interpretation, under Art. 22 of the same treaty. The high court decided that, since the above-mentioned Art. 244 bis A CGI treats in the same manner capital gains on land and buildings and those realized by persons residing outside France on shares in real estate companies, the contested commentary does not misinterpret Art. 3 Para. 4 of the treaty between Belgium and France.

Keeping in mind the principle of subsidiarity established by the *Conseil d'Etat* of France,[27] it is not surprising that French judges called upon to rule on the validity of the taxation in France of a capital gain realized by a resident of Belgium on shares in a real estate company, begin their examination by reviewing the conformity of this taxation with French law. Here, the *Conseil d'Etat* of France was not called upon to verify the validity of a tax assessment, but rather to verify the interpretation given by the French authorities to the treaty between Belgium and France in an instruction of general application. Its interpretation of the treaty nevertheless seems to be very much influenced by the tax regime of the income under review under French law.

In its judgment, the *Conseil d'Etat* blended Art. 3 Para. 2 and Art. 22 of the treaty to justify its reference to the provisions of the CGI and omitted to verify whether the context of the treaty would require another interpretation. In addition, these two rules refer to the national definitions given to a "notion" or "a term" or, in short, the vocabulary used. They do not allow to qualify shares as immovable property on the grounds that French law gives to the income that they generate a tax treatment similar to that of income from real property.[28] For example, in *Banque française de l'Orient*, the *Conseil d'Etat* of France decided that France could not qualify hidden income of a French company as a "dividend" within the meaning of Art. 10 of the treaty of 16 March 1973 between France and the Netherlands, even though such income is deemed to be distributed under French law, since it is not distributed by a company to its shareholders pursuant to a decision taken by a general shareholders meeting.[29]

[27] Cf. supra.

[28] See: K. Vogel, *Klaus Vogel…*, Art. 3, No. 62; K. Vogel, R. Prokisch, *General Report, Interpretation of double tax conventions*, "Cahiers" 1993, Vol. 78a, p. 115.

[29] FR CE. No. 190083, 13 October 1999, *Banque française de l'Orient.* The judgement of 27 July 2001 of the *Conseil d'Etat* of France illustrated the same principle. In order to characterize "interest" paid by a late debtor, it set aside the classification of interest given to it by the CGI and considered that because such income was not "derived from a debt claim" but was rather "an accessory element of the same nature as the principal debt itself, it was not an interest in the meaning of Art. 12 of the treaty of 9 September 1966 between France and Switzerland, as it read prior to the amendment of 22 July 1997" (FR CE, No. 215124, 27 July 2001, *Golay Buchel*).

If one must apprehend treaty terms with reference to French law, it must be noted that neither French general law nor French tax law classifies shares in real estate companies as real property. Art. 244 bis A CGI deals separately with real property and rights relating to such property, on the one hand, and shares or other rights in organizations, on the other hand, while the CGI does not provide a specific definition of real property.[30] If tax law does not define a term, it must be given the meaning it has in other branches of law.[31] Shares do not fall within the notion of real estate, neither in general law nor therefore in tax law. They have the nature of personal property under French law, as well as under Belgian law.

It is remarkable that Art. 164 B CGI mentioned above specifies that international treaties prevail. The CGI cannot be used to deviate from Art. 55 of the French Constitution that establishes the primacy of international treaties over French law. It is surprising that the *Conseil d'Etat* of France decided that tax law assimilates shares in *sociétés civile à prépondérance immobilière* to real property when they are alienated by a person who is not fiscally domiciled in France and validated the disputed administrative commentary.

The administrative court of Montreuil arrived at the same conclusion in a decision of 26 June 2018 in a case where a Belgian tax resident had sold all his shares in the company *Villa les Cigales 2*.[32] The Administrative Court of Appeal of Versailles refused to overrule this decision, for reasons obviously inspired by the judgment of the *Conseil d'Etat*.[33]

The case law of the administrative court of Montreuil shows how inappropriate the definition of the treaty term "immovable property" can be by referring to the national tax system, rather than to the nature of the property as the *Conseil d'Etat* recommended in *Banque française de l'Orient*.[34] In another case that it decided after the above-mentioned *Villa Cigale 2*, the court of Montreuil decided on the taxation in France of capital gains realized by tax residents of Belgium on the sale of their shares in the *SCI Arlique* subject to corporate tax in France. First, it found

[30] Article 150 UB CGI subjects capital gains realized by residents of France on shares of semi-transparent real estate companies *to the regime of* capital gains on buildings. Article 244 bis A CGI deals with capital gains realized by non-residents, as "*defined*" in "e bis and e ter under I of Art. 164 B"; but Art. 164 B CGI does not provide a *definition*: it merely *locates* in France capital gains derived from shares in *sociétés à prépondérance immobilière*.

[31] E. Krings, *L'interprétation des lois fiscales*, "Revue fiscale" 1965, p. 596; see in the same vein the above-mentioned report by Councillor Dagneaux, *Report before FR Cass*…, p. 17.

[32] FR TA Montreuil, 26 June 2018, No. 1703431; see also: FR TA Montreuil, 17 April 2017, No. 170414.

[33] FR CAA Versailles, 18 June 2020, 18VE03429-18VE03430.

[34] FR CE 13 October 1999, No. 190083, *Banque française de l'Orient*; see also: FR CE 27 July 2001, No. 215124, *Golay Buchel*.

that the taxation was provided for by Art. 244 bis A of the CGI. Second, it found that if the claimants had been French residents (which they were not), they would have been subject to the capital gain tax regime for the transfer of securities and corporate rights, since their company was fiscally opaque. This induced the court to decide that the claimants had realized a capital gain on personal property, exempt in France under the treaty with Belgium.[35] It is surprising how shares transferred by one taxpayer were characterized according to the regime that would have been applicable to another taxpayer.

8. Side note: diverging interpretations of the *Cour de cassation* of France and the *Conseil d'Etat* of France

On 2 October 2015, the *Cour de Cassation* of France ruled on the nature of the shares of a real estate company for inheritance tax purposes.[36]

Under French inheritance tax law, personal and real property, wherever located, of a deceased person who was domiciled in France or whose heirs are domiciled in France (and have been domiciled in France for at least six years over the last ten years) are subject to tax in France. The inheritance of a deceased person domiciled outside of France that reverts to heirs domiciled outside of France is subject to French transfer tax only for property located in France. Shares and units of unlisted companies or legal entities whose head office is located outside France and whose assets consist mainly of real estate or real estate rights located in France are considered as located in France, in the same proportion as the value of such assets bears in the total assets of the company. Shares in *sociétés à prépondérance immobilière* are thus considered as located in France, but not as real property.[37]

Furthermore, if the deceased person, alone or with members of his family, directly or indirectly controlled a company that owned a building, he is deemed to have indirectly owned the building. For inheritance tax purposes, one looks through the company.

Article 2 of the inheritance tax treaty of 1 April 1950 between France and Monaco provides that immovable property and immovable property rights forming part of the estate of a national of either of the two contracting

[35] FR TA Montreuil, 7 June 2019, No. 1705505.

[36] FR Appeal No. 14-14256.

[37] See: Br. Gouthière, *Les impôts dans les affaires internationales*, 9th ed., No. 48080 et seq., Francis Lefebvre, Paris 2014.

states are subject to inheritance tax only in the state in which they are situated. The question of whether a property or a right has the nature of immovable property must be solved according to the legislation of the state in which the property is situated.

Article 6 of the same treaty provides that shares and any other personal property left by a national of either state is subject to tax only in the state in which the deceased person was domiciled at the time of his death.

An exchange of letters dated 16 July 1979 between the administrations of the two states deals specifically with *sociétés d'attribution*.[38] According to this arrangement, immovable property and immovable property rights represented by shares in such companies are subject to inheritance tax only in the state in which they are situated.

The French tax authorities considered that, for the purposes of that treaty, the nature of a property was determined according to French law if the property was located in France and that a *société à prépondérance immobilière* was an immovable property under French law. They found support in the exchange of letters of 16 July 1979.

The *Cour de Cassation* of France has been called twice to decide on a case where a Monegasque real estate company named *Cogest* that owned land and buildings in France was part of the estate of a deceased person who was domiciled in Monaco. The *Cour de cassation* of France decided in a plenary session held on 2 October 2015[39] that the French tax regime applicable to shares in *sociétés à préponderance immobilière* does not give these shares the nature of immovable property.

The *Cour de cassation* of France and the *Conseil d'Etat* of France clearly do not share the same approach. The *Conseil d'Etat* of France also seems to have neglected the position of the *Cour de cassation* of Belgium.

[38] The *sociétés d'attribution* referred to in Art. 1655 ter CGI are transparent for the application of transfer duties, although they have legal personality. The application of inheritance duties to the property they hold in France is justified by the transparency that the legislator gives them.

[39] FR Cass. (Com.), 9 October 2012, appeal No. 11-22.033; FR Cass. (ass.) 2 October 2015, appeal No. 14-14.256.

9. Solutions found in the treaty of 9 November 2021

Belgium and France have signed a new tax treaty on 9 November 2021.[40]

Under the new treaty, a French company that is treated as semi-transparent in France because it is subject to tax in France and its members pay taxes on their shares in the company's profits will qualify as a resident of France for treaty purposes (Art. 4 Para. 4, Prot. 4). Income derived through such a company by a resident of Belgium will not be seen as income earned by the shareholder for treaty purposes (Art. 1 Para. 2, Prot. 1). Dividends distributed by a French SCI to an individual resident of Belgium will be taxable in Belgium.[41]

Regarding capital gains in *sociétés à prépondérance immobilière*, the new treaty includes a provision inspired by Art. 13 Para. 4 of the OECD Model Convention. Gains from the disposition of interests in a company or another organization whose value derives directly or indirectly for more than 50 per cent from immovable assets which are not used by such company in the conduct of its business, and which are situated in a contracting state may be taxed in that state if that state treats those gains as realized on immovable property. Shares listed on a regulated stock exchange in the European Economic Area are not covered by this provision (Art. 13 Para. 2).

The new treaty includes another provision that may apply to capital gains realized on shares in real estate companies. In 1977, France made a reservation to Art. 13 of the OECD Model Convention, stating that France wishes to retain the possibility of applying the provisions in its laws regarding the taxation of gains from the alienation of shares or rights which are part of a substantial participation in a company which is a resident of France.[42] The new treaty provides that gains derived by an individual who is a resident of a contracting state from the alienation of shares forming part of a substantial interest in a company which is a resident of the other contracting state may be taxed in that other state if he held those shares while he was a resident of that other state (Art. 13 Para. 4).

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[40] The new treaty (*Convention entre le Royaume de Belgique et la République française pour l'élimination de la double imposition en matière d'impôts sur le revenu et sur la fortune et la prévention de l'évasion et de la fraude fiscale*. Convention between the Kingdom of Belgium and the French Republic for the avoidance of double taxation in income and capital tax matters and for the prevention of tax evasion and fraud) was not yet in force on 16 February 2024.

[41] The same dividend benefits from the dividend received deduction if the shareholder is a Belgian company (Art. 22 Para. 2, c, Prot. 4).

[42] Paragraph 36 of the Commentary on Art. 13 of the 2017 OECD Model.

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Abstract

This contribution illustrates the inability of the Belgian and French authorities and courts to agree on the interpretation the term "immovable property" (*bien immobilier*) used in the double tax treaty of 10 March 1964 between Belgium and France when characterizing

shares in French real estate companies for the purposes of distributing the power to tax dividends or capital gains derived from those shares.

Keywords: immovable property, double tax treaty, capital gains

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Peter Essers[1]

The Importance of the Tax System for the Rule of Law. The Dutch Childcare Allowance Scandal as an Example of a Violation of the Rule of Law in a Constitutional Democracy

1. Introduction

Citizens living in a constitutional democracy based on the rule of law and the separation of the executive, legislative, and judiciary powers are not always aware of the great benefits of such a system. Mostly, they experience their freedom to appeal to an independent court if they feel their rights have been violated by the government or other citizens as something completely normal. The same is true for the trust people have in Parliament as custodian of the government and for their belief that the legislator (mostly the government together with Parliament) respects the constitution and international agreements. But if this system shows failures, e.g., if the government acts as an omnipotent ruler, innocent citizens will be the first victims as they are not in an equal position with the bureaucrats representing this government. Unfortunately, this is not something that is only present in repressive non-democratic regimes like Europe in the last century has experienced during the Nazi and Communist times. This can also happen in modern states that embrace the modern principles

[1] Prof. Dr. Peter Essers, Professor of Tax Law and Head of the Tax Law Department, Fiscal Institute of Tilburg University (the Netherlands); Member of the Senate of the Parliament of the Netherlands (Christian Democratic Party) until 2023. The author has published some parts of this essay in Dutch (*De menselijke maat en 'Ongekend onrecht'*) in: T. Kooijmans, J. Ouwerkerk, C. Rijken, J. Simmelink (eds), *Op zoek naar evenwicht, Liber Amicorum Marc Goenhuijsen*, Wolters Kluwer, Deventer 2021, pp. 219–229.

of democracy and the rule of law. Such a danger is especially present in the field of taxation. The government depends on taxation to finance its policies. Every citizen has to pay his or her fair share. Those who evade taxes will be prosecuted. But because of the complexity of many tax laws, the borderline between fraud and tax planning is not always clear. And even if aggressive tax planning is not at stake, it is possible that citizens make mistakes just because they were not informed properly or because they simply were not aware of all their formal obligations. If this happens, there should be a possibility to redress these mistakes in a proportional way. Fiscal sanctions are necessary, as long as they are proportional. However, proportionality requires comparing the offence with the compensation, taking into account the human dimension. Mostly, a non-wealthy individual citizen not legally skilled and without the help of a tax advisor is not in the same position as a citizen who knows how to find the way in the bureaucracy and legal system. Besides, in massive automated tax processes, there is often no room for an individual proportional approach. Computers do not differentiate between people; they only work on the basis of algorithms. If no escape mechanism is available in these kinds of situations, ordinary citizens threaten to be crushed by the system.

In this contribution to the jubilee book dedicated to my dear colleague, Włodzimierz Nykiel, on the occasion of his 70th birthday, I will illustrate this process with a recent example in the Netherlands with respect to the system of childcare allowances for parents. This system, executed by the Dutch tax administration, has brought about 26,000 parents into huge problems since they had to pay back large sums of received allowances because of presumed offences. This not only led to big financial problems for these parents, combined with seizures, also all kinds of personal problems like divorces and illnesses resulted from this. As turned out later, most of these parents had been wrongly accused. After the publication in 2020 of a report based on a Parliamentary enquiry,[2] at the beginning of 2021 the Dutch government resigned because of this scandal. In this Parliamentary report, all three powers – the legislative, the executive, and the judiciary – were blamed for this tragedy. An often-used argument in the analysis of this scandal is that a lot of misery for the parents could have been prevented if there had been a hardship clause in the relevant legislation. Because the executive tax officers had to follow the wording of the law, there was no place for a policy of leniency. As a result, the least imperfection on the part of the parents in applying for the childcare allowances led to the obligation to pay back the full amount of these allowances received in advance (the "all or nothing" policy).

[2] Parliamentary Interrogation Committee on Childcare Allowances, *Report: Unprecedented Injustice*, 17 December 2020.

In Para. 2 of this contribution, I will first provide for a brief overview of the Dutch childcare allowance system. Paragraph 3 summarizes the Report of the Parliamentary Interrogation Committee on Childcare Allowances (hereinafter: the "Parliamentary Committee"). Paragraph 4 pays attention to the "all or nothing" policy that was one of the main reasons for the catastrophe for so many parents. Paragraph 5 describes the role of the Administrative Jurisdiction Division of the Council of State (hereinafter: "Council of State") as the highest court with respect to administrative law cases, followed in Para. 6 with some further comments. Paragraph 7 concludes this contribution.

2. The Dutch childcare allowance system[3]

In 2004, the Dutch Parliament adopted the Childcare Act (*Wet kinderopvang*).[4] Formally, this law falls under the responsibility of the Ministry of Social Affairs and Employment, but the Allowance Department of the Tax and Customs Administration of the Ministry of Finance (hereinafter: "Tax Administration/Allowance Department") is responsible for its implementation, including payment and fraud prevention. In 2005, the General Act on Income Dependent Schemes (*Algemene wet inkomensafhankelijke regelingen* – AWIR)[5] was introduced; this act dealt with the whole system of allowances, including the childcare allowance system.

In the Netherlands, childcare is not free of charge; parents are generally required to pay for the costs by themselves. However, part of the costs may be covered by a childcare allowance. The amount of this allowance is calculated as a percentage of the hourly rate of the childcare centre or childminding agency, ranging from 33.3% to 96%, depending on the parents' collective income and the number of children. This means that there is a mandatory contribution for parents to pay 4% to 66.7%

[3] J. Frederik, *Zo hadden we het niet bedoeld. De tragedie achter de toeslagenaffaire*, De Correspondent, Amsterdam 2021. See also: *Dutch childcare benefits scandal*, n.d., https://en.wikipedia.org/wiki/Dutch_childcare_benefits_scandal (accessed: 12.04.2021).

[4] NL, Childcare Act of 9 July 2004 [*Wet van 9 juli 2004 tot regeling met betrekking tot tegemoetkomingen in de kosten van kinderopvang en waarborging van de kwaliteit van kinderopvang, Wet kinderopvang*], Offcial Gazette [*Staatsblad*] 2004, 455.

[5] NL, General Act on Income Dependent Schemes of 23 June 2005 [*Wet van 23 juni 2005 tot harmonisatie van inkomensafhankelijke regelingen, Algemene wet inkomensafhankelijke regelingen*], Offcial Gazette [*Staatsblad*] 2005, 344.

depending on their income. Each year, the government sets a maximum hourly rate for which families may receive childcare allowance. Any amount exceeding the maximum hourly rate must be fully paid by the parents. The number of childcare hours for which a family is entitled to a childcare allowance depends on the number of hours that each parent works. The maximum is 230 hours per month per child. Parents may opt to receive their childcare allowance on their own bank account or to have it transferred directly to the childcare centre or childminding agency.

Some childminding agencies committed fraud by applying for a childcare benefit on behalf of their clients without asking for the mandatory contribution of 4% to 66.7%. Sometimes, they provided informal babysitters (e.g., grandparents babysitting their grandchildren) with a formal employment contract, so that childcare allowances could be applied for. The agencies did not inform the parents of the fact that they were legally required to pay for the remainder of the "costs", i.e., the part of the agency's (imaginary) hourly rate not covered by the childcare allowance they had received.

In 2009, a director of such an agency was sentenced to 18 months' imprisonment for forgery and fraud. The Tax Administration/Allowance Department forced the parents involved to pay back all childcare benefits the agency had received in their name.

The parents claimed the funds given to the fraudulent agencies had to be recovered from these agencies instead of from the parents who acted in good faith; such an option was however considered against the law. The parents appealed this decision of the Tax Administration/Allowance Department, but after several lawsuits, the Council of State confirmed that the law required them to pay back the full amount of childcare allowances they had received: the so-called "all or nothing" policy.

In 2013, the Dutch press revealed that a number of Bulgarian citizens were encouraged by criminals to briefly register at an address in the Netherlands and to retroactively apply for EUR 6,000–8,000 health care and housing allowances. At the time, the tax authorities paid allowances immediately and checked eligibility afterwards, at which point the Bulgarians had already left the country.

In response to the Bulgarian migrant fraud, the House of Representatives (part of Parliament) insisted on stricter fraud prevention. As a consequence, the government established a Fraud Management Team, consisting of top officials from the Tax and Customs Administration and the Ministry of Finance.

Later that year, the Fraud Management Team established the Collaborative Anti-facilitation Force (CAF), whereby "facilitation" refers to individuals or institutions that enable or encourage people to commit fraud. In the context of childcare benefit fraud, this meant that the CAF actively looked for childcare centres and childminding agencies that submitted suspicious childcare benefit applications.

With extreme harshness, the CAF investigated agencies and parents by applying "collective punishment", knowing that 20% of the accused parents were innocent. For innocent parents it was virtually impossible to reverse decisions. This gave the impression of institutional prejudice. When the Tax Administration/Allowance Department suspected serious culpable acts, the Dutch bureaucracy would mark the involved parents with the label "Deliberate intent/Gross negligence". Individuals with such a label were no longer eligible for standard debt collection arrangements. Under the standard arrangement, debtors repay their debt as much as possible over a two-year period (without falling below subsistence level) and any debt remaining after that period would then be considered irrecoverable. Because the accused parents were not eligible for such a payment plan, they became heavily in debt. Reclaimed amounts of EUR 20,000 or more per year for families with several children were no exceptions.

Another group of parents fell afoul of strict administrative policies, in which a small mistake (e.g., a missing signature or an undeclared change in income) could lead to a full clawback of the childcare allowance. This was initially confirmed by a decision of the Council of State. In October 2019, however, the Council of State reversed this decision, and decided that the recovered amount had to be returned to the parents, along with compensation on a case-by-case basis.

When it became more and more clear that the Tax Administration/Allowance Department had made/committed serious mistakes/offences against the parents, and that the government had failed to intervene and to adequately inform Parliament, on 2 July 2020 the House of Representatives established the Parliamentary Interrogation Committee on Childcare Allowances (the Parliamentary Committee). On 17 December 2020, this Committee presented a report, *Unprecedented Injustice*. It criticised the Tax Administration/Allowance Department, the Ministry of Social Affairs, the cabinet, the Council of State, and also the House of Representatives. Most of all, the "all or nothing" policy was criticised. According to the Committee, the affected parents had not received the protection they deserved because of the group penalties implemented by the Ministry of Finance, thus violating the fundamental principles of the rule of law.

In response to the report of the Parliamentary Committee, on 22 December 2020 the government announced that all wrongly accused parents would receive EUR 30,000 compensation, regardless of the financial loss, unless they qualified for higher compensation. On 15 January 2021, the cabinet offered its resignation to the King.

One of the common arguments in search of the causes and delinquents of this debacle is that a lot of sorrow for the parents could have been avoided if there had been a hardship clause in the childcare allowance legislation. Because the executive officers had to follow the letter of the law, there seemed to be no place for a policy of leniency. As a result, the "all or nothing" policy was applied, meaning that the least imperfection on the part of the parents would cause the obligation to repay the complete childcare allowance received, with all extremely harsh results.

In my opinion, in a constitutional democratic state, the human dimension should never be held back by rules affecting the rule of law, not even if these rules have been adopted democratically. Nevertheless, this is exactly the discussion that is going on in the Netherlands as a follow-up to the scandal of the childcare allowance whereby tens of thousands of parents became victims of a ruthlessly operating government.

In the following, I will go into more detail of the alleged contradiction between the human dimension and legality. As a starting point, I will take the report of the Parliamentary Committee of 17 December 2020 and the reaction to this report by the present chairman of the Administrative Jurisdiction Division of the Council of State, Bart Jan van Ettekoven, in an article in "Nederlands Juristenblad" (NJB) of 15 January 2021.[6]

3. Report of the Parliamentary Committee

To Dutch understanding, the childcare allowance affair is of an unprecedented size and seriousness. The Parliamentary Committee concludes that in the implementation of the childcare allowances "fundamentals of the rule of law have been violated". In this respect, all three powers can be blamed: the legislator, the executor (especially, the Tax Administration/Allowance Department), and the judiciary (especially the Council of State). The legislator (government and Parliament) is blamed for being responsible for legislation "that was rock hard and for paying insufficient attention to possibilities to justify individual situations". In this context, the Parliamentary Committee mentioned the lack of a hardship clause and the absence of attention "to necessary principles of good governance, especially the proportionality principle".[7] The executor – the Ministry of Finance – is blamed to have been responsible for having executed the childcare allowance as a mass process,

[6] B. J. van Ettekoven, *Tussen wet en recht*, "Nederlands Juristenblad" 2021, No. 2, p. 98.
[7] Parliamentary Interrogation Committee on Childcare Allowances, *Report*…, p. 7.

in which the group approach, the "all or nothing" policy and the manner in which "intent/gross negligence" was handled, caused gross infringements on the principle of the rule of law that optimal justice should be done to people's individual situations.[8] As a result of the "Bulgarian migrant fraud", big political pressure on the fight against fraud arose, every error was considered to be fraud, and parents were wrongly branded intentional frauds. The Parliamentary Committee qualified the way in which the Ministry of Social Affairs had filled in its responsibility for the policy as "far below acceptable".[9] But also the judiciary did not come unscathed through the report. That is precarious because, due to the doctrine of the separation of powers, Parliamentarians should be reluctant in criticizing judges. That is also why the Parliamentary Committee started by saying that they did not want to comment on individual court orders. Nevertheless, it is noted "that also the judges responsible for the Administrative Law for years made an important contribution to maintain the cast iron implementation of the childcare allowance regulations which were not compulsory by law".[10] According to the Parliamentary Committee, the relevant case law on Administrative Law did "neglect its important duty to legally protect individual citizens". The main point of criticism on the Council of State is, according to the Parliamentary Committee, "that, until 2019, it reasoned away the general principles of good governance, which should serve as a bumper and protective blanket to people in distress".

4. "All or nothing" approach

Although the conclusions of the Parliamentary Committee regarding all three powers of the constitutional Dutch democracy are crystal clear, the risk of a judgment that blames everyone is that the three powers can point to each other as to be the "real" chief offender. Careful reading of the report does not answer the question of the chief offender, but does answer the question of which concrete measures affected the involved parents most. Such measures are the group approach which took into the bargain that also parents who were to blame for little or nothing were included in the aggressive fraud investigation (the "80/20" – approach), the way in which "intent/gross negligence" was wielded causing 25,000 to 30,000 parents to fall under this

[8] *Ibidem*.
[9] *Ibidem*.
[10] *Ibidem*, pp. 7–8.

category, resulting in no personal payment arrangements, while afterwards it was determined that in 94% of all cases this qualification to the current standards could be labelled as being wrong,[11] but mostly because of the "all or nothing" approach. "Mostly", because it was precisely that approach through which in so many cases the full amount of childcare allowance received as an advance payment was reclaimed. Without this "all or nothing" approach most of the parents would not have got into such excessive financial problems. The group approach and the "intent/gross negligence" approach worsened the financial and human disaster for the parents even further.

What was the exact origin of this "all or nothing" approach, which was not only applicable in case of the (complete or partial) absence of an own contribution, but also in the case of administrative shortcomings like the absence of a signature? According to the Parliamentary Committee, this approach was not a direct result of the childcare regulations or the Parliamentary debate during the deliberations on these regulations.[12] It was the conscious choice of the Tax Administration/Allowance Department, thereby for many years supported by the case law of the Council of State. In this way, the executive and judiciary powers reinforced each other for many years. Only in 2019, the Council of State changed its view and forbade the "all or nothing" policy.

This statement of the Parliamentary Committee seems somehow at odds with Para. 7 of its report in which the legislator is blamed for having made legislation "that was cast-iron and that did not provide for sufficient possibilities to do justice to individual situations". In this respect, the Parliamentary Committee especially referred to the lack of a hardship clause and the lack of attention for necessary principles of good administration, in particular the principle of proportionality. The question remains whether the "all or nothing" approach could have been prevented if the legislator had implemented a hardship clause in the childcare legislation. Van Ettekoven, chairman of the Administrative Jurisdiction Division of the Council of State, suggests that a hardship clause could have been used by the administrative authorities and the administrative court "to prevent that civilians would be crushed by a combination of rigid legislation and a (too) strict implementation of rules". In my opinion, it is questionable whether such a hardship clause would have had this effect in the case at hand. After all, the opinion of the Tax Administration/Allowance Department was that the "all or nothing" approach was the explicit intention of the legislator. In that case a hardship clause cannot help because this clause is only effective in cases not foreseen by the legislator.

[11] *Ibidem*, p. 25.
[12] *Ibidem*, p. 22.

The same applies to the question whether the general principles of good governance, especially the proportionality principle, are overall applicable and can thus set aside a formal law.

In this respect, the former interpretation of Art. 26 AWIR plays an important role. This article contains the following: "If a revision of an allowance or a revision of an advance payment leads to reclaiming an amount or a settlement of an advance payment with an allowance to that end, the interested party owes the full amount of the reclaim". According to Van Ettekoven, the wording of this article leaves no room for interpretation; in his words: "if a revision of an advance payment leads to an amount to be reclaimed, the party concerned owes the amount of the recovery entirely. I repeat: *entirely*. This is no mistake; it is the will of the legislator. *No Mercy*".[13] Also the executive authorities and (until 2019) the Council of State derived from this text that it was the will of the legislator that if a citizen makes a mistake, even if it is a small mistake, he or she is not entitled to an allowance. If one of the requirements was not (completely) fulfilled, then, based on the aforementioned interpretation of Art. 26 AWIR, the full amount of the advance payment was reclaimed.

In my opinion, this interpretation was and is wrong. Article 26 AWIR only says that if and insofar as there is an amount to be reclaimed, the party concerned owes the complete amount of this reclaim. This means that the Tax Administration/Allowance Department could and should have determined first the exact amount of the reclaim by taking into account the absolutely disproportionate consequences of an "all or nothing" approach. So, the Tax Administration/Allowance Department definitely had discretion when establishing the amount to be recovered. That consideration should have led to a reclaim that in most cases would have been significantly lower. As a consequence, Art. 26 AWIR would have been applied only to that reduced reclaim, without the enormous harm that in reality has taken place. This is also the outcome of the October 2019 judgments of the Council of State.

5. The role of the Council of State

Because of the precarious relationship between Parliament and the judicial power, the Parliamentary Committee acted wisely by asking an independent expert opinion about the case law of the Council of State

[13] B.J. van Ettekoven, *Tussen*…, p. 102; see also p. 99.

on the "all or nothing" approach from 2010 until 23 October 2019, the date of the two judgments[14] in which the assent with this approach was left. The independent expert the Parliamentary Committee approached was S.E. Zijlstra, a professor in constitutional and administrative law, at the Free University of Amsterdam. On the basis of the initial case law of the Council of State, Zijlstra concluded that the most important elements of the "all or nothing" approach came from the relevant childcare legislation: "The legal possibilities for the Tax Administration/Allowance Department for a more lenient policy, if they felt the need to it, were almost nil".[15] According to Zijlstra, termination of the "all or nothing" case law by the Council of State was motivated by the "heavy, negative effects on the financial position of interested parties".[16] Zijlstra also stated that after this judicial turnaround, the Tax Administration/Allowance Department had to apply the proportionality principle in its reclaim policy.[17]

According to Van Ettekoven, the Council of State had two options to come to more fair outcomes: 1) let the proportionality principle prevail over the mandatory law provisions, or 2) a further interpretation of the relevant legal provisions, by judging that on closer examination those provisions still leave room for differentiation and that the Tax Administration/Allowance Department has the power to provide customisation and should apply in this respect the proportionality principle.[18] The Council of State opted for the second option, although, according to Van Ettekoven, this option "leads to a friction with the wording of Art. 26 AWIR". Still, he thinks this is a better option than the first one, which he characterizes as "a bridge too far". The correction of a formal law via the proportionality principle, to his knowledge, has never taken place before.[19] Van Ettekoven and Zijlstra explain the turnaround of the Council of State only in October 2019, by stating that the Council of State heard only later of the disastrous consequences of the "all or nothing" policy and the fact that year after year neither the legislator nor the government intervened, not even after the publications in 2017 of some alarming reports. According to Van Ettekoven, it was therefore necessary to apply an emergency measure.[20] In addition, Van Ettekoven points to the fact that the Council of State was not

[14] NL, Council of State, judgement, 23 October 2019, ECLI:NL:RVS:2019:3535 and ECLI:NL:RVS:3536.

[15] Parliamentary Interrogation Committee on Childcare Allowances, *Report…*, p. 127.

[16] *Ibidem*, p. 131.

[17] *Ibidem*.

[18] B.J. van Ettekoven, *Tussen…*, pp. 104, 105.

[19] *Ibidem*, p. 105.

[20] *Ibidem*, pp. 100, 104.

counteracted by the lower courts (with the exception of the Rotterdam Court) and legal doctrine. He explicitly adds that this remark is meant to be a factual observation and not an accusation.[21]

6. Further comments

By talking about an "emergency measure" leading to a friction with the wording of Art. 26 AWIR, a measure the Council of State considered necessary because of disastrous consequences of the "all or nothing" approach and the absence of intervention by the Tax Administration/ Allowance Department and the legislator, in my opinion Van Ettekoven distances himself too little from the original case law of the Council of State on the "all or nothing" policy. In fact, he claims that this case law resulted from both the wording of Art. 26 AWIR and the intention of the legislator regarding that article. Because the executive authorities and the legislator failed to do something with the alarming signals from practice, according to him, the Council of State had to choose ("an emergency measure") for another interpretation of Art. 26 AWIR. This matches with his statement that, looking back, in the light of the subsequently shown consequences of the interpretation by the Council of State of the relevant legal provisions, this interpretation was "unfortunate".[22]

In my opinion, this interpretation was not only unfortunate, it was wrong. This applies particularly to the initial interpretation of Art. 26 AWIR. Van Ettekoven states that "looking back, it would have been better if [the Council of State] had not applied only one measure for all types of mistakes and shortcomings, but had differentiated".[23] In my opinion, not only would this have been "better", but the Council of State was *obliged* to differentiate between all types of mistakes and shortcomings. This also means that the judgments of the Council of State of October 2019 should not be seen as judgments that are at odds with the wording of the laws and object and purpose the legislator had in mind with these laws; they are completely legitimate judgments which the Council should have taken when the "all or nothing" policy was submitted to it for the first time.

Why are these comments so important? Not because anything would have changed for the affected parents when the Council of State through its

[21] *Ibidem*, pp. 100, 105.
[22] *Ibidem*, p. 105.
[23] *Ibidem*.

president would have dragged themselves through the mud even deeper. Nor would be excused the fact that the Tax Administration/Allowance Department had invented and not adjusted the "all or nothing" policy, even though it knew that parents were heavily affected by it. Neither would be excused the guilt of the legislator who waited too long to intervene (this inaction of the legislator is in strong contrast to the many examples in which the legislator – rightly by the way – normally and energetically picks up signals from the tax administration of taxpayers' improper use to implement reparation legislation).[24] However, a qualification of the initial Council of State case law as "wrong" instead of "unfortunate" is of great importance to avoid future situations in which the fundamental principles of the rule of law state are violated again.

Whether or not a hardship clause is included in a law cannot and may not be a justification for actions by the government in which the human dimension is eliminated.[25] If the execution of a law leads to situations like in the "all or nothing" policy of which in all fairness can be assumed that if during the discussions on the relevant bill in Parliament the legislator had been aware of these situations, this policy had never been accepted, then this should be a strong message for executors of these laws and the judiciary to stop this policy. This also applies to the principles of good governance in these kinds of situations. I do not share the worries of Van Ettekoven, among other people, that there is a danger that a democratically accepted formal law could be set aside by the executive power. If the legislator explicitly wanted a hard limit of, e.g., a criterion with a minimum number of business hours connected to an entrepreneur to be entitled to business facilities, or a maximum purchase house price limit to entitle a house buyer to a real estate transfer tax exemption, then, of course, a tax inspector cannot allow on the basis of the proportionality principle that a lower number of business hours or a fractional higher purchase house price will still lead to a tax benefit.[26] In Germany, these types of tax disadvantages are called *Dummensteuer*: taxes that can be avoided in a legal way.[27] They fall within the category known as "sorry but alas", *lex dura, sed lex*. You cannot act as if you worked more business hours in a year with retroactive effect or that

[24] See also: L.G.M. Stevens, *Was het onrecht rond de toeslagen wel zo ongekend?*, "Weekblad fiscaal recht" 2021, No. 7, p. 38.

[25] Compare: J. Baron, E. Poelman, *De menselijke maat in rechtsvinding*, "Tijdschrift voor Formeel Belastingrecht" 2020, No. 4; J.L.M. Gribnau, *Fatsoenlijke belastingheffing*, "Nederlands Tijdschrift voor Fiscaal Recht" 2021, No. 1125.

[26] See: M. Spanjers, *Alles of niets*, "Weekblad fiscaal recht" 2021, No. 16.

[27] *Was ist eine "Dummensteuer"? Bedeutung, Definition, Erklärung*, 2020, https://www.bedeutungonline.de/was-ist-eine-dummensteuer-bedeutung-definition-erklaerung/ (accessed: 12.04.2021).

you paid a lower purchase price. If the legislator did want that, he would have included, for instance, a sliding scale in the law. But if, like in the case of the "all or nothing" policy, the parents only paid a fraction of their own personal childcare contribution, or if only the signature on the childcare contract was missing, meant that without any mercy tens of thousands of euros had to be paid back (instead of only the amount of the missing personal contribution) and the "offender" was dismissed and treated as a fraud, then that is a disproportionate consequence the legislator had probably never approved if he had been aware of this, since such a policy completely ignores the human dimension.

Therefore, my opinion is that the initial judgments of the Council of State, in which the "all or nothing" policy was approved, were completely wrong and that the judgments of the Council of State of 23 October 2019 were entirely correct. They only came too late; about this, Van Ettekoven rightfully says that "if [the Council of State] had earlier changed its mind, this would have been much better for the parents".[28]

7. Conclusions

According to the Parliamentary Committee, all three main powers of the Dutch constitutional democracy are to be blamed for the tragedy of the childcare allowance case in which the fundamentals of the rule of law were violated. However, despite this conclusion, the "all or nothing" approach was the most direct cause of the misery that plagued about 26,000 parents. This approach does not result directly from the law or the Parliamentary debate.[29] It was the conscious choice of the Tax Administration/Allowance Department, hereby many years supported by Council of State case law until the Council's change of opinion in 2019. Therefore, the executive and judicial powers enforced each other for years. The judgments of October 2019 in which the Council of State came back from its former case law should not be seen as an "emergency measure". Also, it is not sufficient to qualify the initial Council case law in which the "all or nothing" approach was confirmed as "unfortunate". This case law was in my opinion wrong. The absence of a hardship clause in a law can and may never be a justification for an intervention of government authorities in which the human dimension is eliminated. If the execution

[28] Parliamentary Interrogation Committee on Childcare Allowances, *Report*…, p. 106.
[29] *Ibidem*, p. 22.

of a law leads to situations like in the "all or nothing" policy of which it can reasonably be expected that the legislator would not have accepted such a policy if this policy was known during the Parliamentary treatment of the relevant bills, this should mean for the executive and judiciary powers that they have to forbid such a policy. This also applies to the application of principles of good governance in these kinds of situations for all powers involved; taking into account the human dimension is an obligation. There are no excuses not to do so. Only, if the taxpayer has had all reasonable opportunities to avoid a tax disadvantage and this also falls within object and purpose the legislator had in mind with this law, *lex dura sed lex* is applicable.

In the childcare allowance tragedy, a violation of fundamental rules of the rule of law happened. The crucial powers of the constitutional democracy failed in being a shield for vulnerable citizens. It is of great importance that we learn from this and that all responsible persons take measures and include safeguards to prevent similar scandals in the future.

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Abstract

If a tax system does not respect the rule of law and the government acts as an omnipotent ruler, innocent citizens will be the first victims as they are not in an equal position with the bureaucrats representing this government. This can even happen in modern states that embrace the modern principles of democracy and the rule of law. In this contribution this is illustrated with a recent example in the Netherlands with respect to the system of childcare allowances for parents. This system, executed by the Dutch tax administration, has brought about 26,000 parents into huge problems since they had to pay back large sums of received allowances because of presumed offences. This not only led to big financial problems for these parents, combined with seizures, also all kinds of personal problems like divorces and illnesses resulted from this. As turned out later, most of these parents had been wrongly accused. Because the executive tax officers had to follow the wording of the law, there was no place for a policy of leniency. As a result, the least imperfection on the part of the parents in applying for the childcare allowances led to the obligation to pay back the full amount of these allowances received in advance (the "all or nothing" policy). In 2021, the Dutch government resigned because of this scandal.

Keywords: rule of law, separation of powers, childcare allowance, "all or nothing" policy, hardship clause

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Jan J.P. de Goede[1]

Some Policy Reflections on Art. 12B UN Model on Automated Digital Services. A Reasonable Alternative?

1. Introduction

First of all, I would like to congratulate Prof. Nykiel with his 70th birthday and I wish him many happy returns of the day in good health, together with his family. I have known Prof. Nykiel for over 20 years and always admired his great professional drive for (international) tax law and the great achievements he realized in this respect, but also his great leadership as rector of the University of Lodz and his efforts for society which were, for instance, expressed in his membership of the Polish Sejm. Moreover, Wlodek is a very pleasant person, who even during very busy periods in his career, always kept an eye on the well-being of the people he worked with and met, supporting them also in difficult personal situations.

My contribution will focus on the recently adopted Art. 12B on automated digital services as to be included in the 2021 update of the 2017 UN Model Double Taxation Convention between Developed and Developing Countries (hereafter: UN Model).[2] After a section dealing with the setting of the scene with respect to the introduction of that

[1] Prof. drs. J.J.P. de Goede is Senior Principal Tax Knowledge Management at IBFD (International Bureau of Fiscal Documentation) and Professor of International and European Tax Law at the University of Lodz in Poland, as well as visiting Professor at the Renmin University of China in Beijing and the Finance Universty of the Russian Federation in Moscow.

[2] This article was submitted in July 2021, so references in this article are still to the United Nations, Model Double Taxation Convention between Developed and Developing Countries (New York: UN, 2017) hereafter referred to as "the UN Model"); however it can be mentioned that the UN Model 2021 has recently been published in which Art. 12B has indeed been included.

provision by the UN Committee of Experts in International Co-operation in tax matters (hereafter: the UN Tax Committee) and the work done on the topic in other fora while also including a framework for judging the various aspects of the article, I will discuss the draft article itself, to end with some evaluation and conclusions as to whether Art. 12B can be considered a reasonable alternative compared to the so-called Pillar I approach as included in the so-called Blueprint published by the OECD in close co-operation with the BEPS Inclusive Framework.[3]

2. Setting the scene

2.1. Relevant background regarding the UN Tax Committee

In 1963, the OECD Model Double Taxation Convention on Income and on Capital (hereafter: the OECD Model), last updated in 2017,[4] was published. It was a follow-up on previous work on the development of such a Model done in the League of Nations (the predecessor of the United Nations) and as regards the allocation of taxing rights based on a framework developed by a Committee of prominent economists which used economic allegiance theories to determine where cross border business income was generated and thus could be allocated (so-called supply theory which determines that profits are generated and thus can be allocated only to the place where the physical means of production are put to use, versus the supply and demand theory in which the availability and use of a market as such is also considered to be a source of profit generation). The OECD Model was developed to avoid double taxation between the OECD Member States which were generally speaking capital exporting countries. This Model was for several reasons strongly based on residence taxation. It included limited source country taxing rights in case of active business income, but in accordance with the supply theory, only if certain levels of physical presence in the source country were met. In case of passive income like dividends and interest (but not for royalties), a limited tax on the gross

[3] OECD, *Tax Challenges arising from Digitalization – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris 2020.

[4] Organisation for Economic Development and Co-operation, Model Double Tax Convention on Income and on Capital (Paris: OECD 2017) hereafter referred to as the "OECD Model".

amount of such income was allocated to the source state. Such a Model was increasingly deemed unjustified in case of treaties between developed capital exporting countries and less developed capital importing countries as the budgetary balance of such allocation was clearly less favourable for developing countries. Thus, the UN developed and published in 1980 the UN Model in which Model, although also there the supply theory was generally followed, more taxing rights were granted to the source state. Although the UN acts of course in the interest of all its member States, the UN Tax Committee, consisting of 25 members nominated by governments and appointed by the Secretary General of the UN but acting in a personal capacity, focuses in particular also on the interest of developing countries and economies in transition. The latter is reflected in a stronger focus on preserving their tax base (allocation of taxing rights to the source state) and taking into account their level of development by, where possible, avoiding legislative and administrative complexity. Generally, around 15 of the 25 members of the UN Tax Committee are from non-OECD, developing countries, thus securing that focus.[5]

2.2. Problems caused by the digitalized economy, OECD G20 draft Pillar One and main problems with that approach

In the context of the so-called OECD-G20 BEPS, project 15 action points were identified in a holistic approach to tackle the various problems of tax avoidance by multinational enterprises, resulting in a package of minimum standards, recommendations, and best practises. However, no agreement could be reached with respect to the problem of the so-called digitalized economy as identified in the BEPS Action 1 Report.[6] In a nutshell, the problem relates to the fact that modern communication technology increasingly enabled enterprises resident in one country to develop models for doing business and earning income in another country without any physical presence or only very limited physical presence in that other country, whereas the rules included in tax treaties for allocating taxing rights with respect to cross border business profits are still, in accordance

[5] For more information regarding the differences between the OECD and UN Models, see: J.J.P. de Goede, *Would one Flexible Size Fit All? Toward a Single Tax Treaty Model"*, [in:] B.J. Arnold (ed.), *Tax Treaties after the BEPS Project, a Tribute to Jacques Sasseville*, Canadian Tax Foundation, Toronto, 2018, pp. 109–124.

[6] See for the BEPS project: Organisation for Economic Co-operation and Development, BEPS project, published on the OECD website – OECD, *What is BEPS?*, n.d., https://www.oecd.org/tax/beps/about/ (accessed: 10.07.2021).

with the brick-and-mortar economy of the time in which these rules were developed, based on the supply theory mentioned in the previous section, and requiring physical presence in the other country. Under the supply and demand theory, however, profit would also be considered to be generated in the country which provided the market and, in accordance with that theory, allocation of a taxing right to the so-called market jurisdiction could also be justified in the absence of physical presence. The first type of digitalized business models referred to as electronic commerce related to cross border sale of goods over the internet (see section 3.1). In view of the meanwhile much broader developed digitalized economy it was felt unsatisfactory by an increasing number of countries that non-resident enterprises could generate large profits within their jurisdiction without, due to the application of tax treaties, having to pay tax on that in the source or market country but only in the country of residence of the enterprise. In response to this dissatisfaction an increasing number of countries introduced various new types of taxes[7] (including so-called Digital Service Taxes, hereafter DST) to tax the non-resident companies on their profits from targeted digitalized business models while shaping these taxes in such a way to avoid them being considered taxes on income covered by the tax treaties. Although such DSTs are not uniform[8] they generally create a tax liability for the non-resident company based on gross revenue from sales of certain digital products and services in their country. The Office of the US Trade Representative challenged such a DST of several countries on the basis of its Trade Act[9] as constituting discriminatory taxation for US-companies providing digital services and announced trade actions through retaliatory tariffs on imports from these countries. In order to curb and avoid the disruption of international business by the introduction of such unilateral taxes which can cause new forms of double taxation,[10] it was considered desirable to try to reach an inclusive global consensus. After

[7] Such types of taxes were mentioned but not recommended in the final report on Action 1 of the OECD BEPS project to which I also refer for more details on the various relevant digitalized business models. See footnote 6 for the BEPS project.

[8] See for an analysis of types of DST's and a conceptual defense of DST: W. Cui, *The Digital Service Tax: A Conceptual Defense*, https://deliverypdf.ssrn.com/delivery.php?ID=52206510510608210209600512710206609605702506801108603712310008302312211-411212600602811902800405702910011610002506406811411701311103500404704806708707012601710512704604704502109810109512100203010511002908802810006910212207-0079004100106006099117101002&EXT=pdf&INDEX=TRUE (accessed: 10.07.2021).

[9] See: S. Soong Johnston, *U.S. Threatens 25 Percent Tariffs Against Six Countries over DST's*, "Tax Notes International" 2021, Vol. 59, No. 3.

[10] See, however also the ongoing US discussion on a possible credit for DSTs in: D.E. Spencer, *Digital Service Taxes and Proposed U.S. Foreign Tax Credit Rules*, "Journal of International Taxation" 2021, No. 2.

discussions in the so-called OECD G20 Inclusive Framework (comprising of 139 countries) the OECD secretariat developed the so-called Pillar One approach which resulted in an extensive Blueprint. However, on these Blueprints, which besides a Pillar One also include a Pillar Two on a global minimum tax on corporate income, no agreement was yet reached at the time of submitting this article in July 2021.[11]

Basically, in Pillar One it is recognized that companies may create value in market jurisdictions without physical presence if certain digitalized business models and consumer facing business activities are operated in these jurisdictions, and a right is granted to such jurisdictions to levy a tax on income allocated to such value creation. This value creation is expressed in a part of the so-called consolidated residual profits earned by non-resident groups of companies related to such business models.

Pillar One resulted in a very complex system which includes the following elements: revenue thresholds for in scope companies, a definition of the covered business models, rules to determine the residual profits attributable to the business models targeted (problems of segmentation if also other business models are carried out in the group) on the basis of the consolidated group income, nexus thresholds to market jurisdictions and allocation rules for the residual profits to be taxed in these jurisdictions based on so-called formula apportionment, the entities having to pay the tax in the market jurisdictions, how relief of double taxation of the income can be provided, and finally binding dispute resolution to solve any possible disputes arising in the implementation of such income allocation system. Many of these elements still need to be agreed to by the countries participating in the before mentioned Inclusive Framework. The most important country not able to agree to Pillar One is the United States where most digitalized companies operating such models are established. However, recently, the new United States Biden administration made proposals to overcome its principled objection to limit the in scope companies to companies operating the defined digitalized and customer facing business models by proposing (high) monetary revenue and profitability thresholds applicable to all types of multinationals, also enabling some simplification of the Pillar One proposals as business line segmentation would no longer be required.[12] A large part of the technical complexity is, however, also caused by the fact that formula apportionment of part of the profits is introduced within

[11] See footnote 3. It is good to realise that also a second Pillar Two on a global minimum corporate tax was developed and that no agreement on Pillar One seems possible without agreement on Pillar Two.

[12] See: S. Soong Johnston, R. Finlley, *U.S. Pitch May Help Give Tax Peace a Chance, OECD Tax Chief Says*, TNTI document 2021-18553, posted 6 May 2021.

domestic corporate tax systems and tax treaties based on the so-called separate enity and at arm's length system of taxing the separate entities of multinational groups of companies. So, even if the new US proposals can effectively improve the Pillar One concept in some respects, it is yet to be seen whether this would be a sufficient basis for a truly international consensus, not only on Pillar One[13] but also on Pillar Two.[14] Even after such consensus a complex and time-consuming process of changing domestic tax laws and tax treaties needs to be followed to effectively implement it.

2.3. Work done by the UN Tax Committee on the digitalized economy which led to Art. 12B UN Model

In view of the importance of the topic, especially also for developing countries, the UN Tax Committee established in 2017 a Subcommittee on Tax Issues related to the Digitalization of the Economy[15] which, in view of the sensitive nature of the topic and ongoing work in the Inclusive Framework, was exclusively staffed with members of the UN Committee, and not with official UN member country representatives or selected relevant observers as generally customary in the work of the UN Tax Committee. Although this was disappointing, I recognize the sensitivity and great challenge of providing comments on the work done in other fora, especially in the Inclusive Framework, and of developing an alternative approach with the limited resources and tight time schedule to provide contributions at a still relevant stage of the work in this Inclusive Framework. Besides, in a few stages the non-members of the Subcommittee could take note of and provide comments on the development of Art. 12B.

[13] Reference is also made to the revised Pillar One proposals to the Inclusive Framework submitted by the African Tax Administration Forum, building on the abovementioned new US proposals see: S. Marsit, *African Tax Administration Forum Sends Revised Pillar One Proposals to Inclusive Framework. Report on 20.05.2021*, https://research.ibfd.org/#/doc?url=/data/tns/docs/html/tns_2021-05-20_ataf_1.html (accessed: 10.07.2021).

[14] See footnote 11.

[15] The Subcommittee was co-chaired by Mr. Roelofsen, a Dutch member of the UN Tax Committee and Mr. Fowler, a Nigerian member of the UN Tax Committee, who together very ably managed this sensitive topic and steered the discussions which lead to several outputs wich ultimately led to Article 12B. For a complete overview of the work done by this Subcommittee, see: Committee of Experts on International Cooperation in Tax Matters, 22nd Session 19–28 April 2021, *Tax consequences of the digitalized economy – issues of relevance for developing countries*, Co-Coordinators' Report issued on 6 April 2021, E/C.18/2021/CRP.1, https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2021-04/CITCM%2022%20CRP.1_Digitalization%206%20April%202021.pdf (accessed: 10.07.2021).

The Subcommittee drafted the following guiding principles for its work:

1) avoiding both double taxation and non-taxation;
2) preferring taxation on a net basis where practicable;
3) seeking simplicity and administrability.

It was tasked to report and comment on the work done in other fora, including the Inclusive Framework, giving special attention to the interests of developing countries and administrability, fairness, and certainty, and on possible alternative or modified approaches for allocation of taxing rights and nexus rules, including the use of withholding taxes.

The concerns of developing countries with respect to the OECD/G20 project were clearly expressed by the UN Tax Committee in its letter of 12 November 2019 to the OECD secretariat on the latter's Public Consultation Document with the so-called Unified Approach from 9 October 2019 (which included a version of the in section 2.2 mentioned Pillar One).

These concerns include: the need for a reliable impact analysis to base their position on, the high level of revenue threshold for in scope companies, the high country level revenue threshold for nexus to a country, the fact that only part of residual profits are re-allocated to the market jurisdiction, the inclusion of a mandatory binding arbitration procedure, the complexities of the legislation required, and the capacity to effectively implement it and participate in the new administrative processes required to reach mutual agreement on the amounts to be re-allocated. The Committee also urged to adopt a simpler approach, for instance through the use of withholding taxes.[16]

In my view, the letter clearly expresses a lack of confidence that Pillar One will generate sufficient additional revenue from corporate taxation for developing countries for which this tax is relatively more important than for developed countries (a matter of great relevance in the context of the UN Addis Ababa Agreement on SDG's[17] and the disruption of state budgets caused by measures to combat the Covid-pandemic), and the feeling that their interests are not sufficiently taken into account in the process and that the system is too complex and too burdensome for them to have a sufficient level of control over its implementation.

[16] See: the attachment to the document published with respect to the Committee of Experts on International Cooperation in Tax Matters, 20th Virtual Session of 22 June 2020, *Tax consequences of the digitalized economy – issues of relevance for developing countries*, a Co-Coordinators' Paper issued on 30 May 2020, E/C.18/2020/CRP.25, https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-06/CICTM%2020th_CRP.25%20_%20Digitalized%20Economy.pdf (accessed: 10.07.2021) and section 2.3. hereafter.

[17] See: United Nations, *The 17 goals*, n.d., https://sdgs.un.org/goals (accessed: 10.07.2021).

3. Art. 12B UN Model

3.1. Specific background, framework to take into account, and text of Art. 12B

The text and commentaries of Art. 12B were developed in a whole process of which I now only refer to the draft included in the document discussed at the 21st session of the UN Tax Committee, which[18] also contained the comments received on it and the response to these given by the lead-drafters[19] of the Subcommittee. On the basis of that draft, the Tax Committee decided, although with a large opposing minority, to approve the inclusion of Art. 12B and related commentaries, subject to further specifications and a comprehensive inclusion of opposing views to be finally discussed and approved at the last meeting of its term. The final version of the text of article and the commentaries to it[20] were determined in the 22nd session of the Committee in April 2021.

It seems useful, when later evaluating Art. 12B and its commentaries, to in addition to the subcommittee's aims and mandate highlighted in section 2.3, also take into account the internationally agreed principles with respect to dealing with a digitalized economy as formulated in the 2003 Ottawa Taxation Framework Conditions on e-commerce as referred to in section 2.2.[21]

These principles are: neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility.

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[18] See: Committee of Experts on International Cooperation in Tax Matters, 20th Session 20–23 and 26–29 October 2020, *Tax consequences…*, https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-10/CRP41_Digitalization%2010102020A_0.pdf (accessed: 10.07.2021).

[19] Without intending to disregard the efforts and valuable contribution of all members of the Subcommittee, be it in favour or against an approach as included in Art. 12B, it is fair and appropriate to note Mr. Rajat Bansal as one of the most prominent lead-drafters. As one can see from the proceeding documents, and as also reflected in the text of the article and its commentaries, the Subcommittee managed, despite a strong divergence of views, to produce these documents, clearly expressing both the arguments for and those against an approach as expressed in Art. 12B.

[20] See: Committee of Experts on International Cooperation in Tax Matters, 22nd Session 19–28 April 2021, *Tax consequences*...

[21] Reference is made to section 1.2 (Ottawa Framework conditions and the fair allocation of taxing rights) where these Framework Conditions are referred to and discussed, P. Pistone, J. Nogueira, B. Andrade, *The 2019 OECD proposals for addressing the tax challenges of the digitalized economy: an assessment*, "IBFD International Tax Studies" 2019, Vol. 2, No. 2, https://www.ibfd.org/shop/journal/international-2019-oecd-proposals-addressing-tax-challenges-digitalization-economy-0 (accessed: 10.07.2021); see also: OECD, *Implementation of the Ottawa Taxation Framework Conditions*, 2003, https://web-archive.oecd.org/2012-06-15/158956-20499630.pdf (accessed: 10.07.2021).

3.2. Discussion of Art. 12B – Income from Automated Digital Services

3.2.1. General aspects and considerations

The structure of Art. 12B is identical to that of the Arts. 10, 11, 12, and especially also of Art. 12A, on fees for technical services introduced in the 2017 UN Model. We will later discuss the various paragraphs of Art. 12B.[22]

It seems useful to already point out that with respect to several aspects on which critical comments were received, alternative approaches have been included in the commentaries, thus leading to a degree of flexibility for the people negotiating an Art. 12B provision.

The general background (the ability through modern means of communication and digitalization to effectively engage in substantial business activities in the market country without a fixed place of business there, or to conclude contracts remotely with no involvement of individual employees or dependent agents) and the aim of the provision (to be able to apply domestic legislation in levying taxes on income from digital business models in a way which is relatively simple to comply with by business as well as tax administrations) are described in section A of the commentaries called "General Considerations", to which I refer.

It is also important to note that many countries have not yet introduced domestic legislation enabling them to tax the income derived from their country by non-resident enterprises via such business models, which legislation is of course a pre-condition for realizing the taxing rights allocated to the market or source country under Art. 12B.

In the same section A, under paragraphs 8 up to and including 16, the objections against introduction of Art. 12B are included as formulated by the large minority of Committee members that opposed the inclusion of Art. 12B. I will discuss the general objections here and will subsequently discuss the more specific ones at the various paragraphs of Art. 12B to which they relate.

The opposing members are of the view that an allocation of taxing rights to the market country based on mere sales as proposed is not justified as they do not agree that the market on its own generates profits such that

[22] See: the full text of Art. 12B UN Model as meanwhile included in the 2021 UN Model which was published after submission of this article: United Nations, *United Nations Model Double Taks Convention between Developed and Developing Countries, Department of Economic & Social Affairs*, New York 2021, https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2022-03/UN%20Model_2021.pdf (accessed: 10.08.2021).

allocation of taxing rights to that market country should be allocated. So, basically, they do not recognize value creation by the mere availability of the market and the use of it. I do want to point out that, besides the old allegiance theory of supply and demand mentioned in section 2.1, also in recent academic literature reference is made to theoretical underpinnings of market country taxation through the benefit principle and the use of so-called location specific benefits.[23] Thus, I think that there is a principled underpinning of market country taxation, but the subsequent fundamental questions are how broad the scope of tax liability should then become, and which profits can be attributed to mere use of an organized market. Furthermore, the international approach as expressed in the OECD Blueprint on Pillar One covers some specific business models creating value through acquisition of user data from the market country and so-called consumer facing business, whereas Art. 12B also covers the first but not the last category as that would make the proposal too complex, according to the drafters. Finally, also the Biden proposals previously mentioned in section 2.2 no longer focus on specific types of business models (to avoid definitional problems and sector discrimination) but on general revenue and profitability criteria, thus also recognizing a source taxing right for market countries without the value creation condition of generating user data or consumer facing activities. Overall, I think the increasing erosion of the tax base of market jurisdictions due to digitalization sufficiently justifies a revisit of the current allocation of taxing rights in tax treaties, and Art. 12B provides a bilateral option in that respect.

I do, however, agree that a global solution for the digitalized economy, covering also the undesirable introduction of unilateral measures like Digital Service Taxes claimed to be outside the scope of tax treaties, would be preferable due to the multilateral nature of the problem and the difficulty of effectively taxing non-resident groups of multinational companies while also avoiding double taxation, which problems also arise under Art. 12B (see hereafter in this respect also section 3.2.3).

I do regret that two suggestions I made during the discussions on a previous draft Art. 12B were not picked up.

The first one was to add a provision to Art. 12B or a suggestion in the commentaries to add such a provision in the treaty, stating that as from the moment of effectiveness of Art. 12B, the contracting parties would cease to apply any unilateral measures targeting the income covered within the scope of the provision. This would have given a strong signal that such undesirable unilateral measures would end when including

[23] P. Pistone, J. Nogueira, B. Andrade, *The 2019 OECD proposals…*; W. Cui, *The Digital Service Tax…*

Art. 12B in a tax treaty, which could have added to the attractiveness of agreeing on inclusion of Art. 12B. I, by the way, understand that including such type of a provision is also part of the recent Biden administration proposal regarding Pillar One[24] and was in this context surprised by the announcement of the EU Commission to, in the context of financing the economic recovery of the EU after the coronavirus pandemic, develop a new kind of DST which would be compatible with tax treaties, as it seems to complicate the process of reaching a multilateral agreement on pillar One,[25] and threatens to take us in substance back to the situation of unilateral measures outside the scope of tax treaties which were intended to be avoided in a global consensus.

My second suggestion was to add a provision to Art. 12B or a suggestion in the commentaries to add such a provision in the treaty, stating that if the contracting parties agreed to a multilateral solution, and such a solution has become effective, the provision of Art. 12B would no longer be applicable. This would then also meet the objections voiced by the minority view that if an international consensus would be reached, the possible overlapping with Art. 12B would need to be addressed. I take the view that such a provision would also have increased the chances of Art. 12B being accepted, at least as a temporary solution until a multilateral agreement had been reached and the contracting parties to the treaty also joined that multilateral agreement.

We should also not forget the political pressure to generate additional own resources from the profits of digitalized enterprises which only increased after the pandemic, and the fact that there was no prospect at all of reaching an international consensus at the time the UN Committee decided to accept and include Art. 12B in the UN Model (October 2020). Also now, some time after the Biden proposals were made, there is no final agreement on an technically elaborated Pillar One solution yet, whereas it is also still uncertain whether such a solution would also sufficiently meet the needs of developing countries. Although certainly not perfect as we will soon see, Art. 12B seems to present a possible alternative and at least provides a strong signal that developing countries want their views to be effectively taken on board in a possible international consensus.

Article 12B Para. 1

In this provision only payments or income from automated digital services are covered and not income derived in the source country from consumer facing business which was considered too complex by the drafters. This

[24] See footnote 12.

[25] See footnotes 12 and 13.

does, however, inevitably lead to a more limited taxable income base with respect to digitalized business. Furthermore, I note the specific formulation of the paragraph compared to the formulation in similar provisions in Arts. 10, 11, 12, and 12A UN Model, which was chosen because the provision not only covers the taxation of payments, but also of income in case the taxpayer has opted for taxation of net profits as included in Para. 3 of Art. 12B.

Article 12B Para. 2

The wording of this provision follows the same structure of the other articles on passive income and has strong similarity with Art. 12A Para. 2 UN Model. However, contrary to that latter provision, Arts. 16 and 17 do not take precedence over Art. 12B, which seems justified as it is considered unlikely that the provision of automated digital services would be covered by these specific articles. The simplicity of a withholding tax system on the gross amount of payments for automated digital services is mentioned as one of the main benefits for the tax administration of developing countries, whereas also business may consider this easier than complicated net income calculations or attribution of parts of the total profits of an enterprise which have a greater chance of causing differences of opinion with the tax authorities of its country of residence. It also gives developing countries a kind of control over their tax affairs without having to acquire relevant data from outside their countries from the taxpayer or from the foreign tax authorities.

The opposing minority view expressed warns, however, that gross basis taxation may lead to an excessive burden and that tax may not be able to be relieved in the country of residence. Although such warning is generally justified and is also recognized with respect to the existing Arts. 11, 12, and 12A UN Model which, like Art. 12B, leave open the rate of tax allowed to be levied on that gross amount to the tax treaty negotiations, the commentary also extensively cautions against a high rate and recommends a moderate rate of a maximum 3 to 4%, while further listing possible factors to take into account when setting the exact level of the rate.

The minority view also pleads for introducing thresholds for payments to avoid application of Art. 12B to small taxpayers and start-ups, and to include an exception for payments by individuals receiving the services for personal use. Such possible thresholds related to the worldwide income of the beneficial owner, and the amount of revenue from automated digital services derived by that beneficial owner, are included in Para. 26 of the commentaries on Art. 12B, whereas for an exclusion of individuals for personal use reference is made to such a provision in the text of Art. 12A Para. 3 UN Model. Although the idea of such thresholds is certainly appealing, I note that such thresholds do not exist in other articles dealing with taxation of payments on a gross basis and that these would add substantial complexity to its administration. Furthermore, the introduction of thresholds and the exclusion of payments by individuals could lead to substantial losses of source country revenues, on top of the fact that compared to Pillar One, income from a digital consumer facing business is not included in Art. 12B.

Article 12B Paras. 3–4

In Art. 12B Para. 3, taxpayers who are beneficial owners of the income from automated digital services are given the possibility in the source country to opt for net taxation on qualified profits instead of gross taxation of the payments received. It is intended to meet the criticism on previous drafts of Art. 12B that gross income taxation basis may lead to double taxation, be unfair towards start-ups and more generally loss-making companies.

The provision is a compromise between simplicity and complexity, as qualified profits cannot be determined according to the regular profit determination methodology but are defined as 30% of the profitability ratio of the taxpayer's revenue from automated digital services derived from the market country in accordance with the sourcing rules in Art. 12B Paras. 9–10. If no segmental accounts are maintained by the taxpayer, the overall profitability ration of the beneficial owner of the income is used.

It goes beyond the size of this contribution to deal in detail with all criticism with respect to the 30% and the perceived unclarity of terms used to determine the profitability (with respect to which it is mentioned in the commentaries that the profitability is calculated in accordance with the rules in the country of the beneficial owner of the income, or in group situations of the country where the ultimate parent is situated).

I do, however, agree that if a provision like Art. 12B is included in a tax treaty it would be in the interest of both the two tax authorities as well as the taxpayer(s) that more detailed clarity is provided on the calculation of these ratios and on the corrections to be made to the profits shown in the commercial accounts to limit the need at audits by the source country for checks with the other country's tax authorities and to thus also provide more legal certainty.

It is further stated in Para. 3 that if the taxpayer is part of a multinational enterprise group (as defined in Para. 4 of Art. 12B), the profitability ratio of the business segment of the group needs to be applied, and if no segmental accounts exist, the overall profitability ratio of the group, but only if these are higher than the respective profitability ratio of the taxpayer in the respective period! This is intended as an anti-abuse provision aimed at neutralizing possible reduction of profitability of the taxpayer by tax driven related party transactions. Clearly this is a rather blunt anti-abuse provision, which may, as observed in the minority view, may lead to allocating profitability and thus a tax liability on a taxpayer which, in accordance with international standards, did not realize such a profit or even suffered a loss. Finally, if in the respective period no such profitability ratio is available to the source country, the option for net taxation does not apply to that period at all!

In Para. 48 of the commentaries on Art. 12B Paras. 3–4, a minority view text alternative is included which contains three elements: a. instead of the abovementioned 30% the percentage is left open for negotiations, but only the ratio's of the taxpayer are taken into account, and c. the profitability ratio is reduced by a percentage to exclude routine profits which may already have been taxed in other countries.

Although the point regarding routine profits seems justified (and is also taken into account in the Blueprint on Pillar One by only re-allocating part of the residual profits) it seems that the reasoning of the drafters is that the 30% is an approximation of the profitability which can be attributed to the sales function in a formula apportionment approach where equal weight is given to the factors sales, capital, and labour, and that routine functions are thus already rewarded as part of the 70% profitability not allocated to the source country. Furthermore, flexibility in agreeing in bilateral situations to different percentages may in my view increase the risk of overtaxation or undertaxion at the group level.

The alternative of only taking into account the ratios of the taxpayer, but then also adding a specific anti-abuse clause to be able to counter any tax driven related party transactions, seems an appealing approach, but a concrete proposal for that is unfortunately missing in the alternative text.

I also observe that, especially if the taxpayer is part of a group and the parent is not a resident of the country of the taxpayer but of a third country, it may be difficult to avail of the relevant group ratios, especially if no treaties exist between the source country or the country of the taxpayer with that third country enabling exchange of information, and no relevant country-by-country reporting is available. In this respect, it seems to me that if indeed profitability ratios of companies in third countries are involved, a multilateral solution would be preferable.

Finally, as regards Art. 12B Para. 3, I think it should not be possible for the source country to refuse granting the option for net taxation unilaterally without having at least consulted the tax authorities of the country of the taxpayer and without having a possibility for the taxpayer to appeal such a decision in the source country and having the option to invoke the mutual agreement procedure in this respect. Thus, a provision securing these elements should be included in the text or the commentaries of the Model.

In Art. 12B Para. 4, the notion of a multinational enterprise group is primarily defined from the perspective of availability of consolidated financial statements as required for financial reporting purposes, but such a group is also considered present if such consolidated statements are not required but would be required if equity interests in any of the enterprises were traded on a public stock exchange. Only limited reference is made in Para. 44 of the commentaries on Art. 12B Paras. 3–4 to the international standards on transfer pricing. I thus missed a further clarification of the group definition in relation to the text of Art. 9 of the UN Model which deals with associated enterprises and related parties' transactions which are the reason for the anti-abuse approach in Para. 3 of Art. 12B, and of the interpretation of the text of the extension of the notion of a multinational enterprise group as regards going beyond the situation where consolidated financial statements are required. I note, however, that no specific comments on the group definition were raised in the minority view.

Article 12B Paras. 5 and 6

In Art. 12B Para. 5, automated digital services are defined as any service provided over the internet or another electronic net-work requiring minimal human involvement from the service provider (which definition is further clarified in the commentaries), whereas in Art. 12B Para. 6, for the sake of providing legal certainty, a list of examples is given which will often constitute automated digital services (which examples are also clarified in the commentaries). These provisions have been taken from the Blueprint on Pillar One[26] and were I assume the fruit of careful consideration.

The examples listed are, however, contrary to the Blueprint, not conclusive, in the sense that also in those cases the conditions of Art. 12B Para. 5, must be met. This inevitably reduces the legal certainty which the list is probably aimed to provide. However, such additional test is justified in view of the rapid development of the various business models, and I would also like to point at out the definition of the notion of permanent establishment in Art. 5 Para. 1, and the list of examples of what may constitute such permanent establishment in Art. 5 Para. 2 of both the UN and the OECD Model, where identical wording is used in the text of Para. 2 ("includes especially") and the commentaries on that provision make clear that also in those cases the conditions of Para. 1 should be met. Thus, the approach taken here is consistent with the one taken with respect to the definition of permanent establishment in both Models.

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[26] See footnote 3.

Article 12B Para. 7

Article 12B Para. 7 provides that Art. 12B is not applicable if the payments underlying the income from automated digital services qualify as royalties or fees for technical services dealt with in Arts. 12 and 12A of the UN Model. Thus, any possible conflicts of qualification with respect to the payments for certain services seem in theory resolved. However, such apparently in practise sometimes inevitable overlaps of different types of income included in different articles, require in practise a case-by-case qualification. Also, with respect to so-called mixed contracts, where payments may comprise of different types of income covered by different provisions in the tax treaties, the same methodology of disentangling the various elements, or qualifying for the whole payment in accordance with the dominant one is followed here, as mentioned in the commentaries to the provision. Such qualification issues occur more often when distinguishing different categories of income and should where possible be avoided with respect to already identified cases by providing relevant interpretation of the Articles with respect to these in the commentaries to the Models, but cannot in my view be a decisive element in judging the introduction of 12B which apparently is considered way to meet the needs of a majority of the UN Tax Committee members.

A more fundamental issue, also addressed in the commentaries to this provision, is the fact that Art. 12B does not exclude payments made by individuals for automated digital services for their personal use, whereas comparable payments by individuals for technical services covered by Art. 12A of the UN Model are excluded from that Article. A minority of members of the UN Tax Committee expressed that such payments should also be excluded from Art. 12B, because the imposition of withholding tax obligations on individuals for such payments would be difficult to enforce and might cause serious compliance problems. That minority also provided a text for a provision in Art. 12B Para. 7, to explicitly exclude such payments.[27] The commentaries on Art. 12B Para. 7, do however, state that although such payments are not a deductible expense in such circumstances (one of the arguments used to exclude these from Art. 12A), many multinationals derive a very significant portion of income from the provision of automated digital services to individuals for their personal use and that other collection mechanisms than withholding of tax by individuals may be required which are already in place in some countries.

I do from a budgetary perspective have understanding for the choice to include such payments by individuals, especially against the background

[27] See: Para. 66 of the Commentary to Art. 12B Para. 7, in UN Model: United Nations, *United Nations Model Double Taks Convention...*, p. 468.

of the generally supported idea of allocating more taxing rights on income from automated digital services to the market or source country (also included in the Blueprint on Pillar One) and the fact that income from consumer facing business (included in the Blueprint on Pillar One) is not included in Art. 12B. I think that at least in theory such other collection mechanisms are feasible. In the commentaries creating a liability for the non-resident service provider to withhold the tax or putting such liability on financial intermediaries like banks when settling payments by the individuals to the non-resident service provider, are mentioned. This would create additional complexities and implementation problems, but these may, as regards the imposition of an obligation to withhold tax on the non-resident service provider, become manageable if the country of residence of the service provider is prepared and able when necessary to support such implementation via the possibility of mutual administrative assistance provided for in the tax treaties based on the UN (and OECD) Model. Thus, I would be more in favour of such an approach than involving the financial intermediaries for which it seems much more difficult to distinguish the type of payments under the various business models on which a tax should be withheld.

Article 12B Para. 8

Article 12B Para. 8, contains a provision similar to those included in the Paras. 4 of Arts. 10, 11, 12, and 12A of the UN Model, which, as explained in the commentaries to Art. 12B Para. 8, generally[28] implies that Paras. 1, 2, and 3 of Art. 12B will not be applicable if the income from automated digital services is effectively connected with a permanent establishment or a fixed base through which the service provider carries out its business in the source state. This means that the source country will be relieved from the limitations imposed on its taxing rights by Art. 12B and that the income from automated digital services may be taxed in the source country in accordance with Arts. 7 or 14, which most countries interpret as taxing the net income in accordance with their domestic tax law.[29]

During the discussions in the plenary meeting of the UN Tax Committee in October 2020, the issue was raised whether the profit allocation to such permanent establishment (or fixed base) with respect

[28] I abstain here from also describing the special situation of the limited force of attraction as included in Art. 7 Para. 1, letter c, which situation is adequately described in the commentaries on Para. 8 to which I refer.

[29] If Art. 7 applies, this must however be done in accordance with Art. 24 Para. 3, of the Model – assuming such a provision is also included in the tax treaty – which prohibits discriminatory taxation of permanent establishments compared to the taxation of resident enterprises.

to automated digital services would not be problematic and a source of potential conflicts with the taxpayer, and thus would require a special rule, for instance comparable to the one included in Art. 12B Para. 3,[30] but apparently further consideration of that issue did not lead to such a special rule, and the minority view subsequently expressed did not raise that potential issue.

Article 12B Paras. 9–10

The provision in Art. 12B Para. 9 contains a so-called sourcing provision similar to those included in Arts. 11, 12, and 12A of the UN Model, which, as explained in the commentaries to this provision, implies that only payments made by residents of the source country, or payments made in respect of obligations to make the payment incurred and borne by a permanent establishment or fixed base which a non-resident maintains in the source country, will be covered by Art. 12B. As a result, under Art. 12B, a source taxing right with respect to income from automated digital services is only allocated in the case of such payments but not if only the user of the service is in the source country. This is contrary to the approach in the Blueprint of Pillar One, in which a taxing right is also allocated to the country of the user even if the user makes no payment for the service used. The commentaries explicitly also state that it cannot be argued that the voluntary or unvoluntary provision of data by users must be considered as a type of payment in consideration for the automated digital services.

Leaving aside whether this is appropriate in view of the value created for the enterprise receiving the data which might justify taxation of such value creation in the country of the user, I can only conclude that Art. 12B does not allocate a source taxing right in this respect and agree to the minority view that Art. 12B does not comprehensively address the challenges posed by the digitalized economy.

This can be illustrated by the case of the online advertising business models of social platforms, where the payor of the advertisement may very well be a resident of a third country, whereas the users of the platform (providing data to the company maintaining the platform and thus creating value for it), may be residents of the source country, in which value creation would then not be taxable in the country of the users. The minority view also mentions the risk that companies may restructure their business models in such way to avoid payments being made from

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[30] In which case probably an exception would have to be made to Article 24; see: Para. 3 of the Commentary to Art. 12B in UN Model: United Nations, *United Nations Model Double Taks Convention*..., p. 435.

countries which have such source taxing rights under Art. 12B to avoid its application. I think this may be a valid point and such structuring may perhaps only be challenged in situations where an artificial construction was chosen with the main aim of avoiding the withholding tax, like in back-to-back situations.

The drafters indicated in the oral discussions on Art. 12B that they accept that its budgetary revenues may be more limited than in the more complex alternatives as internationally discussed.

The provision in Art. 12B Para. 10 contains an exception to the sourcing rule included in Para. 9, similar to such provision included in Art. 12A Para. 6, of the UN Model, which is aimed at avoiding a double source and thus possible double taxation.

Article 12B Para. 11

Article 12B Para. 11, contains the in passive income articles habitual provision (see: Para. 6 of Arts. 11 and 12, and Para. 7 of Art. 12A of the UN Model) that the provisions of this article shall only apply to the arm's length part of the amount of the payment if the payment exceeds such amount due to a special relationship between the parties and needs no further comment.

Article 12B and compatibility with EU and WTO Law

The compatibility of an EU DST with EU and WTO law has already been thoroughly analysed in academic literature.[31] However, given the normative differences, a few words on such compatibility of Art. 12B with EU law (and after that WTO law) seems warranted. Between EU countries, a levy on the gross income within the context of domestic taxation of income and tax treaties seems admissible as turnover is considered a suitable indication of ability to pay.[32] However, a withholding tax on the gross income applicable solely in the cross-border context may be considered

[31] See: J.F. Pinto Nogueira, *The Compatibility of the EU Digital Services Tax with EU and WTO Law: Requiem Aeternam Donate Nascenti Tributo*, "International Tax Studies" 2019, No. 1, https://www.ibfd.org/shop/journal/european-union-compatibility-eu-digital-services-tax-eu-and-wto-law-requiem-aeternam (accessed: 10.08.2021). See also: G. Kofler, *The Future of Digital Service Taxes*, "EC Tax Review" 2021, No. 2, https://research.ibfd.org/#/doc?url=/collections/bit/html/bit_2011_12_e2_1.html (accessed: 11.08.2021).

[32] HU: ECJ, judgment, 3 March 2020, Case C-75/18, Vodafone Magyarország Mobil Távközlési Zrt. v. Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága, Case Law IBFD, Para. 50 et seq. See also: CFE ECJ Task Force, Opinion Statement ECJ-TF 2/2020 on the ECJ Decision of 3 March 2020 in Vodafone Magyarország Mobil Távközlési Zrt. (Case C-75/18) on Progressive Turnover Taxes, "European Taxation" 2020, Vol. 60, No. 12, Journal Articles & Opinion Pieces IBFD.

a violation of the freedom of services if no complete and effective relief is possible in the country of residence of the recipient of the payment.[33]

The net income option, included in Art. 12B Para. 3, might, in intra-EU situations raise doubts with respect to its compatibility with EU law. According to the provision, such net taxation takes place on a deemed basis, and if the service provider is part of a group, even the higher profitability of the group is to be used, by comparison to the regular taxation of a resident performing the same activities. This leads to a different taxation of comparable residents and non-residents which may be considered as incompatible with EU law.

In this context it seems useful to mention that invoking anti-abuse in such cases as justification may not lead to compatibility unless there is a wholly artificial arrangement.[34]

On WTO compatibility, and even though one could think of tensions with WTO law, if the other country accepted Art. 12B in a treaty it will not challenge its application, whereas there seems to be no way for taxpayers to challenge it.

4. Evaluation and conclusions

4.1. Evaluation of Art. 12B as regards the achievement of aims pursued and the Ottawa Taxation Framework Conditions

Although it would go beyond the scope of this contribution to elaborately discuss whether the aims of the UN Tax Committee as mentioned in the commentaries and in section 2.3, and the principles to be observed according to the so-called Ottawa Taxation Framework Conditions as mentioned in section 3.1 were met, I would like to make some global comments with respect to these.

With respect to the aims pursued with Art. 12B:

1) definite share of taxation for the source country: there is a definite share of tax on automated digital services for the market jurisdiction and

[33] NL: ECJ, judgment, 8 November 2007, Case C-379/05, *Amurta SGPS v. Inspecteur van de Belastingdienst/Amsterdam*, Case Law IBFD. See also: G.W. Kofler, *Tax Treaty "Neutralization" of Source State Discrimination under the EU Fundamental Freedoms?*, "Bulletin for International Taxation" 2011, Vol. 65, No. 12, https://research.ibfd.org/#/doc?url=/collections/et/html/et_2020_12_cfe_1.html (accessed: 11.08.2021).

[34] UK: ECJ, judgment, 12.09.2006, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, Case Law IBFD, Paras. 51 and 55 et seq.

preservation of domestic taxing rights (once established, if not yet included in domestic law) but unfortunately no budgetary estimates have been made, so a comparison with the revenue to be expected from Pillar One (which is also not clear yet as no full agreement is reached on the various parameters) is not possible;

2) avoidance of double taxation and non-taxation: seems met when the tax is levied on the gross amount of the payment (assuming the rate applied will be sufficiently moderate to avoid excess credits), but is more questionable if the net income taxation option is applied, especially if a higher group profitability is used, as in that case the taxation in the source country may exceed the taxable income of the recipient at which level relief may then not be fully realized, whereas there is no entitlement to such relief for other members of the group; avoidance of non-taxation is achieved, at least in the case of payments (but maybe not if there are no payments from the source country but only users of non-monetized services in that country);

3) preferably taxation on a net income basis: an option for net taxation is available at the request of the taxpayer, but if it is a member of a group of enterprises the determination of such net income may, for reasons of assumed tax avoidance by the beneficial owner of the income, deviate substantially from the customary internationally agreed determination of such income;

4) simplicity and administrability: seem achieved in case of application of a withholding tax system, however keeping payments by individual customers for their personal use within scope, would require a more complex collection system to secure taxation which requires additional legislation and may be more difficult to administer; taxation on a net income basis, as may be required by the taxpayer, would certainly be less simple than taxation of gross revenue and would most likely raise challenges as regards its implementation.

With respect to the Ottawa Taxation Framework Conditions:

1) neutrality: the allocation of an additional source taxing right is clearly only covering specified digitalized services, but establishing different taxing rights under domestic law and distinguishing different types of income in tax treaties, affecting different sectors of business differently, seems not to necessarily violate neutrality compared to different business models which may already be covered by such taxing rights in income taxes and seems different from an introduction of a separate sector specific tax like a DST;

2) efficiency: a withholding tax system on gross income may be considered an efficient system from the perspective of a tax administration, but due to the absence of thresholds, businesses may find this less efficient

when small amounts of payments are concerned, whereas an alternative collection system for payments related to individual customers in a personal capacity may decrease that efficiency, and the optional net income tax system may entail substantial compliance and administration costs making it less efficient;

3) certainty and simplicity: seem well achieved in a system of taxation of gross income albeit discussions may still arise with respect to the business models covered, whereas these seem less achievable as regards the alternative collection system for payments by individuals in a personal capacity and the net income option; more generally, in many countries domestic legislation will need to be introduced enabling these to realize the taxing rights allocated by Art. 12B, whereas also the tax treaties need to be changed, which latter aspect raised the interesting issue of a UN Multilateral Instrument to achieve this speedily and efficiently;[35]

4) effectiveness: can as regards the in scope business models most likely be reasonably achieved if the alternative collection system for individuals paying for automated digital services in a personal capacity can be effectively implemented. If the aim would have been to more broadly cover value created due to digitalized business activities in a jurisdiction this would be less met as no taxing right is allocated with respect to user participation;

5) fairness: it can be considered fair that source countries (especially developing countries which generally rely more heavily on revenues from company taxation) which tend to lose taxing rights in the digitalized economy compared to the traditional brick-and-mortar economy are compensated by additional taxing rights with respect to such business models;

6) flexibility: as regards the withholding tax on a gross income basis, flexibility is achieved by leaving the establishment of the rate of tax to the negotiations on the treaty, by the option for net taxation and several other text options offered in the commentaries (including the exclusion of payments by individuals for personal use and the introduction of thresholds, and as regards the net taxation a deduction of a percentage of the profits related to routine profits and the abolition of the use of group ratios).

When viewing the various elements addressed, it can be concluded from this global evaluation that Art. 12B is a possible but certainly not perfect solution for the very complicated problem of developing taxing rules for the digitalized economy when judged from the perspective of the various aims and principles mentioned.

[35] See: R. Rawal, *Conceptualizing the U.N. MLI*, "Tax Notes International" 2021, Vol. 102, No. 10, https://www.radhakishanrawal.com/post/conceptualizing-the-u-n-mli (accessed: 11.08.2021). The possibility of developing such UN Multilateral Instrument is, by the way, meanwhile also being considered by the UN Tax Committee.

4.2. Conclusions

The taxation of the globalized economy is a very complicated issue and there seems to be a general feeling, which I share, that more fundamental long-term reforms are required to deal with the taxation of the profits of multinational enterprises in the context of increasingly flexible and less tangible business processes in a global economy. In view of the multilateral character of the issues and the aim to avoid both double taxation and non-taxation, I want to express again my preference for a multilateral solution in a truly inclusive global consensus.

Given its membership, its particular mandate to pay attention to the interest of developing countries, including also an increase of domestic resource mobilization in the context of the SDG's internationally agreed to, it is fully understandable that the UN Tax Committee in view of the discomfort of developing countries with the progress and perceived lack of adequate attention for their specific needs,[36] did not only confine itself to commenting on the work done by the OECD/G20 Inclusive Framework, but wanted to look at a possible alternative with which its members from developing countries felt more comfortable. In view of the at that time absence of such global consensus and, despite some optimism due to the Biden proposals, and lack of short term prospects for it, and the fact that such consensus would equally have had to be tested against the aims and principles mentioned, and would also require a substantial time to implement, and finally in view of the end of the term of the then existing UN Tax Committee, Art. 12B was developed and accepted in October 2020 and its text and commentaries finalized in April 2021, albeit with a large opposing minority of its members.

Against this background, it is commendable that the UN Tax Committee, with so little resources available, was able by the relentless efforts of a number of its members, to develop Art. 12B in an attempt to find an international solution within the context of tax treaties, thus also avoiding the uncoordinated introduction of unilateral types of taxation leading to forms of double taxation.

When reading the specific comments in chapter 3 and section 4.1, it is clear that Art. 12B met a lot of the aims pursued and several generally accepted principles discussed but is indeed not an ideal solution as it was as not able to meet all these aims and principles and may in the specific EU/EEAA context raise issues of compatibility with EU law.

[36] Meanwhile such feelings also seem to be recognized by the OECD, see: Nana Ama Sarfo, *The Other Pillar 3*, "Tax Notes International" 2020, Vol. 100, No. 11, in which she quotes the Director of the OECD CTPA in this respect.

Article 12B clearly carries features of a compromise solution with respect to its various aims and offers due to the various alternative text proposals included in the commentaries, also by the opposing minority view, a reasonably flexible toolkit for tax treaty negotiators.

Although the starting point of Art. 12B was a relatively simple, easily administrable withholding tax system on gross payments, complexities arose, especially due to the fact that recourse needs to be taken to alternative collection mechanisms in order to be able to capture the payments made by individuals in view of automated digital services received for their personal use. Further complexities arose from the very reasonable, but in the context of withholding tax systems in the UN Model, unprecedented option for taxpayers to be taxed on a deemed net income tax basis. Also matters of definition regarding the type of services covered and possible qualification issues which may arise in relation to Arts. 12 and 12A of the UN Model inevitably contribute to more complexity than originally aimed at. One should also realize that as in other options which were internationally considered, the Art. 12B approach would require substantial amendments to the domestic legislation of countries which did not yet such legislation and corresponding amendments of tax treaties to be able to realize such (new) taxing rights.

Important questions relate to what additional revenue may be expected from this approach and whether countries where important providers of covered automated digital services are resident, will be prepared to accept such Art. 12B in their tax treaties? As regards the first question, it is regrettable, although due to the tight time frame understandable, that no revenue estimates could be made which could have provided a better basis to judge the value of Art. 12B and be used by developing countries in the context of the ongoing discussions on a possible international consensus. As regards the second question, I cannot be very optimistic given the strong opposing minority views from in particular members from developed countries. In the absence of a global multilateral agreement, Art. 12B might in my view have gained more support if a provision would have been added providing that countries would in their bilateral situation abstain from unilaterally levying other types of taxes and levies (including also DST's) going beyond the revenues covered by Art. 12B as long as Art. 12B would be effective. Also for those who consider that the nature of the problems relating to the digitalized economy should preferably be dealt with in a multilateral preferably global and inclusive consensus, it would have been important to have a provision included stating that Art. 12B would cease to have effect once a multilateral consensus solution was signed and sealed and put into effect by the contracting parties of the respective tax treaty in which Art. 12B was included?

As there was no such global inclusive consensus yet, and may still not come, I do on balance consider it a good idea which fits its specific mandate that the UN Tax Committee (despite the large opposing minority) agreed to the inclusion of Art. 12B as a tax technically well considered and a reasonable alternative solution within the framework of the existing tax treaties aimed to provide a definite share of tax revenue to developing countries while, generally speaking, avoiding both non-taxation and double taxation. Even if Art. 12B would in practise not be a success and would be overtaken in the future by a global consensus,[37] I hope the adoption of Art. 12B provided a strong signal of the views of developing countries and may then at least have contributed to a for these countries acceptable multilateral agreement and truly global inclusive consensus.

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[37] Although published shortly before the expiration of my deadline for submitting this contribution in July 2021, I would like to mention an interesting article which may contribute to achieving a global consensus in combining elements of Pillar One, The Biden proposals and the UN SDG's, by proposing a DST like additional tax outside the scope of income taxes on the most profitable multinationals, i.e.: S. Chatel, J. Li, *Repurposing Pillar One into an Incremental Global Tax for Sustainability: A Collective Response to a Global Crisis*, "Bulletin for International Taxation" 2021, Vol. 75, No. 5, https://research.ibfd.org/#/doc?url=/collections/bit/html/bit_2021_05_o2_2.html (accessed: 15.05.2021).

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Abstract

The article deals with policy aspects related to the introduction to the new Art. 12B as to be included in the 2021 update of the 2017 UN Model Double Taxation Convention between Developed and Developing Countries dealing with the elimination of double taxation of income from automated digital services. The Author discusses the draft article itself and ends with some evaluation and conclusions as to whether Art. 12B can be considered a reasonable alternative compared to the so-called Pillar I approach as included in the so-called Blueprint published by the OECD in close co-operation with the BEPS Inclusive Framework.[38]

Keywords: income from automated digital services, the UN Model Tax Convention between Developed and Developing Countries, tax treaty policy

[38] OECD (2020), *Tax Challenges arising from Digitalization – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris, https://doi.org/10.1787/beba0643-en (accessed:10.07.2021).

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Daniel Gutmann[1]

The Principle of Personality of Tax Penalties: A General Principle with a Narrow Scope?

1. Introduction

It is a great honour to have an opportunity to express my admiration for Professor Nykiel's work in the Jubilee Book dedicated to him by his colleagues and friends. In order to tackle a tax topic which fits within the general focus of this book on contemporary tax challenges and, at the same time, takes account of Professor Nykiel's expertise in the relationship between taxation and human rights, I have chosen to offer a French approach to the tax dimension of a fundamental principle of criminal law: the principle according to which no one should be punished for offences committed by others.

This principle is well established in the case law of the European Court of Human Rights (ECtHR). At point 53 of the *EL*, *RL* and *JO-L* v. *Switzerland* case,[2] it held that "it is a fundamental rule of criminal law that criminal liability does not survive the person who has committed the criminal act". In the Court's opinion, such a rule is required by the presumption of innocence enshrined in Art. 6(2) of the European Convention of Human Rights (ECHR).[3] "Inheritance of the guilt of the dead", says the Court, "is not compatible with the standards of criminal justice in a society governed by the rule of law". It concludes that when this happens, there is a violation of Art. 6(2).

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[1] Prof. Dr. Daniel Gutmann, Professor, Sorbonne Law School, University Paris-1 (France).

[2] ECtHR, judgment, 29 August 1997, *E.L.*, *R.L.* and *J.O.-L.* v. *Switzerland*, No. 75/1996/694/886; ECtHR, judgment, 29 August 1997, *A.P.*, *M.P.* and *T.P.* v. *Switzerland*, No. 71/1996/690/882.

[3] Council of Europe, Convention for the Protection of Human Rights and Fundamental Freedoms, 4 November 1950, amended.

2. The principle in French law

In French Constitutional law, the principle derives from Art. 8 of the 1789 Declaration of Human Rights[4] which implies, according to the Constitutional Court (CC), that "no one can be punished except for his own actions". The Constitutional Court adds that "this principle applies not only to penalties imposed by the criminal courts but also to any sanction having the character of a punishment".[5]

The Conseil d'Etat (CE; the French administrative court dealing with most tax matters) and the Cour de Cassation (which deals, among other things, with criminal law cases) have already had several opportunities to draw some consequences from this principle (even anticipating, in the case of the Conseil d'Etat, the judgments of the ECtHR).[6] The Conseil d'Etat thus considers that "both the principle of personal responsibility and the principle of the personality of penalties preclude tax penalties, which have the character of a punishment intended to prevent the repetition of the acts they target, from being pronounced against taxpayers, natural persons, when they have not participated in the acts that these penalties punish".[7] Even more precisely, the Court held that "tax penalties, which have the character of a punishment intended to prevent the repetition of the conduct they target and do not have as their object the mere pecuniary reparation of a loss, constitute, even if the legislator has left the task of establishing and imposing them to the administrative authority, 'criminal charges' within the meaning of the provisions of paragraph 1 above. The principle of the personality of penalties derives from the principle of the presumption of innocence laid down by the provisions of paragraph 2 [of Art. 6 ECHR]".[8]

Once it is acknowledged that nobody should be punished because of offences committed by someone else, legal practice shows that this principle is not always easy to reconcile with the institutional framework of taxation. This may occur in family situations. This may also happen in the field of business taxation.

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[4] FR, The Declaration of the Rights of Man and of the Citizen [*Déclaration des droits de l'homme et du citoyen*], 26 August 1789.

[5] See for instance: FR, CC, decision, 4 May 2012, No. 2012-239 QPC.

[6] FR, CE, decision, 2 March 1979, No. 6646. See also: FR, CE, decision, 10 July 1987, No. 55762–57763; FR, CE, decision, 6 April 1987, No. 55862.

[7] FR, CE, decision, 5 November 2014, No. 356148.

[8] FR, CE, decision, 5 October 2016, No. 380432.

2.1. Family situations

2.1.1. Heirs

As seen above, the ECtHR considers, on the basis of Art. 6(2) of the ECHR, that the principle of the individual nature of penalties precludes the imposition of tax penalties on heirs for acts committed by the deceased. It, however, does not preclude the recovery of tax penalties finally imposed on the tax offender from the heirs. European case law and French constitutional case law converge around this analysis, which explains why the Constitutional Court, in the aforementioned decision, reached the conclusion that Art. 1754 of the French Tax Code,[9] according to which "in the event of the death of the offender […], the fines, surcharges and interest owed by the deceased […] constitute an inheritance […] charge", is in conformity with the Constitution.[10] A reading of the comments on this decision published on the website of the Constitutional Court by its legal service shows the Court's concern to provide a solution consistent with the case law of the ECtHR. These principles have been implemented by lower courts, too.[11]

2.1.2. Joint taxation of couples and tax penalties

It should be noted, however, that the Conseil d'Etat takes a rather restrictive approach to the consequences of the principle in other circumstances. In the decision of 5 October 2016 quoted above, it had to establish how the principle could be accommodated in a system such as the French one which is based on joint taxation of couples. Let us recall in this respect that under the terms of Art. 6 of the French Tax Code, "married persons are subject to joint taxation for the income received by each of them and those of their children and dependents". According to Art. 156 of the same Code: "Income tax is established according to the total amount of annual net income available to each tax household".

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[9] FR, French Tax Code [*Code général des impôts*], Decree No. 50-481 of 6 April 1950, amended.

[10] FR, Constitution of 4 October 1958, amended.

[11] FR, Adm. Court of Rennes, judgment, 13 June 2002, No. 98-3228, 98-3239 and 98-3242; FR, Adm. Court of appeal of Lyon, judgment, 28 June 2011, No. 09LY00328, 2nd ch. The CE refused to admit the appeal against this decision on 27 July 2012 (decision No. 352200). See also: FR, Adm. Court of appeal of Paris, judgment, 24 September 2009, No. 07-3771.

Based on these texts, the Court held that "when it adds an additional penalty to an income tax reassessment to punish the behaviour of a taxpayer, the administration is bound to respect the principle of the personality of penalties […], which prevents a tax penalty from being directly applied to a person who has not taken part in the actions that this penalty punishes. This principle must, however, be reconciled with the system of joint taxation […] Thus, when only one of the spouses has taken part in wrongful acts, the resulting tax penalties must be considered as having been pronounced solely against him or her, even if they increase, for the income concerned by these acts, the tax due by the tax household formed by the two spouses, on all their income. It follows from the foregoing that the principle of the individuality of penalties enshrined in the stipulations of Art. 6 of the European Convention on Human Rights had to be applied taking into account the principle of joint taxation of married couples and did not prevent the penalties incurred because of the actions of only one of the spouses from being charged jointly to the members of this couple".

At first sight, this outcome may seem quite surprising. Its explanation is, however, to be found in the Advocate General's opinion[12] which puts forward that the principle of joint taxation "amounts to creating a legal fiction that is neither a natural nor a legal person, which is not even a legal person, which is at most a fiscal entity imagined for the sole purpose of establishing income tax, and behind which one immediately finds the natural persons who constitute the couple subject to joint taxation. The imposition of a tax penalty on the tax household constituted by a married couple based on the behaviour of only one of its members does not therefore amount to sanctioning a person other than the one to whom this behaviour is attributable". The Advocate General also stressed that civil law provisions enable the spouse, upon later dissolution of the community of assets between the spouses, to claim indemnity for the tax penalties triggered by the other spouse's behaviour during the marriage. The same mechanism also applies between spouses who have chosen a separatist matrimonial regime. This somewhat complex intellectual construction shows that the Conseil d'Etat wishes to preserve the institution of joint taxation of couples through the combination of an abstract conception of the tax household and the finding that civil law provides a remedy to avoid unfair penalization of an innocent taxpayer.

This pragmatic approach to the consequences of the principle of personality of penalties may also be found in the field of business taxation.

[12] FR, Advocate General (*rapporteur public*) V. Daumas, opinion under CE, decision, 15 October 2016, No. 380432.

2.2. Business situations

2.2.1. Mergers

A "classical" issue in French law is whether criminal or administrative penalties relating to offences committed by a legal person may be transferred to its legal successor in case of merger (or demerger). Here, the Conseil d'Etat has adopted a rather constructive approach to the principle of the personality of penalties, which it considered necessary to adapt to the specific situation of legal persons. In particular, it considered that "having regard to the objectives of preventing and repressing tax fraud and evasion to which tax penalties respond, the principle of the personality of penalties does not prevent these pecuniary penalties from being applied in the event of a merger or demerger, taking into account the universal transfer of assets and liabilities, from being borne by the acquiring company, a new company created to carry out the merger or companies resulting from the demerger, in respect of breaches committed, prior to this operation, by the acquired or merged company or by the demerged company".[13]

This approach was until recently, contrary to the position adopted by the Cour de Cassation (CdC), which is the Supreme Court in criminal law matters, which used to hold that no criminal liability could be established against the absorbing company by virtue of offences committed prior to the merger by the absorbed company.[14] However, the Cour de Cassation reversed its case law in a landmark judgment[15] where it held that in the case of a merger of a company with another company falling within the scope of Council Directive 78/855/EEC of 9 October 1978 on the merger of public limited liability companies,[16] as last codified by Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017,[17] the acquiring company may be subject to a fine or confiscation for an offence committed by the acquired company prior to the transaction. By relying on a recent judgment of the ECtHR,[18] the Cour de Cassation gave up its

[13] FR, CE, decision, 4 December 2009, *Sté Rueil Sports*, No. 329173.

[14] FR, CdC, judgement, 20 June 2000, No. 99-86.742; FR, CdC, judgement, 14 October 2003, No. 02-86.376; FR, CdC, judgement, 18 February 2014, No. 12-85.807.

[15] FR, CdC, judgement, 25 November 2020, No. 18-86.955.

[16] EU, Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54(3)(g) of the Treaty concerning mergers of public limited liability companies, OJ L 295, 20 October 1978, p. 36.

[17] EU, Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law, OJ L 169, 30 June 2017, p. 46.

[18] ECtHR, judgement, 24 October 2019, *Carrefour France* v. *France*, No. 37858/14.

earlier approach, which equated the dissolution of a legal person with the death of a natural person, in favour of the specificity of legal persons, whose economic activity continues within the company that absorbed them. This renewed interpretation of the domestic texts is intended to prevent the merger from being an obstacle to the criminal liability of companies.

2.2.2. Group tax consolidation

Another interesting issue also arises in the context of tax consolidation which occurs between companies of the same tax group (called "*integration fiscale*"). Article 223A of the French Tax Code states that "each company of the group is jointly and severally liable for the payment of the corporate income tax and, where applicable, of the corresponding late payment interest, surcharges and tax fines, for which the parent company is liable up to the amount of the tax and penalties which would be due by the company if it were not a member of the group". Notwithstanding the wording of the law, the mechanism put in place by Art. 223A still leaves a number of uncertainties.

First of all, the law is silent on whether the penalties resulting from infringements committed by tax-consolidated subsidiaries should be calculated on the basis of the adjustments made at the level of each member company or on the basis of the consequences of these adjustments on the overall profit of the tax group. The administration's practice seems to be to impose penalties on the parent company only when an adjustment results in the appearance of an increase in the overall profit. However, there is room for a question that an advocate general before the Conseil d'Etat formulated in the light of Art. 6(2) of the ECHR.[19]

One might even go a step further than just choosing the most appropriate method of calculating penalties. Does Art. 6(2) not prevent the parent company of the group from being liable for the penalties relating to the breaches committed by its subsidiaries?

According to the Conseil d'Etat, there is no incompatibility between the rule of Art. 223A of the French Tax Code and the ECHR. In a recent decision[20] where the question was whether the parent company of a tax consolidated group should be held liable of a penalty for the abuse of law committed by a subsidiary, the Court recalled that according to Art. 223A of the French Tax Code, "the parent company bears the consequences of infringements committed by group companies". Among these penalties is the 80% increase

[19] FR, Advocate General [*rapporteur public*] Cl. Legras, opinion under CE, 13 December 2013, EURL Pub Finance, No. 338133.

[20] FR, CE, decision, 11 December 2020, *Société BNP Paribas*, No. 421084.

in duties payable by the taxpayer in the event of abuse of law within the meaning of Art. L 64 of the Tax Procedure Code,[21] provided for in Art. 1729 of the French Tax Code. The Court went on to say that "it follows from the provisions of Art. 223A of the French Tax Code that a company which opts for the tax consolidation regime provided for by this article and the following articles of the same Code chooses to be solely liable, not only for the corporation tax due on all the income of the group formed by itself and its subsidiaries which are members of it, but also for the tax penalties of a pecuniary nature applied, as the case may be, on account of infringements committed by the latter". It held that the applicant company is not entitled to argue that the abovementioned provisions of Art. 223A of the French Tax Code, "which are limited to designating, in the event of an option for the consolidated tax group regime, the person legally liable for the financial penalties imposed on the companies belonging to the group, would disregard the principle of the personality of penalties protected by Art. 6(2) of the ECHR".

The Advocate General's opinion[22] allows us to better understand the justification of the Court's decision. The applicant company indeed tried to transpose to the parent companies of tax consolidated groups the existing case law on partners of partnerships, who cannot be subject to penalties such as those provided for bad faith if they did not personally participate in the acts in question, in particular when they did not have the status of manager.[23] However, with regard to fiscally integrated groups, the Advocate General took the view that "the penalties are established at the level of each member company on the basis of their own behaviour, and the parent company is only liable for them financially".[24] In other words, the parent company's liability for penalties is a freely accepted financial consequence of tax consolidation within a group.

3. Conclusion

As the examples developed in this article have illustrated, there is an unavoidable tension between the specific institutions established by tax legislation and the traditional individualistic conception of human

[21] FR, Tax Procedure Code [*Livre des procédures fiscales*], decree No. 81-859 of 15 September 1981, amended.

[22] FR, Advocate General [*rapporteur public*] L. Cytermann, opinion under CE, decision, 11 December 2020, *Société BNP Paribas*, No. 421084.

[23] Cf. for example, FR, CE, decision, 27 June 2016, *Min. c/ M.F…*, No. 376513.

[24] Cf. in this sense FR, CC, decision, 27 September 2019, No. 2019-804 QPC, Para. 9.

rights. This tension is even increased by the need to take into account the specificity of legal persons, as compared to individuals. The study of French case law shows that the courts so far have tried to preserve the institutional framework of tax law and to prevent human rights from being instrumentalized by legal persons in order to avoid repression. To date, the tension therefore seems to be resolved at the detriment of a strict implementation of human rights. It is, however, probable that in the eternal swinging of the? pendulum between repression and protection, the balance between opposite forces will continue to evolve.

Abstract

The principle of personality of tax penalties is well established in the case law of the European Court of Human Rights. It is also very important in the case law of the French administrative Supreme Court. However, this principle may conflict with traditional institutions of tax law such as, for example, joint taxation of couples or group tax consolidation. This article studies the technical consequences of the principle of personality of tax penalties in a variety of tax matters and describes how the French case law has tried to find a balance between opposite constraints.

Keywords: tax penalties, personality, family taxation, mergers, group consolidation

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Pedro M. Herrera[1]

Greening up Local Taxes (an Environmental Approach to Municipal Taxation from a Spanish Perspective)[2]

1. Legal and constitutional background

Traditionally, local taxes and charges in Spain have not been related to protecting the environment. Although the Spanish Constitution[3] requires public authorities to protect the environment (Art. 45(2)), the original Act on Local Finances (LHL)[4] only provided tax exemptions for "forests populated with slow-growing species" (Art. 62(1)(f) LHL)) and for "the surface of the mountains in which afforestation or regeneration of wooded masses are carried out subject to management projects or technical plans approved by the Forest Administration" (Art. 62(2)(c) LHL).[5]

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[1] Prof. Dr. Pedro M. Herrera Molina, PhD in Law (1988), Full Professor of Tax and Financial Law, Department of Business Law, National University of Distance Learning (UNED), Spain.

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[3] ES, Spanish Constitution of 27 December 1978 [*Constitución Española*], Official Gazette No. 311, 29 December 1978, amended.

[4] ES, Act on Local Finances (consolidated text), enacted by Royal Legislative Decree No. 2 of 5 March 2004 [*Ley de Haciendas Locales*], Official Gazette No. 59 of 9 March 2004, amended. The original Act on Local Finances, No. 39 of 28 December 1988 was published in the Official Gazette No. 303 of 30 December 1988.

[5] A. Tandazo Rodríguez, *La fiscalidad de los bosques*, Instituto de Estudios Fiscales, Madrid 2014, p. 134; C. Galarza, *Las Haciendas Locales frente al cambio climático*, "Revista Aranzadi de Derecho Ambiental" 2010, No. 18, Para. III.3.1.

2. Environmental tax credits regarding local taxes

From 1998 on, various reforms of the Act on Local Finances (LHL) have granted local authorities the *possibility* to introduce environmental tax credits through regulations (so-called *optional* tax credits).[6]

2.1. Specific tax credits

2.1.1. Real estate tax (IBI)

Regarding the real estate tax (IBI), the law provides "a tax credit of up to 90% of the tax due […] for the immovable property with special features".[7] Municipalities can implement this provision to promote wind and solar farms (Art. 74(3) LHL). Local authorities can also apply reduced or increased tax rates to power plants (Art. 72(2) LHL).

Furthermore, "local regulations may provide a tax credit of up to 50% […] for an immovable property with facilities for the thermal or electrical use of solar energy". The application of this credit requires technology approved by the competent administration (Art. 74(5) LHL).

2.1.2. Tax on economic activities (IAE)

The tax on economic activities (IAE) includes an optional tax credit of up to 50%. Requirements include:

1. The business should use or produce renewable or co-generated energy.
2. Taxpayers should "carry out their industrial activities, from the beginning of their activity or by subsequent transfer, in facilities far from the most populated areas of the municipality".
3. Taxpayers should "provide a transportation plan for their workers that aims to reduce energy consumption and emissions caused by travelling to the workplace and to promote the use of the most efficient means of transport, such as public transport or the shared one" (Art. 88(2)(c) LHL).

[6] A. García Martínez, *El ejercicio del poder tributario municipal en el Impuesto sobre Actividades Económicas*, "Tributos Locales" 2006, No. 58, pp. 11 et seq.; L. Gil Maciá, *Cómo regulan las capitales españolas las bonificaciones medioambientales en sus impuestos*, "Revista Aranzadi de Derecho Ambiental" 2019, No. 42.

[7] Cf. J. Calvo Vérgez, *En torno a la discutida categoría de los «bienes inmuebles de características especiales» en el IBI*, "Jurisprudencia Tributaria Aranzadi" 2007, No. 13.

2.1.3. Circulation tax (IVTM)

The circulation tax (IVTM) provides optional tax credits of up to 75% for environmentally friendly motor vehicles (Art. 95(6) LHL).

2.1.4. Tax on constructions, facilities, and works (ICIO)

Regarding this tax (ICIO), local authorities can implement a "tax credit of up to 95% in favour of constructions, facilities or works with devices for the thermal or electrical use of solar energy". The application of this credit requires approval from the competent environmental administration (Art. 103(2)(b) LHL).

2.1.5. Tax on the increase in value of urban land (IIVTNU)

The tax on the increase in value of urban land (IIVTNU) is the only one without specific environmental incentives.

2.2. General tax credit for economic activities of particular interest

Besides, the legislation of all local taxes – except for the circulation tax – includes an optional tax credit of up to 95% for economic activities declared of particular interest or municipal utility for social, cultural, historical, artistic circumstances, or for employment promotion.[8]

A city council will decide on the declaration of particular interest, upon request of the taxpayer, by a simple majority of its members (Art. 74(2)(4) LHL regarding IBI, Art.88(2)(e) regarding IAE, Art. 103(2)(a) regarding ICIO and Art. 108(5) regarding IIVTNU). Such provisions are controversial. The legal requirements are ambiguous, and, in our view, a city council enjoys an excessive margin of discretion.[9] Furthermore, they could be considered forbidden state aid.[10]

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[8] J.M. Martín Rodríguez, *Las nuevas bonificaciones potestativas por especial interés o utilidad municipal en IBI, IAE e IIVTNU. Análisis crítico a través del antecedente en el ICIO*, "Tributos Locales" 2014, No. 116, p. 7.

[9] Cf. *ibidem*, pp. 44 et seq.

[10] Cf. T. Calvo Salés, *Los beneficios fiscales en tributos locales bajo la lupa del TJUE*, "Consultor de los ayuntamientos y de los juzgados" 2019, No. 4 extra, Para. III.3.

These tax credits are not specifically designed to protect the environment. However, environmental damage has a social impact. Therefore, local authorities could use them to promote environmental protection as long as their social impact is justified. Some cities have followed this path in the tax on constructions (ICIO).

3. Use of levies other than taxes for environmental goals

3.1. Charges

The regulation of charges in the Act on Local Finances (LHL) does not refer to protecting the environment, although it offers various possibilities by providing environmental-related services or controls: vehicle parking fees (Art. 20(3)(u)), rural nursery (Art. 20(4)(d)), special surveillance (Art. 20(4)(f)), granting of urban planning licenses or administrative control activities (Art. 20(4)(h)), licenses to open a business (Art. 20(4)(i)), sanitary inspection services (Art. 20(4)(1)), sewerage and wastewater treatment services (Art. 20(3)(4)), collection of solid urban waste and its treatment and disposal (Art. 20(4)(s)).

Also, literature has proposed higher rates for intensive polluters regarding waste or sewerage charges.[11] According to the Supreme Court, local entities can only introduce non-fiscal purposes in taxes to the extent that there is an explicit or *implicit* legal authorization.[12]

3.2. Fees

We can apply analogue reasoning to the fees mentioned in Art. 20(6) LHL (related to waste collection, sewage, water supply, etc.), when the city provides services through a private legal status or administrative franchises.[13]

[11] I. Puig Ventosa, *El uso de instrumentos económicos para potenciar las energías renovables y el ahorro energético desde el ámbito local*, "Conferencia Europea sobre Gestión Energética en la Administración Local", Sevilla, 26 March 2003, pp. 4 et seq., https://ent.cat/el-uso-de-instrumentos-economicos-para-potenciar-las-energias-renovables-y-el-ahorro-energetico-desde-el-ambito-local/?lang=es (accessed: 29.03.2021); C. Galarza, *Las Haciendas*…, Para. III.3.6.

[12] ES, Supreme Court, judgment, 22 May 2019, case No. 1800/2017.

[13] Cf. A. Tandazo Rodríguez, P.M. Herrera Molina, *Una nueva parafiscalidad: Constitucionalidad de las tarifas como prestaciones patrimoniales de carácter público*, "Tributos Locales" 2019, No. 142, pp. 29 et seq.

3.3. Special contributions

So-called "special contributions" (*Beiträge* in German) are compulsory payments to finance public works or implement or expand public services.

They offer green possibilities when the public work or the relevant public service is related to protecting the environment or repairing environmental damage (Arts. 28 et seq. LHL). Legal literature suggests implementing special contributions to finance works required by the polluting activity of the taxpayer. An example will be the financing of public works for ground and water decontamination.

4. General assessment of the current legislation

In our opinion, the current legislation is inadequate. In particular, in the area of taxes, credits have a threefold limitation:

1. They are external to the fundamental tax design. It would be advisable to tax polluting activities and not only grant credits for less polluting activities.
2. They are optional for local authorities and, if applied, will reduce local tax revenue. Consequently, municipalities use them in a limited way (although we must recognize that all the provincial capitals have established some of the tax credits mentioned above).
3. The Act on Local Finances barely defines the requirements to implement the environmental tax credits. Therefore, local authorities find it challenging to design a proper regulation. Some cities have abused tax credits to introduce "tax havens" in the field of circulation taxes.[14]

The Commissions for the Spanish Tax System Reform (2014) and the Local Finances Reform (2017) have proposed to modulate the circulation tax based on the polluting emissions of the vehicles (CO_2, particles)[15] and to

[14] Cf. A. García Martínez, F. Vega Borrego, *El Impuesto sobre Vehículos de Tracción Mecánica*, [in:] D. Marín-Barnuevo Fabo, J. Ramallo Massanet (eds), *Los tributos locales*, Civitas, Madrid 2011, Para. 8.8.1; C. Banacloche Palao, *Algunas cuestiones en torno al IVTM a la luz del Informe de la Comisión de Expertos para la Revisión del Sistema de Financiación Local (julio 2017)*, [in:] P. Chico de la Cámara (ed.), *Aspectos de interés para una futura reforma de las Haciendas Locales*, Tirant lo Blanch, Valencia 2019, p. 118.

[15] M. Lagares et al., *Informe de la Comisión de Expertos sobre el Sistema Fiscal Español*, Ministerio de Hacienda, Madrid 2014, p. 331; A. Muñoz Merino et al., *Informe de la Comisión de Expertos para la Revisión del Modelo de Financiación Local*, Ministerio de Hacienda, Madrid 2017, p. 42.

introduce a municipal tourist tax related to preserving the environment.[16] However, the legislator has not embraced such proposals.

Regarding charges and special contributions, the provisions of the Act on Local Finances are also inadequate. In theory, they offer a great deal of flexibility to local authorities. In practice, many small municipalities lack the means to prepare a proper regulation that will withstand court challenges. It would be advisable to have more detailed legislation that would offer legal certainty to both local entities and taxpayers.

5. Regional environmental taxes

Given the central powers' inaction, regional parliaments have introduced environmental taxes, which probably would make more sense at a local level.

As some examples, we can mention:

1) several regional taxes on large stores[17] (which have been accepted by the Spanish Constitutional Court[18] and the European Court of Justice[19]);

2) the Catalan tax on CO_2 emissions from motor vehicles (which has also been declared constitutional)[20];

3) the Catalan and Balearic taxes on tourist stays (one of whose goals is to tackle the "former excessive exploitation of territorial and environmental resources").

We must also mention the "compensatory levy"[21] established by the Autonomous Community of Andalusia on the construction of wind and solar parks. The tax revenue is transferred to the municipalities.

According to the Spanish constitutional framework, some of these levies might be turned into municipal taxes by the Central Parliament, establishing adequate compensation to the affected autonomous communities. However, it will not be easy from a political point of view.

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[16] A. Muñoz Merino et al., *Informe…*, p. 42.

[17] A. del Blanco García, P.M. Herrera Molina, *El impuesto sobre grandes establecimientos comerciales y el Derecho europeo*, "Rivista di Diritto Tributario Internazionale" 2018, No. 3, pp. 7 et seq.

[18] Cf. ES, Constitutional Court, judgment, 5 June 2012, No. 122.

[19] CJEU, judgment, 26 April 2018, *ANGED*, C233/16.

[20] A. Tandazo Rodríguez, P.M. Herrera Molina, *Constitucionalidad y comentario crítico del impuesto catalán sobre emisiones de dióxido de carbono de los vehículos de tracción mecánica Análisis de la STC 87/2019, de 20 de junio*, "Revista de Contabilidad y Tributación" 2020, No. 44, pp. 99 et seq.

[21] J. Carpizo Vergareche, *La fiscalidad energética autonómica y local: Problemática y posibles soluciones*, "Estudios sobre la Economía Española" 2019, No. 21, p. 8.

6. Conclusions

The current local tax model is in crisis. Some examples are the tax on economic activities (which currently only applies to large companies) and the tax on the increase in the value of land (which the Constitutional Court has declared unconstitutional.[22]

On the other hand, local authorities are in an excellent position to deal with specific environmental problems, given their proximity to pollution sources. Administrative measures (limitation of vehicle entry to city centres) may be necessary. Still, they are insufficient and must be coordinated with economic instruments such as environmental taxes and environmental tax credits.

Since 1998, the central legislator has introduced optional tax credits with environmental goals in the Act on Local Finances. They are optional, meaning that it is up to the local municipal governments to implement them and approve the detailed regulation.

Local charges and fees could also include environmental goals through increased tax rates for intensive pollutants. Legal reforms would be advisable to promote the implementation of environmental charges, fees, and so-called special contributions.

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[22] ES, Constitutional Court, judgment, 11 May 2017, no. 59; ES, Constitutional Court, judgment 31 October 2019, No. 126; ES, Constitutional Court, judgment 26 October 2021, No. 182. Cf. C. Palao Taboada, *Por qué yerra el Tribunal Constitucional en las sentencias sobre el IIVTNU*, "Nueva Fiscalidad" 2017, No. 2, p. 23.

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Tandazo Rodríguez A., Herrera Molina P.M., *Una nueva parafiscalidad: Constitucionalidad de las tarifas como prestaciones patrimoniales de carácter público*, "Tributos Locales" 2019, No. 142.

Abstract

Spanish local taxes and charges are not adequately designed to protect the environment. Nevertheless, most of them include tax credits to foster environmentally friendly activities (e.g. installation of solar panels or acquisition of electric vehicles). Our paper deals with the current legislation and proposes reforms to improve the environmental role of local taxes and charges.

Keywords: local taxes, environmental taxes and charges, tax incentives

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Michael Lang[1]

Interpretation of Double Taxation Conventions – The Judgement of the German Federal Fiscal Court (*Bundesfinanzhof*) in the Light Designer Case

1. The judgement of the German *Bundesfinanzhof* of 11 July 2018 (I R 44/16)

Włodzimierz Nykiel is one of those Polish tax law scholars who is very present on the international scene and is also one of the most recognisable faces of Polish tax law around the world. He himself was a pioneer in the field, and it is partly to his credit that many Polish tax law experts today are outstandingly well-connected with their colleagues on an international level. Moreover, he has established numerous contacts around the world on behalf of his own university. One of his fundamental beliefs is that the future lies in international cooperation, not in national isolation. Meanwhile, the two of us are bound by a decade-long, intensive friendly collaboration on several levels: the tax law institutes of our universities are members of the EUCOTAX group, and my colleagues and I have often travelled to Lodz for lectures and conferences. Vice versa, we frequently invite Włodzimierz to come and deliver lectures on topics of international tax law at the Vienna University of Economics and Business (WU). Furthermore, we have both been members of the Board of Trustees of the IBFD in Amsterdam for several years.

[1] Prof. Dr. DDr. h.c. Michael Lang is head of the Institute for Austrian and International Tax Law of WU and academic director both of the LL.M. program in International Tax Law and of the doctoral program in International Business Taxation (DIBT) of this university. The author would like to thank Yasmin Lawson for her valuable support.

We also share a great interest in issues of double taxation conventions. Therefore, I wish to use the occasion of the milestone birthday of my friend and colleague to address the principles of interpretation of double tax conventions. The Festschrift published in 2018 to celebrate the 100th anniversary of the German Supreme Tax Court (*Bundesfinanzhof*, formerly *Reichsfinanzhof*) gave me the opportunity to examine the development of German case law in the field of interpretation and application of double tax conventions.[2] After completing my contribution for the said paper, the judgement of the *Bundesfinanzhof* of 11 July 2018, I R 44/16 was published, introducing additional aspects to German case law on DTCs. I wish to present and analyse this judgement here, also in order to make it better known to the international tax law community. I do so in the firm belief that courts are by their very nature not bound to the judgements rendered in other states, but that they are well-advised to consider them in the reasoning of their decisions on similar legal issues, and to either follow their example or explain why they opt for a different approach. I share this belief with Włodzimierz Nykiel, whom I hold in high regard. I hope he will be pleased with my contribution.

The facts on which the decision of the *Bundesfinanzhof* were based are quickly told: The taxpayer is resident in Germany. He works as a light designer in different opera houses outside Germany (Belgium, Denmark, France, Italy, Spain, Sweden, Switzerland, and Japan). His employer statements from France, Sweden, and Switzerland show that the taxpayer receives income from employment there. The German Tax Office has classified the work of the light designer under German tax law as independent activities.[3] The question presented before the *Bundesfinanzhof* was how to qualify the income from these three states according to the three double taxation conventions.

2. No solution of qualification conflicts through Art. 23 A Para. 2 OECD MC for DTCs concluded before 2000

In view of the fact that the three aforementioned source states do classify the income as employment income, but that such income is considered income from independent activities under German tax law, the question

[2] M. Lang, *Auslegung und Anwendung von Doppelbesteuerungsabkommen*, [in:] K. Drüen, J. Hey, R. Mellinghoff (eds), *100 Jahre Steuerrechtsprechung in Deutschland: Festschrift für den Bundesfinanzhof*, Verlag Dr. Otto Schmidt, Köln 2018, pp. 983 et seq.

[3] About the preceding case in front of the Finanzgericht Berlin-Brandenburg, 16 July 2015, 15 K 1093/10: A. Cloer, N. Niedermeyer, *Die Qualifikation der Tätigkeit im Quellenstaat ist für deutsche Finanzbehörden bindend*, "Deutsches Steuerrecht kurzgefaßt" 2017, No. 11, pp. 176 et seq.

arose as to whether the qualification in the source state is relevant for the application of the DTC in the state of residence. Since 2000, the Commentary of the OECD Fiscal Committee on the OECD Model Convention takes the view that, according to Art. 23A Para. 1 OECD MC, the state of residence is bound to the assessment in the source state for tax convention purposes.[4]

The *Bundesfinanzhof* has – once again[5] – rejected this view:[6] "For the DTC with Sweden, which has remained unchanged despite the new version of the OECD Model Commentary, this conclusion already follows from the existing case-law. The Senate has already rejected the assumption of a commitment to the source state's qualification (*Qualifikationsverkettung*) for existing DTCs without a corresponding treaty-based order […] The fact that Art. 23A Para. 1 OECD MC requires the exemption in the state of residence of income which 'in accordance with the provisions of this Convention, may be taxed in the other Contracting State', does not result in the state of residence being bound to the qualification in the source state." In my opinion, this view is conclusive:[7] The quoted formulation in the convention hinges on whether, according to this convention, the income *may be taxed in the other Contracting State*. Art. 23A Para. 1 OECD MC does not require that *the tax authorities* of the other Contracting State hold the view that they may tax.[8]

The subsequent reasoning of the German *Bundesfinanzhof*, however, is not convincing:[9] "Instead, one should, also in the light of this Method Article, consider the question as to the 'ability to tax' in conformity with Art. 3 Para. 2 OECD Model Convention, and thus according to the (national) law of the taxpayer's state of residence – the so-called applying state […]." This is because Art. 3 Para. 2 OECD Model Convention primarily requires an

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[4] OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, 18 December 2017, p. 317, Para. 34.

[5] Previous rulings: DE, Bundesfinanzhof, judgement, 29 August 1984, I R 68/81, Para. 1; DE, Bundesfinanzhof, judgement, 12 July 1989, I R 46/85, Para. 3; DE, Bundesfinanzhof, 29 October 1997, I R 35/96, II Para. 2; DE, Bundesfinanzhof, order, 4 April 2007, I R 110/05, Para. 13; DE, Bundesfinanzhof, judgment, 25 May 2011, I R 95/10, Para. 16; DE, Bundesfinanzhof, order, 13 November 2013, I R 67/12, Para. 16.

[6] DE, Bundesfinanzhof, judgement, 11 July 2018, I R 44/16, Para. 16.

[7] Already M. Lang, *Die Bedeutung des innerstaatlichen Rechts für die DBA-Auslegung*, [in:] G. Burmeister, D. Endres (eds), *Aussensteuerrecht, Doppelbesteuerungsabkommen und EU-Recht im Spannungsverhältnis: Festschrift für Helmut Debatin zum 70. Geburstag*, C.H. Beck, München 1997, p. 287; M. Lang, *Auslegung*…, p. 996.

[8] Similarly also K. Schulz-Trieglaff, *Zulässigkeit einer Qualifikationsverkettung auch ohne entsprechende Anordnung in den Verteilungsnormen*, "Internationales Steuerrecht" 2018, No. 9, p. 344.

[9] DE, Bundesfinanzhof, judgement, 11 July 2018, I R 44/16, Para. 16.

interpretation from the context of the convention.[10] The *Bundesfinanzhof* should have taken this approach, and I shall return to this point later.

On the other hand, the additional reasoning of the *Bundesfinanzhof* as to why it cannot follow the view held in the OECD Commentary since 2000 for previously concluded DTCs is conclusive:[11] "Moreover, it is contrary to the adjudication practice of the Senate to attach – for the sake of a dynamic convention interpretation – a dispute-settling significance to the later development or amendment of OECD statements for the understanding of already negotiated conventions for the avoidance of double taxation […]".

The *Bundesfinanzhof* extends this view also to those conventions that were concluded before 2000 and revised after 2000, but which remain unchanged as regards the provision modelled on Art. 23A Para. 1 OECD MC. One may per se take the stand that, as part of an amendment of the convention, the Contracting States could subsequently adopt the positions set out in the OECD Commentary also in other parts of the convention. This stand, however, would not be very compelling.[12] Therefore, one must agree with the following reasoning of the *Bundesfinanzhof*:[13] "In addition, a commitment to the source state's qualification (*Qualifikationsverkettung*) must also be dismissed with regard to the DTC with France and the DTC with Switzerland. In particular, the Senate cannot subscribe to the view of the plaintiff that these conventions should be interpreted according to the new version of the OECD Model Commentary simply because – albeit without a positive order for a commitment to the source state's qualification (*Qualifikationsverkettung*) – they were promptly modified after the new version of the Commentary by the Law on the Complementary Convention of 20 December 2001 between the Government of the Federal Republic of Germany and the Government of the French Republic on the DTC with France (Federal Law Gazette II 2002, 2370, Federal Law Gazette I 2002, 891) and by the Law on the Revision Protocol of 12 March 2002 on the DTC with Switzerland (Federal Law Gazette II 2003, 67, Federal Law Gazette I 2003, 165) […]".

[10] To that most recently M. Lang, *Tax Treaty Interpretation – A Response to John Avery Jones*, "Bulletin for International Taxation" 2020, No. 11, p. 660.

[11] DE, Bundesfinanzhof, judgement, 11 July 2018, I R 44/16, Para. 16.

[12] M. Lang, *Die Bedeutung des Musterabkommens und des Kommentars des OECD-Steuerausschusses für die Auslegung von Doppelbesteuerungsabkommen*, [in:] W. Gassner, M. Lang, E. Lechner (eds), *Aktuelle Entwicklungen im Internationalen Steuerrecht*, Linde Verlag, Wien 1994, pp. 24 et seq.; *idem*, *Die Auslegung von Doppelbesteuerungsabkommen in der Rechtsprechung der Höchstgerichte Österreichs*, [in:] M. Lang, J.M. Mössner, R. Waldburger (eds), *Die Auslegung von Doppelbesteuerungsabkommen in der Rechtsprechung der Höchstgerichte Deutschlands, der Schweiz und Österreichs*, Linde Verlag, Wien 1998, p. 123.

[13] DE, Bundesfinanzhof, judgement, 11 July 2018, I R 44/16, Para. 17.

It is interesting that the *Bundesfinanzhof* also considers whether the later OECD Commentary can nevertheless – as an expression of "practice" – be used for the interpretation of previously concluded conventions. First, the *Bundesfinanzhof* describes the importance of practice in the interpretation of international law treaties:[14] "One must start out from Article 31 of the Vienna Convention on the Law of Treaties of 23 May 1969 – VCLT – […], where according to Paragraph 1 'a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose […]". Similarly, in addition to the systematic 'context' described in more detail in Art. 31 Para. 2 VCLT, according to Art. 3 Para. 3 VCLT any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions (a) as well as any subsequent practice in the application of the treaty which establishes the consensus of the parties regarding its interpretation (b) must be equally taken into account. Correspondingly, a shared understanding of the convention and a common 'practice' of the participating tax administrations can be of significance for the interpretation of the convention […] Finally, according to Art. 31 Para. 4 VCLT, "special meaning shall be given to a term as interpretative guidance if it is established that the parties so intended." The *Bundesfinanzhof* thus takes the opportunity to relativise the meaning of "later practice" right from the outset. The fact that it once again argues – as it usually does in its case law on DTCs[15] – that its interpretation is limited by the meaning of the letters of the law is problematic: such an absolute limit to interpretation is not intrinsic to international law interpretation or to any other interpretation.[16]

The *Bundesfinanzhof* subsequently stresses that it had already ruled in the past that a view expressed in the OECD Commentary cannot justify a "subsequent practice" to be taken into consideration, but that it merely constitutes the opinion of the participating tax administrations, and that it can leave the question open at this point.[17] The *Bundesfinanzhof* hints that only the specific application of the convention is relevant in later practice, which in the dispute under consideration has led to a rejection by the Tax

[14] *Ibidem*, Para. 18.

[15] DE, Bundesfinanzhof, judgement, 20 August 2008, I R 39/07, Para. 18; DE, Bundesfinanzhof, judgement, 2 September 2009, I R 90/08, Para. 20; DE, Bundesfinanzhof, judgement, 2 September 2009, I R 111/08, Para. 16; DE, Bundesfinanzhof, judgement, 12 October 2011, I R 15/11, Para. 16; DE, Bundesfinanzhof, judgement, 13 June 2012, I R 41/11, Para. 16; DE, Bundesfinanzhof, judgement, 10 June 2015, I R 79/13, Para. 16; DE, Bundesfinanzhof, judgement, 30 May 2018, I R 62/16, Para. 23.

[16] For a detailed critique see: M. Lang, *Auslegung*…, p. 1007.

[17] DE, Bundesfinanzhof, judgement, 11 July 2018, I R 44/16, Para. 20.

Office of Germany's obligation to comply with the foreign tax certificate.[18] The *Bundesfinanzhof* leaves these questions open, since "for the judiciary – especially in view of the principle of the separation of powers – only the text and context of the convention are relevant […], and any deviation can only apply if the (alleged) 'subsequent agreements of the Contracting States' or 'bilateral practices' find expression in an amended convention and a corresponding transformation law […]"[19].

The *Bundesfinanzhof* thus attaches importance only to the text and context of the convention. The "bilateral practices" – obviously referring to the "subsequent practice" of Art. 32 Para. 3 VCLT – as well as the "subsequent agreements between the Contracting States" must thus only be taken into account if they are reflected in an amended convention. As a result, however, the *Bundesfinanzhof* comes to the conclusion that subsequent practice and subsequent agreements are not at all relevant for the interpretation, since if the agreement itself was amended – and a corresponding transformation law was adopted – it is no longer about the interpretation of the previous agreement.

The *Bundesfinanzhof* already mentioned the "principle of the separation of powers" in the said passage, thus stressing the relevance of national constitutional law. It subsequently draws on further constitutional arguments for the following consideration:[20] "It follows from these constitutional principles that the agreement reached between the tax administrations – according to which a subsequent agreement of the Contracting States would be relevant for the interpretation of the convention (in the form of the OECD Model Commentary) – cannot result in an international law treaty assuming a different meaning than the one intended in the legal domestic act which approves the international treaty (*Zustimmungsgesetz*) […]".

The reasoning of the *Bundesfinanzhof*, rooted in German constitutional law, is not very convincing: The rules for the interpretation of international law expressed in the VCLT are derived from international law, and cannot be modified by the national constitutional law of a contracting state. When the *Bundesfinanzhof* stresses the meaning that "an international law treaty assumes for national law",[21] it obviously suggests that it considers it possible that the meaning of the agreement according to the international law treaty may differ from the one under the approval law (*Zustimmungsgesetz*), which belongs to German national law and which transforms the international law treaty into national law. This, too, is problematic: The validity of the

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18 *Ibidem*.
19 *Ibidem*.
20 *Ibidem*, Para. 22.
21 DE, Bundesfinanzhof, judgement, 11 July 2018, I R 44/16, Para. 22.

international law treaty may differ, or the latter may cease to be applicable at the national level. The meaning of the international law treaty, however, remains the same.[22] This is independent of the form of incorporation of international treaties in national law[23] and of whether the relationship between international law and national law is interpreted on the basis of monistic or dualistic theories.[24]

Ultimately, however, the *Bundesfinanzhof* is right: Interpretation is not a schematic or formalised process.[25] The objective is to determine the meaning of the provision. In international treaties, the importance of "subsequent practice" may vary. In the case of tax treaties, its importance is a priori limited. Considerations with regard to the separation of powers play a role here. The reason, however, does not lie in German constitutional law, but in the fact that numerous constitutional legal systems are founded on such principles, which are significant in many states, especially in legal areas like tax law.[26] Therefore, one should generally not expect from double taxation conventions to leave a lot of room for subsequent practice. The fact that these treaties do not only govern the legal relations between two states but also have an impact on third parties – i.e., the taxpayers – and their legal position must be predictable which further reduces the significance of subsequent practice.[27] Constant practice, however – as the *Bundesfinanzhof* itself suggests *en passant*[28] – is predominantly shaped by decisions of authorities and courts which specifically apply the DTC.[29] These do not include the representatives of the finance ministries, who regularly modify the Commentary to the OECD Model Convention within the framework of the OECD. Therefore, there is no reason to use a more recent Commentary of the OECD Fiscal Committee for the interpretation of previously concluded DTCs.[30]

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[22] See: M. Lang, *Doppelbesteuerungsabkommen und innerstaatliches Recht*, Wirtschaftsverlag Dr. Anton Orac, Wien 1992, p. 22.

[23] *Ibidem*, p. 21.

[24] *Ibidem*, p. 21 et seq.; G. Frotscher, *Internationales Steuerrecht*, C.H. Beck, München 2020, Para. 239.

[25] M. Lang, *Die Bedeutung des Musterabkommens…*, p. 21.

[26] On this topic M. Lang, *Doppelbesteuerungsabkommen…*, p. 90; D. Gosch, *Über die Auslegung von Doppelbesteuerungsabkommen*, "Internationales Steuerrecht" 2013, p. 92; M. Lang, *Die Bedeutung des OECD-Kommentars und der Reservations, Observations und Positions für die DBA-Auslegung*, [in:] J. Lüdicke, R. Mellinghoff, T. Rödder (eds), *Nationale und internationale Unternehmensbesteuerung in der Rechtsordnung: Festschrift für Dietmar Gosch zum Ausscheiden aus dem Richteramt*, C.H. Beck, München 2016, p. 239.

[27] M. Lang, *Bedeutung des Musterabkommens…*, p. 28.

[28] DE, Bundesfinanzhof, judgement, 11 July 2018, I R 44/16, Para. 23.

[29] In more detail M. Lang, *Die Bedeutung des Musterabkommens…*, pp. 26 et seq.

[30] Already *ibidem*, p. 39; M. Lang, *Seminar B, Teil 2: Das OECD-Musterabkommen – 2001 und darüber hinaus: Welche Bedeutung haben die nach Abschluss eines Doppelbesteuerungsabkommens erfolgten Änderungen des OECD-Kommentars?*, „Internationales Steuerrecht" 2001, No. 17,

3. No solution of qualification conflicts through Art. 23 A Para. 1 OECD MC for DTCs concluded since 2000

The judgement of the *Bundesfinanzhof* also includes statements on the significance of the version of the OECD Commentary that had already existed at the time of the conclusion of the treaty:[31] "Although the OECD Commentary can be significant for the interpretation of treaties concluded later, it is by no means on the same level with the international law rule subject to interpretation. Its importance is rather similar to that of legal materials used in interpreting national law, so it cannot be ruled out that the intentions of the 'commentators' are not reflected in the text of the law, or that they are supplanted by overriding systematic or teleological considerations."

These arguments are conclusive: One should not overestimate the importance of the OECD Commentary for the interpretation of treaties concluded at a later stage. At times, the relevant literature almost gives the impression that it is the OECD Commentary to be interpreted, and not the treaty itself. The parallel drawn with the law materials is to the point:[32] They are just one of several tools of interpretation, and they must often take a back seat to systematic and teleological arguments. Occasionally, individual passages in the law materials simply prove to be flawed. Equally, arguments in the OECD Commentary may suffer the same fate.

The *Bundesfinanzhof* emphasises that, even in the case of an amendment to a treaty after publication of a new version of the OECD Commentary, this version of the OECD Commentary is not relevant if the treaty provision itself has not changed:[33] "If the issue at hand is the interpretation of the treaty or the transformation law, it is crucial for the pending proceedings that the already existing method articles have not been amended – in the passages relevant for the dispute under consideration – by the Law on the Complementary Convention of 20 December 2001 between the Government of the Federal Republic of Germany and the Government of the French Republic on the DTC with France […] and by the Law on the Revision Protocol of 12 March 2002 on the DTC with Switzerland […]

p. 538; A. Schnitger, *Die Einbeziehung des OECD-Kommentars in der Rechtsprechung des BFH*, "Internationales Steuerrecht" 2002, No. 12, p. 408; R. Mellinghoff, *Heranziehung von OECD-Musterabkommen und -Musterkommentar*, [in:] C. Kaeser (ed.), *Doppelbesteuerung: Festgabe zum 75 Geburtstag von Franz Wassermeyer*, C.H. Beck, München 2015, p. 43; M. Lang, *Die Bedeutung des OECD-Kommentars*…, p. 240.

[31] DE, Bundesfinanzhof, judgement, 11 July 2018, I R 44/16, Para. 24.

[32] Already M. Lang, *Die Bedeutung des Musterabkommens*…, p. 22.

[33] DE, Bundesfinanzhof, judgement, 11 July 2018, I R 44/16, Para. 25.

Instead, the treaties were only modified elsewhere. Moreover, Switzerland had expressed a reservation to OECD Model Commentary No. 32 in OECD Model Commentary No. 81 on Article 23A OECD MC to the extent that the qualification conflict concerns the modification of national law after conclusion of the treaty. None of the two amendments contains any verifiable evidence that the Contracting States had intended a commitment to the source state's qualification (*Qualifikationsverkettung*)."

The additional argument put forward by the *Bundesfinanzhof* is also convincing:[34] When one of the two States issues an observation to a passage of the OECD Commentary, this points out to a disagreement over the meaning of the treaty provision already in 2000. For this reason, too, one cannot assume that, with the text of the treaty provision, the Contracting States also adopted the view held in the Commentary.

At the heart of this reasoning by the *Bundesfinanzhof*, however, is the consideration that the unchanged wording of a provision does not change its meaning through modified arguments in the OECD Commentary. This subsequently raises the question as to whether this conclusion changes in any way if a double taxation convention was newly concluded after 2000.[35] In this case, too, the provision of Art. 23A Para. 1 OECD MC has remained unchanged. Only the view held in the OECD Commentary on this provision has changed. When sufficiently strong arguments can be drawn in favour of a specific conclusion from the wording, the systematics, and the teleology of the unchanged rule, the new view held in the OECD Commentary will definitely take a back seat. It is questionable whether it can tip the scales in case of other conflicting arguments. Yet the *Bundesfinanzhof* did not have to address this question in the judgement under consideration.

The *Bundesfinanzhof* summarises its conclusion, also referring to the principle of harmonisation of decisions on an international level (*Entscheidungsharmonie*):[36] "On that basis, it cannot be questionable that the change of the OECD Model Commentary on issues of commitment to the source state's qualification (*Qualifikationsverkettung*) was not included in the treaties under consideration, and for the reasons outlined, it is thus also not suitable to bring about a meaning that is divergent from the previous, handed-down convention interpretation. The principle of harmonisation of decisions on an international level (*Entscheidungsharmonie*) cannot change

[34] DE, Bundesfinanzhof, judgement, 11 July 2018, I R 44/16, Para. 25; in greater detail already M. Lang, *Die Bedeutung des Musterabkommens…*, p. 20.

[35] This is taken into consideration by J. Schönfeld, N. Häck, *Article 23A*, [in:] J. Schönfeld, X. Ditz (eds), *Doppelbesteuerungsabkommen*, Verlag Dr. Otto Schmidt, Köln 2019, Para. 9.

[36] DE, Bundesfinanzhof, judgement, 11 July 2018, I R 44/16, Para. 26.

anything about that either. This principle does not in any way rule out that the treaty interpretation of the Contracting States will lead to qualification conflicts and that these will, if necessary, be settled or mitigated by way of a mutual agreement procedure […]". Here, too, the *Bundesfinanzhof* is right: This principle does not imply an obligation to subscribe to the view of the administrative authorities or courts on the convention provisions in the other Contracting States.[37] Rather, it suggests that one should examine the arguments that were used by courts of the Contracting States or even by those of other states.[38] The *Bundesfinanzhof* must be reproached, however, for not having considered such decisions at all.

4. The interpretation provision of Art. 3 Para. 2 OECD MC

The *Bundesfinanzhof* remanded the case to the lower court and instructed the latter to also examine the application of the convention provisions modelled on Art. 17 OECD MC:[39] "According to what is meanwhile well-established case law, […] the definition of entertainer in the DTC provisions modelled on Article 17 OECD MC, which – subject to Article 12 Para. 2 of the DTC with France, which merely covers the self-employment of entertainers – include those of the treaties concluded with the states in which the plaintiff was employed […], must be independently interpreted on the basis of the treaty if the DTC concerned provides a basis for it. The definitions of entertainer under the national law of the applying state – such as, for instance, the definition of artistic activity in Section 18 (1)(1)(2) and in Section 50a (4)(1)(1) of the Income Tax Act – are, by contrast, not relevant. On that point, it follows from an overall reading of the exemplary theatre, motion picture, radio or television artists, and musicians listed in Article 17 Para. 1 OECD MC and from the equation with athletes that eligibility does not depend on a particular artistic level

[37] Also J. Schönfeld, N. Häck, *Article 23A*, Para. 9.

[38] On the principle of harmonisation of decisions on an international level: D. Gosch, *Über die Auslegung…*, p. 87; M. Lehner, *Abkommensauslegung zwischen Autonomie und Bindung an das innerstaatliche Recht*, [in:] C. Kaeser (ed.), *Doppelbesteuerung: Festgabe zum 75 Geburtstag von Franz Wassermeyer*, C.H. Beck, München 2015, pp. 16 et seq; in more detail: H. Hahn, *Zur Auslegung von Doppelbesteuerungsabkommen: Der Grundsatz der Entscheidungsharmonie im Crash-Test*, [in:] R. Gocke, D. Gosch, M. Lang (eds), *Körperschaftssteuer, Internationales Steuerrecht, Doppelbesteuerung: Festschrift für Franz Wassermeyer zum 65 Geburtstag*, C.H. Beck, München 2005, p. 631.

[39] DE, Bundesfinanzhof, judgement, 11 July 2018, I R 44/16, Para. 28.

or a specific degree of original creativity. Instead, the relevant factor is whether it is a personal (e.g.) performing activity that primarily serves the audience's artistic enjoyment or merely its entertainment […] An artistic activity requires that the entertainer performs in public either directly or indirectly through media; accordingly, it is essential that the remunerated activities are directly linked to a performance before an audience […] Accordingly, Article 17 Para. 1 OECD MC does not cover remunerations for scene painters […] or directors and set designers […], who are engaged in a creative activity. The differentiation from an artistic activity within the meaning of Article 17 Para. 1 OECD MC must be made according to whether the main activity of the artist relates to the work itself or to the creation of the same before the audience […]". The *Bundesfinanzhof* thus not only stressed the independent interpretation of the definition of entertainer on the basis of the treaty – detached from the respective national law – but also demonstrated the approach to be taken.

It is all the more regrettable that the *Bundesfinanzhof* took a different approach in the interpretation of the definition of employment (Art. 15 OECD MC):[40] "Subject to Article 13 (1) DTC with France, Article 15 Para. 1 DTC with Sweden, and Article 15 Para. 1 DTC with Switzerland, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. The convention provisions do not define the terms "employed", "employment" or "remunerations". Therefore, the Senate […] assumed that according to Article 3 Para. 2 OECD MC, Article 2 Para. 2 DTC with France, Article 3 Para. 2(2) DTC with Sweden, and Article 3 Para. 2 DTC with Switzerland, from the point of view of Germany as the applying state, they must be interpreted through recourse to Section 19 Income Tax Act, and to Section 2 of the Implementing Decision concerning Wages Tax. The Senate had already previously ruled […] that the question as to whether income from independent activities or employment is involved was subject to German law (also) for the interpretation of a DTC, since the DTCs do not contain any rules on the differentiation between types of income. The same applies to the relevant convention provisions in the proceedings pending […]".

One must concede to the *Bundesfinanzhof* that the interpretation of the term "entertainer" from the context of the convention seems easier at first glance: Art. 17 Para. 1 OECD MC itself contains examples that already provide rough outlines of the term. The distinction between independent

[40] DE, Bundesfinanzhof, judgement, 11 July 2018, I R 44/16, Para. 13.

activities and employment, however, pervades the entire OECD MC, so that systematic arguments can be deduced here as well.[41] The more demanding interpretation required here should not prompt a court to give up prematurely. The price to pay for this are qualification conflicts, for whose solution the convention – as the *Bundesfinanzhof* itself rightly highlights – does not provide any basis.

Even so, the *Bundesfinanzhof* convincingly answered the question as to the tax law of which State should be subsidiarily relevant according to Art. 3 Para. 2 OECD MC: Unless the context otherwise requires, one must resort to the national law of the applying state. The *Bundesfinanzhof* did not follow the view held by John F. Avery Jones that according to Art. 3 Para. 2 OECD MC only the source state applies the convention.[42] From the German point of view, the applying state of the convention is Germany, as the state of residence.[43]

5. Concluding summary

202 In its judgement of 11 July 2018, I R 44/16, the *Bundesfinanzhof* confirmed that Art. 23A Para. 4 OECD MC does not provide a basis for the settlement of qualification conflicts: This provision does not oblige the state of residence to follow the assessment in the source state. Moreover, the *Bundesfinanzhof* made it clear that the OECD Commentary is of no significance at all for the interpretation of previously concluded DTCs, and that its relevance for DTCs concluded later is also limited: Similar to legal materials in national law, it is important whether the views held in the Commentary are reflected in the text of the treaty, how clear and consistent the view held in the Commentary is, and which arguments can be derived from the systematics and teleology of the convention provisions. Although some of the arguments put forward by the *Bundesfinanzhof* prove to be problematic, there are other arguments in favour of the position taken by the *Bundesfinanzhof*, so that it is conclusive as a whole.

[41] For more details see: M. Lang, U. Zieseritsch, *Der Begriff der unselbstständigen Arbeit nach Art 15 OECD-MA*, [in:] W. Gassner, M. Lang, E. Lechner, J. Schuch, C. Staringer (eds), *Arbeitnehmer im Recht der Doppelbesteuerungsabkommen*, Linde Verlag, Wien 2003, pp. 44 et seq.; to some extent also – though not consistently – F. Wassermeyer, M. Schwenke, *Article 15*, [in:] F. Wassermeyer (ed.), *DBA*, C.H. Beck, München 2020, Para. 63.

[42] Most recently J.F. Avery Jones, *A Fresh Look at Article 3(2) of the OECD Model*, "Bulletin for International Taxation" 2020, No. 11, p. 659.

[43] To this effect also M. Lang, *Auslegung…*, p. 994.

Qualification conflicts can be best avoided through autonomous interpretation: The more the courts and other legal practitioners in the Contracting States focus their attention on interpreting the convention provisions from their context and leave aside their own national law in the process, the greater the odds are that they will reach concordant results across borders. The *Bundesfinanzhof* confirmed the principle of autonomous interpretation based on the example of Art. 17 OECD MC. It is unfortunate that the *Bundesfinanzhof* did not attempt in the same judgement to also establish the distinction between independent activities and employment from the convention itself, but hastily resorted to national law instead.[44]

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[44] See also: R. Ismer, S. Piotrowski, *Internationale Streitbeilegung in Steuersachen und innerstaatliches Verfassungsrecht: Auf zu gerichtsförmigen Verfahren!*, "Internationales Steuerrecht" 2019, No. 21, p. 849 who discuss this case and convincingly take the view that international arbitration boards would tend to prefer an autonomous interpretation.

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Abstract

In its judgement of 11 July 2018, I R 44/16, the German Bundesfinanzhof had to qualify income from a German resident arising from his activities as light designer in three different countries according to the respective DTCs. This gave the court the opportunity to consider the framework for solving qualification conflicts, in particular the view that Art. 23A Para. 1 OECD MC binds the state of residence to the assessment of the source state (*Qualifikationsverkettung*). This was, in conformity with its earlier jurisprudence, rejected by the court. However, this approach was included in the OECD Commentary in the year 2000. The court therefore also discussed the effect of the updated Commentary on treaties concluded before and after its adoption respectively. It held that this change to the Commentary has definitely no effect on treaties concluded before 2000. The court could leave it open whether the position articulated in the updated Commentary might have effects on the interpretation of new treaties. This contribution will examine this judgement in detail, providing an analysis of qualification conflicts and a critical appraisal of the court's solution.

Keywords: double taxation treaty (DTC), qualification conflicts, autonomous interpretation, commentary, *Qualifikationsverkettung*

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Jörg Manfred Mössner[1]

Interpretation of Double Tax Convention – a Still Controversial Topic

1. Introduction

It was years ago when I first met the highly estimated colleague Prof. Nykiel. During the years I could observe his success in building up the science of tax law in Poland. One can only admire what is now the situation in Poland. In his honour, I dedicate some thoughts on a topic on that I have been working on for more than thirty years.

It is a strange situation: Art. 3 Para. 2 OECD Model Convention contains rules for the interpretation of double tax conventions (DTCs) in order to avoid controversies in the application of a DTC; but Art. 3 Para. 2 OECD Model itself is subject of a controversial[2] interpretation since the

[1] Prof. (em.) Dr. Jörg Manfred Mössner, University of Osnabrück.

[2] See: J. Avery Jones, *A fresh look at Art. 3(2) of the OECD Model*, "IBFD" 2020, No. 11, https://research.ibfd.org/#/doc?url=/collections/bit/html/bit_2020_11_o2_2.html (accessed: 10.07.2012); M. Lang, *Tax treaty interpretation – a response to John F. Avery Jones*, "IBFD" 2020, No. 11, https://research.ibfd.org/#/doc?url=/collections/bit/html/bit_2020_11_o2_1.html (accessed: 10.07.2021); J.M. Mössner, *Auslegung von Doppelbesteuerungsabkommen – Auf ein Neues!*, [in:] D. Gosch, A. Schnitger, W. Schön (eds), *Festschrift für Jürgen Lüdicke*, C.H. Beck, München 2019, p. 485; *idem*, *Zur Auslegung von Doppelbesteuerungsabkommen*, [in:] K.H. Böckstiegel, H.E. Folz, J.M. Mössner, K. Zemanek, *Völkerecht, Recht der Internationalen Organisationen, Weltwirtschaftsrecht (Festschrift Ignaz-Seidl-Hohenveldern)*, Carl Heymanns, Köln 1988, p. 403; A. Rust, *Art. 3*, [in:] A. Reimer, E. Rust (eds), *Klaus Vogel on double Tax Conventions*, 4th ed., Kluwer Law International, Alphen aan den Rijn 2015, p. 207 et seq.; M. Lehner, *Die autonome Auslegung von Doppelbesteuerungsabkommen im Kontext des Art. 3 Abs. 2 OECD-MA*, [in:] J. Lüdicke, J.M. Mössner, L. Hummel (eds), *Das Steuerrecht der Unternehmen (Festschrift Frotscher)*, Haufe-Gruppe, Freiburg 2013, p. 383; K. Vogel, M. Lehner, *Doppelbesteuerungsabkommen: DBA*, 7th ed., C.H. Beck, Munich 2021, Art. 3, No. 97 et seq.; J. Avery Jones, *Qualification conflicts: the meaning of application in art. 3(2)*

time when the rule was inserted into the OECD Model.[3] One thing seems accepted: Art. 3 Para. 2 OECD Model has to be interpreted according to the rules of treaty interpretation as codified in the Vienna Convention of Treaties.[4]

In section three of this convention, the rules (Arts. 31–33) deal with the interpretation. The fundamental rule is found in Art. 31 Para. 1: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

Three elements are to be respected according to this rule:

1) the ordinary meaning of the terms,
2) the context, and
3) its object and purpose.

Art. 31 Para. 2 defines the context as the textual and legal environment in which the treaty is embedded. This means that the interpretation of an article of a treaty must take into account the meaning of this article in the light of other articles and the functioning of the whole legal instrument. The interpretation cannot be restricted to the article itself.

The ordinary meaning of a term is the linguistic approach, object, and purpose that leads to a teleological interpretation. And finally: What are the effects of the one or the other possible interpretation in the light of the whole treaty.

2. Linguistic interpretation of Art. 3 Para. 2 OECD Model Convention

The wording of Art. 3 Para. 2 runs as follows:

"As regard the application of the convention at any time by a contracting state, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at the time under the law of the state for the purposes of taxes to which the convention applies,

of the OECD Model, [in:] H. Beisse, M. Lutter, H. Närger (eds), *Festschrift fűr Karl Beusch zum 68. Geburtstag am 31. Oktober 1993*, Walter de Gruyter, Berlin–New York 1993, p. 43 et seq.

[3] For the history of the rule see: J. Avery Jones, *The interpretation of tax treaties with Particular Reference to Article 3(2) of the OECD Model – II*, BTR 1984, 14 et seq., 90 et seq., https://heinonline.org/HOL/LandingPage?handle=hein.journals/britaxrv1984&div=18&id=&page= (accessed: 10.07.2021).

[4] Vienna Convention on the Law of Treaties, 1969, Arts. 31–33 (quoted as Vienna Convention).

any meaning under the applicable tax laws of that state prevailing over a meaning given to the term under other law of that state."

One thing seems undisputable: the "terms" are the terms of tax law. But besides this, the questions arise: What is the application of the convention and who applies the convention? What is the function of "unless"? What is the "context"?

Let us take a simple example: A – resident of State X – is employed by an enterprise and works in State Y. He has an employment treaty for 10 years. After 7 years the enterprise undergoes a reorganisation and has no further need for the services of A. In a treaty, A and the enterprise agree that A leaves the enterprise and receives a severance payment. Which state has the right to tax this severance payment, X or Y? We assume that such payments according to the tax law of Y are taxed as a part of the salary paid to A, and under the tax law of X, this payment is taxed as other income.

3. The applying State

John Avery Jones[5] sees only the state of origin as the state which applies the convention.

The first question is: What does it mean to apply the tax convention? A legal norm is applied by a legal entity which is the addressee of the norm and whose legal position is touched. Avery Jones has several times stressed that the Arts. 6–22 OECD Model only concern the state of origin. States have by their sovereign position the right under international law to tax all economic events occurring in their territory.[6] This is not contested. The rules of a double tax convention are restrictions on this right to tax as far as the contracting states agreed upon: the so-called barring-effect of double tax conventions.

Looking at Arts. 6–23, indeed, the result is whether the state of origin may or may not tax. When reading the articles, one could have the impression that also the right to tax of the state of residence is touched. But if the articles give the exclusive right to tax to the state of residence, then it follows directly from Arts. 6–22 that the state of origin may not tax the item of income. On the other hand, if the article upholds the taxing rights of the state of origin

[5] J. Avery Jones, *Qualification Conflicts: The Meaning of Application in Article 3(2) of the OECD Model*, p. 45.

[6] For example, cf. American Law Institute, J.B. Houck, *Restatement of the Law. The foreign relations law of the Unites States*, "International Lawyer" 1986, Vol. I, p. 259 et seq.; K. Vogel, M. Lehner, *Doppelbesteuerungsabkommen…*, p. 169.

nothing is said for the state of residence in Arts. 6–22 but in Art. 23. Avery Jones is right: the state of origin is the state "applying" Arts. 6–22.

4. The meaning of "unless"

Taking into consideration the wording of Art. 3 Para. 2 it seems clear: a term of a DTC has the meaning under the tax law of the applying state. This interpretation has been called the national interpretation. The state of origin applies the notion of its tax law. For example: State Y treats a severance payment as part of a salary. A is working in an enterprise situated in Y, therefore, in the wording of Art. 15 of the OECD-Model "the employment is exercised" in that state and the payment may be taxed in the state of origin as part of the salary.

A different result could be achieved if the context requires otherwise. But the wording is not "if" but "unless". As Avery Jones several times[7] pointed out, this "unless" in English understanding describe a strict exception. Overwhelmingreasons must exist to depart from the national interpretation. And these reasons must derive from the context whatever this means.

The German relevant wording is as follows: "wenn der Zusammenhang nicht anderes fordert". This "wenn" (if) can be understood not as an exception of the national interpretation but as a condition for the national interpretation.[8] In understanding Avery Jones, the first step is the national interpretation and as an exception the interpretation according to the context. In understanding the German wording, it is the other way: first interpretation according to the context and as ultima ratio the national interpretation as second step. Many, if not most, German DTC are concluded in a version of the German language, and sometimes the version in a foreign language is not the English version.

This poses the question of the relevance of the OECD Model[9] for the interpretation of treaties in other languages and the question of the interpretation of multilingual treaties.[10] These are two questions that will

[7] See: "IBFD" 2020, No. 11.

[8] K. Vogel, M. Lehner, *Doppelbesteuerungsabkommen…*, Grundlagen Art. 3, No. 116a.

[9] K. Vogel, M. Lehner, *Doppelbesteuerungsabkommen…*, Grundlagen No. 123 et seq.; a topic often discussed, cf. O. Milanin, *Die Bedeutung des OECD-Musterabkommens für die Auslegung von Doppelbesteuerungsabkommen*, Nomos, Baden Baden 2021.

[10] R.X. Resch, *The Interpretation of Plurilingual Tax Treaties: Theory, Practice, Policy*, Universiteit Leiden, Hamburg 2018.

not be treated with in this article. But it seems clear that it is a difficult to answer the question whether the English version of the Model Convention must be observed when interpreting the DTC though an English version is not an authentic text of the DTC.

5. The meaning of "context"

According to Art. 31 of the Vienna Convention, the context is defined as any other relevant document or text agreed upon by the parties. The context, surely, is the double text convention itself. One article must be seen and interpreted in the light of the other articles. Besides this Art. 31 Para. 1 of the Vienna Convention demands the interpretation in the light of the object and purpose of the treaty. Both – context and purpose – are not the same but complete each other's. Context relates more to a systematic approach, a purpose to a more teleological one. Arts. 6–22 are in a strong relation to Art. 23. When discussing Arts. 6–22 one must also look at Art. 23.

6. The function of Art. 23 OECD Model Convention

Article 23 applies if the state of origin may tax the item of income according to Arts. 6–22. If the state of origin may not tax the income, nothing is said in Art. 23 because in this situation the taxing right of the state of residence is not restricted. It derives from the self-executing character of the treaty that the state of origin may not tax; it is barred from taxation. As a consequence, the taxing position of the state of residence is not touched in any way. But if the state of origin may tax; it is the obligation of the state of residence to grant relief of double taxation following the exemption or credit method.

The precondition for this obligation is that the state of origin taxes "in accordance with the provisions of the convention". What does this mean?

The controversial point in the interpretation of this term is whether taxation takes place if the state of origin applied its own tax law concept with the effect that it may tax the income (national interpretation) and the state of residence is bound to accept this interpretation,[11] or whether

[11] In this sense K. Vogel, M. Lehner, *Doppelbesteuerungsabkommen…*, Art. 232 No. 38 et seq.

the state of residence may also apply its domestic tax law in deciding whether the taxation took place in accordance with the provisions of the convention.[12]

The difference cannot be argued away[13] that if the credit method has to be applied in any way, double taxation is avoided by granting credit according to the national tax law, and the problem remains only under the exemption method. Countries like Germany[14] do not apply the nation law of granting credit if a double tax convention concerning income tax exists between Germany and the foreign state. Avery Jones' solution does not solve the case that, according to the national tax law of the state of residence, the state of origin may not tax.

The above example demonstrates very clearly the different positions. According to Avery Jones, state Y taxes according to the provisions of the convention, State X has to accept this and has to grant credit (or exemption). The other position is that State X, according to its national tax law, qualifies the severance payment as other income and applies Art. 21 giving that state the only right to tax. Both states tax as a result of double taxation. Alternatively, if X happens to be the state of origin and Y the state of residence, X would not tax because of the application of Art. 21 and Y would not tax because of Art. 15. If; however, as Avery Jones argues, the state of residence must always follow the qualification of the state of origin, and the result is that Y can also tax by applying Art. 21.

This example proves that it always would be Y which "wins" the conflict of taxing rights when following Avery Jones and that double or non-taxation would be the result when following the other interpretation giving the state of residence the right to also apply its domestic tax law.

7. Autonomous interpretation

In order to avoid these unsatisfying outcomes, many[15] prefer the so-called autonomous interpretation of the treaty by both contracting parties and applying only the national interpretation if the autonomous interpretation is impossible as ultima ratio.

[12] Cf. J.M. Mössner, *Auslegung von Doppelbesteuerungsabkommen…*, pp. 490, 495 with further quotations.

[13] As Avery Jones tries, for example "IBFD" 2020, No. 11.

[14] Cf. J.M. Mössner, S. Seeger, I. Oellerich, *Körperschaftsteuergesetz Kommentar*, 4th ed., Herne 2019, Para. 26, No. 341.

[15] Cf. Lehner, *Die autonome Auslegung…*, pp. 383, 400.

In the given example, the German Federal Tax Court[16] interpreted Art. 15 in the way that the state of origin may only tax the remuneration if it is derived by the person as the counterparty for exercising services in that country. Severance payments are paid not for the services that are delivered but for the non-exercise and decided, therefore, that severance payments do not fall under Art. 15.

If both contracting parties interpret the rule only under the wording of the convention and do not take into account their national tax law the result will be that both states apply the rule in the same sense. No controversy of interpretation would exist and the convention functions perfectly. Because it is the object and purpose of the tax convention to eliminate double taxation this would be the best approach for the interpretation of the rules of the convention. In the light of Art. 31 of the Vienna Convention, the wording of the treaty must be interpreted in a way that object and purpose is best realized. The "unless" must be understood in a way respecting the purpose of the treaty.

It goes without saying that the autonomous interpretation does not in all situations avoid a different interpretation by the courts of the two countries. It is a common phenomenon that two courts even of the same state come to different results when interpreting a text. But the different interpretations of the same text would be clearly minimized by the autonomous interpretation in relation to the national interpretation.

John Avery Jones[17] argues, as far as I understand him, that the types of income within the treaty do not always correspond to the same types of income in national tax law and that, therefore, because of different qualifications of a given income, it may come to double or no taxation. To prove this, he presents the following example:

"A is a resident of the State R. He holds a participation in a partnership in R. At the same time, he is an employee of this partnership, and he works for this partnership in State S where the partnership does not dispose over a permanent establishment. The States R and S treat the income received by a partner of a partnership who is at the same time an employee of the partnership differently as business income or as income from employment. The dividing line between these two kinds of income in the treaty cannot be the same as in the national tax laws." According to Avery Jones, the treaty is ineffective if the national dividing line is narrower than the treaty's dividing line. I have a different view on this situation.

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[16] BFH (Federal Tax Court) decision 18.7.1973 – I R 52/69, BStBl (Official Journal of the Ministry of Finance), Vol. II, 1973 p. 757; decision 30.9.2020 – I R 76/17, BStBl II 2021, p. 275.

[17] "IBFD" 2020, No. 11.

Case 1: State S treats the income of A as income from employment. As A exercises his employment in this state without being a resident of this state, according to the tax law of S, A is taxable in this state.

(1a) According to the autonomous interpretation of the treaty, A receives income from employment (Art. 15). It follows that the taxation in S is upheld by the treaty and R has to gives relief from double taxation (Art. 23) by credit or exemption.

(1b) According to the double tax convention, A receives business income (Art. 7). Because there is no permanent establishment in S, Art. 7 DTC bars the taxation by S and only R may tax this income.

For case 1, in both possibilities, I fully agree with Avery Jones.

Case 2: According to the tax law of State S, the employee of a partnership who holds a share in the partnership is qualified as business income.

(2a) In the light of the autonomous interpretation of the DTC, A also receives business income. As there is no permanent establishment in S, this state may not tax this income.

(2b) The treaty upholds the taxation of State S as, according to its autonomous interpretation, says it is income from employment, but S applies its rules – business income – and does not tax A as there is no permanent establishment in S.

This seems to be Avery Jones' solution for Case 2. But there are objections against this result. These objections are based on the dogmatic structure of restricted tax liability.

A tax rule like the one differentiating business and employment income is not applicable by itself; on the contrary, the applicability to a given case is decided by a rule that belongs to the field of conflicts of law. These rules are in tax law are only unilateral other than in civil law where they are bilateral, which means the tax rule of State S only determines whether the national tax law of S is applicable to a situation or not, while in civil law the rules also say which state's law is applicable. In tax law, two types of such rules are known. First, the rule of residence – in its various criteria – is based on the relation of a person to a given country. A personal connection must exist between a person and a territory in the sense that the country is the centre of one's personal life. As a result, the whole tax law is applicable to world-wide income: the so-called unlimited tax liability. If such a connection does not exist, but the taxpayer receives income out of the country, the taxation is restricted to this kind of income and the rules of conflict of laws existing for this type. The states define in their tax law on the limited tax liability which is meant by "income out of the country" by stipulating the criterion for each type of income. These examples are exercising an activity within the country for employment income and the existence of a permanent establishment for business income. In example (2b) in State S, no rule of the conflicts of law for business income is realized: there is no permanent establishment. Therefore, A is not subject to income tax on business income but only to income from employment as he exercises the activity within the territory of S, and he is an employee of the partnership.[18] The income tax rules on business income are not applicable to the case.

8. Conclusion

When taking all these aspects and arguments into consideration one could ask what the advantage is or even necessity of Art. 3 Para. 2 of the OECD Model. At the time when Art. 3 Para. 2 was inserted in the OECD Model the Vienna Convention did not exist. For a time after the existence of the Vienna Convention the question was what does Art. 3 Para. 2 add to this convention. The answer can only be: nothing apart from academic controversies on this unclear and disputable text of Art. 3 Para. 2. And a caveat: interpretation of a text means understanding the content of the text. This is always a difficult and comprehensive heuristic process that cannot be regulated by quasi mechanic rules.

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[18] See more on this: J.M. Mössner, *Theorie und Praxis im internationalen Steuerrecht*, [in:] J. Lüdicke, J.M. Mössner, L. Hummel (eds), *Das Steuerrecht der Unternehmen, Festschrift für Gerrit Frotscher zum 70. Geburtstag*, Haufe Gruppe, Freiburg–München 2013, p. 461; *idem*, *Isolierende Betrachtungseise*, [in:] F. Klein, H.P. Stiehl, F. Wassermeyer (eds), *Unternehmen Steuern: Festschrift für Hans Flick zum 70. Geburtstag*, Verlag Dr. Otto Schmidt KG, Cologne 1997, p. 939.

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Abstract

The article deals with controversies regarding the interpretation of tax treaties based on Art. 3 Para. 2 of the OECD Model in relation to Vienna Convention on the Law of Treaties.

Keywords: interpretation, tax treaties, the OECD Model, Vienna Convention on the Law of Treaties

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Pasquale Pistone[1]

A Constructive Criticism on Turnover Taxes

1. Introduction

During the past decades national tax sovereignty has dramatically changed. Within the framework of the limits imposed by supranational and international law states have partly surrendered the substance of their tax sovereignty, or at least loosened the core of its absolute nature.

Such limits currently operate – *de jure*[2] or *de facto*[3] – as actual constraints on the exercise of taxing powers by the national legislator, questioning how taxes are shaped and determining their validity.

These constraints contribute to outline the contour of national tax policy, also when the latter pursues regulatory goals, as much as constitutional principles and the need for sound economic objectives do, producing important repercussions in cross-border scenarios, too.

In parallel with this phenomenon, the criteria that determine international tax nexus are gradually losing their validity. This is clearly visible in respect

[1] Prof. Dr. Pasquale Pistone, Full Professor of Tax Law, University of Salerno (Italy); Academic Chairman, IBFD in Amsterdam (the Netherlands); Holder of a Jean Monnet *ad personam* Professor in European Tax Law and Policy, WU Vienna University of Economics and Business (Austria).

[2] The existence of a wide network of tax treaties across the world considerably limits the exercise of taxing powers of most countries in addition to the ones that states voluntarily introduce on a unilateral basis by their own domestic legislation. Moreover, in areas of economic integration, such as the European Union, the surrender of sovereignty implicitly also narrows down the exercise of taxing powers in order to preserve the supremacy of supranational over national law of Member States.

[3] The developments nudged by the international tax coordination campaigns – such as the ones on tax transparency and the fight against base erosion and profit shifting – undertaken under the political impulse of the G20 are the best examples of how globally desirable goals in fact affect national tax policies.

of income taxation. Remotely operated business models and risk mainly borne outside the market countries either prevent the exercise of taxing powers by the state of source on income, or end up allocating in fact a limited income to such a country. In such context, the permanent establishment nowadays often fails to achieve a balanced allocation of taxing powers in cross-border situations. Moreover, the COVID-19 pandemics has shown that remote operation of other activities, including various forms of employment, entertainment, and sport, challenge the functioning of the place of exercise of the activity as international tax nexus also for such types of active income.

A comprehensive reform of the international tax nexus[4] is therefore of paramount importance to preserve inter-nation equity and avoid an international tax war, which showed some preliminary warnings already a few years ago.[5]

The current global tax scenario partly reflects a certain degree of chaos and schizophrenia as to income taxation, which exposes business to a significant degree of legal uncertainty and to an undesirable extra tax burden. On the one hand, states show awareness of the importance of international tax coordination to counter base erosion and profit shifting. On the other hand, they are much less concerned with the overkill effects for measures that go beyond countering unintended double non-taxation and may result in double taxation across the borders. The latter situation clearly arises from the exponential growth of anti-avoidance measures introduced in connection with the implementation of the BEPS project. However, such measures may still be justified, especially if one considers that unregulated tax competition still leaves notable room for exploiting cross-border tax disparities and tax rate differentials. A growing consensus for regulatory tax measures across OECD countries may soon lead to a stop in the race to the bottom with the introduction of a global standard of minimum income taxation on business by means of international tax coordination.[6]

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[4] The International Tax Law Committee established in 2020 in the framework of the International Law Association is currently conducting a comprehensive study on the reform of international tax nexus, with a view to establishing a new framework that is consonant with inter-nation equity and consistent with public international law. Such conditions are essential for the establishment of a new international tax nexus made to last for several decades and capable of addressing the needs of a globalised community.

[5] See: US Treasury, *White Paper: The European Commission's Recent State Aid Investigations of Transfer Pricing Rulings*, 24 August 2016, https://home.treasury.gov/system/files/131/WhitePaper-EU-State-Aid-8-24-2016.pdf (accessed: 19.07.2021). This paper is the first reaction of the United States to the numerous tax state aid procedures initiated some years ago by the European Union against multinational enterprises, most of which are based in the US.

[6] This is also known as the Second Pillar of the BEPS 2.0 Project. Based on a Franco-German proposal put forward in the framework of international tax coordination studies conducted under the auspices of the OECD (on which see: J. Englisch, J. Becker, *International*

In the absence of a comprehensive reform of an international tax nexus, this situation may soon become unsustainable, especially if one considers a new spontaneous trend that is gaining momentum across the world to protect national tax sovereignty from erosion. Several states have introduced unilateral levies, especially in the form of turnover taxes on digital services. Such taxes expose business to an additional burden on top of income taxation, usually still due in the state of residence.

This short study develops some constructive criticism from a legal and policy perspective, with a view to developing the possible cornerstone for using turnover taxes in the framework of coordinated action at the EU and international level. Moreover, it draws some conclusions on potential future developments also in connection with the taxation of digital services and international minimum income taxation.

2. Corporate turnover taxes: the reasons for their global success

Turnover taxes have long been known for operating in the framework of consumption-type[7] and of income-type[8] value-added taxation.

Effective Minimum Taxation – The GLOBE Proposal, "World Tax Journal" 2019, No. 4, pp. 483–528; P. Pistone, J. Nogueira, B. Andrade, A. Turina, *The OECD Public Consultation Document "Global Anti-Base Erosion (GloBE) Proposal – Pillar Two": An Assessment*, "Bulletin for International Taxation" 2020, No. 2, pp. 62–75; A. Perdelwitz, A. Turina (eds), *Global Minimum Taxation? An Analysis of the Global Anti-Base Erosion Initiative*, IBFD, Amsterdam 2021), in 2021 this plan received the endorsement of the reform of US international taxation, proposed by the Biden administration, and of the G20.

[7] Before the introduction of the EU VAT common tax system, taxes on turnover were frequently used in the European Union, but were then gradually faded out, due to their interferences with the goals of the internal market, mainly connected with their cascading effects and implications in cross-border relations. See for instance the Irish turnover tax, or the Italian *imposta generale sulle entrate* (IGE). These taxes still apply in some countries, also as an alternative to VAT. See for instance the case of the South African turnover tax. Moreover, taxation of turnover also operates in the framework of a simplified levying of taxes on small business as a single integrated levy that also replaces the ones on income and VAT on an optional basis. See for instance the case of the so-called *monotributo* in Argentina, operating under the Law 24.977 of 3 June 1998 on Simplified Regime for Small Taxpayers (*Regimen Simplificado para Pequeños Contribuyentes*).

[8] See for instance the numerous examples of the business taxes around the world, such as the French *taxe professionnelle*, the German *Gewerbesteuer*, the Hungarian Local Business Tax, the Italian *Imposta sul Reddito delle Attività Produttive* (IRAP), the Spanish *Impuesto sobre Actividades Económicas* (IAE), and the Mexican *Impuesto Empresarial a Tasa Única* (IETU).

The crisis of income taxation at the international level has sparkled up a blossoming of corporate turnover taxes. In particular, two factors have contributed to the dramatic increase of latter taxes across the globe. First, such taxes allow the market country to exercise its jurisdiction in respect of value created on its territory and otherwise usually lacking corporate income tax nexus. Second, turnover taxes allow the market country to enhance level-playing field, by equalising the tax burden on its territory for all corporate players, as it has concretely occurred also in the case of the Hungarian and Polish sectoral turnover taxes.[9]

In such a scenario, turnover taxes have thus been perceived by the market countries as a quick fix to stop the erosion of tax revenue without infringing the international obligations contracted in respect of income taxes. Moreover, they have been perceived as an instrument of tax fairness, especially considering that, in the absence of single taxation, several multinational corporate players often escape income taxation and thus enjoy a competitive advantage over players operating mainly in a single jurisdiction.

The author acknowledges that, in such circumstances, levying unilateral taxes on turnover was perhaps one of the few tax policy options left. In the absence of a comprehensive reform of international tax nexus, or at least until some concepts are adjusted to the new business models,[10] states have indeed little room for manoeuvring on the side of income taxation. Moreover, in the European Union, action is also difficult on the side of consumption taxes, due to the general scope of value added tax and the existence of additional harmonised levies, such as excise duties.

However, not all that glitters is gold. A fair assessment of how turnover taxes operate in European and international tax law requires also a clear understanding of the implications for business when such taxes are levied on top of the ones on income and consumption. Turnover is not only a proxy for value consumption, but also for value creation. However, considering that in the current scenario countries usually levy turnover taxes only on some types of business, it is important to verify whether this policy decision, prompted by revenue goals, is also consonant with fundamental legal

[9] As indicated below in section 3, turnover taxes are currently used as an instrument to pursue fairness of tax competition. As shown by the Hungarian and Polish cases analysed by the Court of Justice, sectoral corporate turnover taxes target some market players only.

[10] This could for instance be the case of adjusting income tax nexus for business with a virtual permanent establishment concept, which reflects the significant economic presence in a country other than that of residence of the enterprise. Such a solution (first proposed by P. Hongler, P. Pistone, *Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy*, "IBFD White Papers", Amsterdam 2015, pp. 1–63) would have the merit of changing the allocation of taxing powers while preserving the traditional conceptual categories of income taxation.

principles and in line with the requirements established by competition law. Both are particularly important within the internal market, where EU Member States preserve taxing powers at the national level and must exercise them consistently with the supremacy of EU law, thus also with the supranational competition policy established by Art. 107 TFEU.

The cases of the progressive turnover taxes levied by Poland on retailers and by Hungary on advertisements have received particular attention within the tax community in Europe, due to the failed attempts by the European Commission to question their validity and compatibility with the prohibition of state aid. After admitting that such taxes were compatible with the non-discrimination principle, the Court of Justice also acknowledged that such taxes do not infringe the prohibition of state aid.[11]

The analysis of the implications arising from those taxes for the exercise of tax sovereignty and the legitimacy of taxes on turnover within the European Union is particularly important to evaluate the extent to which they are a desirable feature of tax systems across the world.

3. The implications of the European judgments for turnover taxes

In two important blocks of judgments,[12] the Court of Justice of the European Union has assessed, during the years 2020 and 2021, the compatibility of turnover taxes with EU law, focusing in particular on the non-discrimination principle and the prohibition of state aid.[13]

The endorsement by the Court of Justice to the validity of turnover as economic indicator[14] is a good starting point for the conceptual remarks that also address some fundamental principles of taxation.

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[11] See below in section 3.

[12] CJEU, judgement, 3 March 2020, *Vodafone Hungary*, C-75/18; CJEU, judgement, 3 March 2020, *Tesco*, C-323/18; CJEU, judgement, 16 March 2021, *Commission* v. *Poland*, C-562/19 [retail sales tax]; CJEU, judgement, 16 March 2021, *Commission* v. *Hungary*, C-596/19 [advertisement tax].

[13] Moreover, the judgment *Vodafone Hungary*, C-75/18 also addressed the compatibility of turnover taxes with the common EU VAT system, based on the interpretation of Art. 401 of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Official Journal of the EU L 347, 11.12.2006, pp. 1–118.

[14] CJEU, judgement, 3 March 2020, *Vodafone Hungary*, C-75/18, Para. 50; CJEU, judgement, 3 March 2020, *Tesco*, C-323/18 Para. 70; CJEU, judgement, 16 March 2021, *Commission* v. *Poland*, C-562/19, Para. 41; CJEU, judgement, 16 March 2021, *Commission* v. *Hungary*, C-596/19, Para. 47.

The fact that a taxpayer derives a turnover from the exercise of an economic activity shows indeed that such a taxpayer may be asked to pay taxes by reference to such turnover. In the Hungarian cases decided in 2020,[15] the Court indicated that progressive taxation may be based on turnover, as it constitutes a neutral criterion of differentiation and a relevant indicator of a person's ability to pay taxes.[16] Then it added from a state aid perspective that progressivity was a structural feature of turnover taxes, and, as such, suitable to integrate the so-called reference framework used to determine when a selective tax advantage occurs.[17]

When assessing the potential indirect discrimination, the Court had to verify whether the levying of such taxes could indirectly disfavour business exercising fundamental freedoms as compared to purely domestic situations. When assessing the potential tax state aid, the Court had to verify whether the powers of the EU Commission had been exercised in conformity with the rule of law and had given sufficient evidence of the existence of a selective advantage in favour of those business operators, which either do not pay these taxes, or do so at more favourable conditions, namely such that would create distortions to the internal market, which would be incompatible with Art. 107 TFEU. Not even by bundling both types of scrutiny can we reach a comprehensive assessment of the consistency of those taxes with the principles of fair taxation and the constitutional principles, which will require a separate analysis.[18]

Even if turnover represents a valid economic indicator, the validity of sectoral turnover taxes must be reconciled with their ability to achieve the policy goals for which they have been established. Accordingly, if we get back to the specific EU law perspective, the judgment of the Court of Justice on the Hungarian and Polish sectoral turnover taxes should not be perceived as giving *carte blanche* to the levying of these taxes in the European Union.

In most tax systems, taxes on turnover are always bundled together with other taxes that also relate to value creation, such as in particular the ones levied on income. The CJEU judgments on the Hungarian and Polish cases have hardly explored the profiles concerning the combined effect of income and turnover taxes, except for the fact that the levying of sectoral turnover taxes on certain economic activities does not per se give rise to indirect discrimination and/or to an infringement of the prohibition of state aid.

[15] CJEU, judgement, 3 March 2020, *Vodafone Hungary*, C-75/18; CJEU, judgement, 3 March 2020, *Tesco*, C-323/18.

[16] See: CJEU, judgement, 3 March 2020, *Tesco*, C-323/18, Para. 70.

[17] See: CJEU, judgement, 16 March 2021, *Commission* v. *Hungary*, C-596/19, Para. 47.

[18] See below section 5.

Turnover is per se a less refined economic indicator than income, as the latter goes beyond showing value creation and, especially in the form of net income, it reflects an increase in the taxpayer's capital.

Yet, if the economic activity exercised by a person produces a given turnover, the latter is also a sound criterion for triggering the tax liability of such a person. Assessing whether the levying of turnover taxes is fair and legitimate requires a more in-depth analysis of the scenarios in which such taxes operate.

The recent trends of turnover taxes show that they hardly ever apply on a general basis; rather, they present the typical features of sectoral taxes and are levied on specific types of activities. This occurs in the case of the taxes levied in Hungary and Poland, scrutinised by the Court of Justice, as well as in the ones that many other EU Member States levy on digital services. It is reasonable to expect that the EU itself may introduce turnover taxes at the supranational level on the supply of digital services.

In the cross-border scenario, turnover taxes may hardly fall within the objective scope of tax treaties.[19] Insofar as they do not, such taxes, unlike the ones levied on income, are not subject to the limitations established in the framework of the said tax treaties. This concretely means that states may levy turnover taxes without any international restriction on their taxing powers and thus regardless of whether they keep the jurisdiction to levy taxes on income.

An example can show more concretely the implications of such a situation. In the absence of a permanent establishment, only the country of residence can levy taxes on profits. By contrast, no similar restriction affects the exercise of taxing powers on turnover by the state in which the economic activity is exercised, also often known as the market country. In the example of the Polish and Hungarian taxes, this circumstance has allowed exercising the tax jurisdiction on turnover regardless of whether the same occurs on income. Accordingly, some economic activities pay taxes on income and turnover in Hungary and Poland, and others pay taxes in such countries on turnover, but not on income. However, in such a case the country of residence preserves the right to tax income, thus giving rise to a potential situation in which the same value creation is taxed by reference to the turnover in one country and to income in another country. Even though this is not double taxation in a strict sense, it remains a form of

[19] Depending on their actual features some of them do, some others do not. Moreover, different opinions have been held in literature, including that of the author, who is generally not inclined to admit that turnover taxes may fall within the scope of Art. 2 OECD MC. See further on this in: P. Pistone, A. Ullmann, *Digital Taxes and Art. 2 OECD Model Convention 2017*, [in:] G. Kofler, M. Lang, P. Pistone, A. Rust, J. Schuch, K. Spies, C. Staringer (eds), *Taxes Covered – The Scope of Double Taxation Conventions*, IBFD, Amsterdam 2021 and the literature quoted therein.

duplication of taxes in respect of the same value creation, which ought to be addressed through dedicated measures. Currently, no such measures exist at the international level.[20]

When both taxes on turnover and income are levied in the same country, some form of coordination between them is more likely to take place, for instance by deducting turnover tax from the one levied on income. This helps in addressing the difference in treatment that the levying of sectoral turnover taxes would otherwise determine in comparison with the tax burden applicable on other economic activities.

By contrast, no such coordination is often to be found when two different countries use the two different proxies for taxing the same value creation, as neither of such countries is willing to unilaterally surrender a portion of the collected tax revenue.

The likely introduction of an international minimum standard for taxing corporate income may in fact produce indirect repercussions on the need to levy turnover taxes, going as far as undermining one of its two rationales. The reason is simple to explain: an international minimum income taxation will prevent undertaxation of global players and thus remove any competitive tax advantage that they otherwise enjoy in respect of economic players that operate in the purely domestic scenario of the market country. However, insofar as the presence of business does not trigger the income tax nexus, as in the example indicated earlier, income tax will be levied by the residence state, rather than by the market one. Therefore, the issue may arise as to whether one could still justify the levying of turnover taxes in the market country, and, even more, whether their progressive nature will still fit into a conceptual framework that creates a global coordination for securing an effective taxation of income.

4. Turnover taxes from a policy perspective

The policy choice of levying sectoral taxes on turnover from some business activities per se generates a different treatment as compared to the one applicable to activities that are not liable to such taxes. Considering the

[20] The Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, COM(2018)148 final, Brussels, 21 March 2018, mentioned this type of issues in its recital 27, indicating that EU Member States were expected to give a deduction of turnover from corporate taxes. However, such indication was left without a corresponding provision within the articles of the said proposed Directive.

arguments put forward by the Court of Justice in the Hungarian and Polish cases,[21] this policy choice is per se neither problematic, nor arbitrary.

The steep progression of the Hungarian and Polish sectoral turnover taxes ended up mainly targeting sizeable operators, which are in fact almost exclusively non-residents. This policy choice relies upon the assumption that such operators do not pay a fair share of taxes, including in the market country. Said assumption partly justifies the heavier tax burden on them, in order to re-establish level-playing field with smaller players,[22] but in fact gives rise to a sui generis form of redistributive taxation.[23]

The Court of Justice endorsed it as a structural feature of both types of turnover taxes, which also presuppose the likelihood of low taxation, resulting from the policy choices of the residence state and the general absence of liability for income tax purposes in the market country.

Even though, in principle, this is often the case, one may have doubts as to the overall legitimacy of a schedular application of compensatory taxation, i.e. as to the fact that the latter applies regardless of what happens in the country of residence of the large business operators. Especially when the latter country keeps and exercises taxing rights on income of such taxpayers, the combined application of such tax with the one levied by the market country on corporate turnover may give rise to overtaxation and unfair conditions for the exercise of economic activities across the borders.

The rationale of progressive corporate turnover taxes in the Hungarian and Polish experience, as well as in the similar sectoral levies applicable in other countries, including on turnover from digital services, shows an interesting development from a constitutional perspective. In particular, fairness justifies a special kind of compensatory taxation across different types of taxes, i.e. more turnover tax in the market country replaces the likelihood of less income tax levied in the residence state.

In such a context, the function of compensating the likelihood of lower income taxes abroad contributes to the validation of a tax policy choice underlying progressive corporate turnover taxes and their overall fairness goals. By doing so, it adds a cross-border dimension of justice to

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[21] See above section 3.

[22] The other possible justification for levying heavier corporate turnover taxes is that the bigger economic operators are more competitive than the smaller ones. However, if that were the case, then the two categories would also not be comparable for other purposes, which the Court of Justice denies in connection with the application of state aid rules.

[23] The capacity of turnover taxes to pursue redistributive goals (especially when levied on persons other than the ultimate bearers of the ability to pay taxes) can be questioned from various perspectives. See further on this: P. Pistone, J. Nogueira, A. Turina, *Digital Services Tax: Assessing the Policy Reasons for its Introduction in the European Union*, "International Tax Studies" 2021, No. 4, IBFD Tax Research Platform/el.

the constitutional principles of equality and ability to pay.[24] The need to establish a level-playing field justifies the different treatment of sizeable operators in the market country as compared to the one that such a country applies to small and medium size (mainly domestic) business operators.

In the author's view, the need for a consistent application of the latter principle should also produce another corollary, which can become particularly important in the future scenario of international standards of minimum corporate income taxation. No significantly higher taxation may apply in the market country, when the residence state exercises its taxing jurisdiction on the same value creation by levying either income or turnover taxes. This corollary does not solve the issues of inter-nation equity, which require an adjustment of tax nexus in order to align it for income and turnover taxes. This alignment will avoid major inconsistencies across the systems that could generate forms of overtaxation that are detrimental to cross-border business activities.

5. Turnover taxes from a constitutional perspective

From a constitutional perspective, the levying of sectoral taxes on turnover raises various issues, which essentially concern the equality principle and its related expression, usually known as the ability-to-pay principle. Besides the general endorsement by the Court of Justice, it remains to be seen whether possible frictions with the said constitutional principles may arise in connection with the concrete functioning of progressive turnover taxes.

The steep progression of the Hungarian and Polish sectoral corporate turnover taxes raises the issue as to whether this policy choice really fits within the constitutional framework. Leaving aside the analysis of the positive dimension of the said principles in the specific Hungarian and Polish legal system, the point is that progressive taxation is generally used to pursue substantial equality among the ultimate holders of the ability to pay taxes. In such a context, imposing a heavier contribution for the richer ones to contribute to funding the state budget is in line with the redistributive goals of taxation.

By contrast, taxes levied on corporate income are hardly ever progressive. This may be due to the circumstance that such taxes usually operate as an advance payment of tax due by taxpayers that have a separate legal personality from those which are the holders of the ultimate ability

[24] See further below in section 5.

to pay taxes. However, it must be acknowledged that several tax systems across the world apply different (and generally more favourable) taxes to small and medium enterprises. Different views can be held as to whether such more favourable tax conditions are meant to pursue redistributive goals in the strict meaning of the expression, or to secure some form of intervention to allow such a business to preserve a reasonable degree of competition with multinational enterprises. However, in the presence of such more favourable conditions, also corporate income tax ends up presenting some progressive features, thus confirming that, even if for a different specific goal, also when levied on persons other than the ultimate owners of the ability to pay, progressive taxes may have a sound rationale.

Taken into account such a consideration, the author submits that the justification of progressive taxation of business is more closely connected with the protection of free competition within the EU internal market than with their capacity of reflecting the different ability to pay.[25]

The actual relevance and boundaries of the ability to pay principle in European Union law and its links with the constitutional dimension of such principle are still surrounded by a certain degree of uncertainty.

The constitutional relevance of the ability to pay is expressly stated in some countries[26] and in other countries derived by reference to the principle of equality and the goals that it pursues.[27] Such systems may differ as to the boundaries and implications of the said principle. However, from a conceptual perspective, insofar as the ability to pay principle presupposes the levying of taxes in connection with a suitable economic indicator, it establishes a legal framework for tax fairness, which can be used to question the validity of tax policy choices made by the legislator.

In search for a common constitutional dimension of this principle, the Court of Justice has evolved its interpretation in three main phases. First, when applying the EU fundamental freedoms it acknowledged that, in connection with the application of the EU non-discrimination principle, ability to pay justified consideration of the personal situation of the taxpayer

[25] Nevertheless, the author is aware that the Court of Justice, in its judgments on the Hungarian and Polish cases, has endorsed the view that the levying of progressive turnover taxes is justified in the light of the ability to pay principle.

[26] See: Art. 53 of the Italian Constitution; Art. 31 of the Spanish Constitution: Art. 24(1) of the Cypriot Constitution; Art. 4(5) of the Greek Constitution; Arts. O and XXX of the Hungarian Constitution. For a comprehensive analysis of such issues, see: J. Kokott, P. Pistone, *Taxpayers in International Law: International Minimum Standards for the Protection of Taxpayers' Rights*, Hart Publishing, Oxford 2022, sec. 8.1.4.

[27] See for instance the German Basic Law, on which see: J. Kokott, P. Pistone, *Taxpayers…*

in order to secure the consistent exercise of fundamental freedoms.[28] Then, the Court of Justice expanded this line of interpretation of the non-discrimination principle to business-related deductions.[29] Eventually, the Court endorsed the relevance of ability to pay as a principle validating the levying of the Hungarian and Polish turnover taxes.[30]

Even though one could argue that there is no(t yet an) express recognition of the relevance of the ability-to-pay principle in European Union law, the statements included by the Court of Justice in the Hungarian and Polish judgments show that such principle has in fact gained momentum also within the framework of supranational law. In particular, by using ability-to-pay to validate corporate progressive turnover taxes the Court has implied the need for complying with such principle in order to avoid forms of arbitrary taxation that could be unacceptable for EU law. On turn, arbitrary taxation could lead to violations of the principle of equality and thus interfere with the common principles underlying non-discrimination and the prohibition of state aid.

In the light of the arguments already put forward earlier,[31] the author submits that the validity of turnover taxes should be assessed not only in a purely domestic situation and by reference to a domestic reading of the constitutional principles, but in a more general framework that also involves the potential implications arising for supranational law and in the international context.

Moreover, also taking into account the circumstance that turnover taxes are usually bundled together with income taxes and generally have the features of sectoral taxes, it is important to determine the implications of the ability to pay principle in such a scenario. Among others, this may also be relevant when determining whether the combined effect of such taxes can give rise to a disproportionate tax burden in connection with the levying of different taxes, or even whether it may raise possible problems of confiscatory taxation.

Such issues have to be addressed both when arising in connection with the exercise of taxing powers by one country, or as a consequence of cross-border tax disparities arising from the levying of different taxes and at different conditions by different countries.

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[28] See: CJEU, judgement, 14 February 1997, *Schumacker*, C-279/95, Para. 32. This interpretation has since become settled case law.

[29] See: CJEU, judgement, 12 June 2018, *Bevola*, C-650/16, Paras. 39 and 49–50.

[30] See: CJEU, judgement, 16 March 2021, *Commission* v. *Poland*, C-562/19, Paras. 40–41; CJEU, judgement, 16 March 2021, *Commission* v. *Hungary*, C-596/19, Paras. 46–47; CJEU, judgement, 3 March 2020, *Vodafone Hungary*, C-75/18, Para. 50; CJEU, judgement, 3 March 2020, *Tesco*, C-323/18, Para. 70.

[31] See above section 4.

Insofar as turnover operates as an additional proxy for value creation as compared to income, the assessment of tax fairness through the ability to pay principle should be conducted in the light of the tax burden that results from the combined levying of both taxes. When assessing such fairness, it can be useful to remember that the absence of a common supranational tax policy in the European Union may not deprive EU Member States of their prerogatives in this field, but nevertheless obliges to exercise them in conformity with the supremacy of EU law. In such circumstances, therefore, the fact that the Court of Justice has endorsed the levying of progressive turnover taxes in the Hungarian and Polish cases does not automatically mean that all such taxes would be compatible with EU law. The compatibility might indeed remain problematic in the presence of connected with a steeper progression, or without taking into account the combined effects of turnover and income taxes. This applies from both the perspectives of indirect discrimination and the prohibition of state aid.

6. Conclusions

Turnover taxes have become extremely popular in the recent years for various reasons, including the fact that states could introduce them without violating their international obligations at least from a formal perspective. It is reasonable to expect that they are there to stay also for the years to come. However, some changes are indispensable in order to allow such taxes to reflect the goals of tax fairness that have prompted their introduction.

In particular, insofar as one can agree that fair tax competition among business operators requires a level-playing field, it is important not only to avoid undertaxation of the ones operating across the borders, but also their overtaxation. For such a purpose, it is essential to establish forms of coordination between the various taxes levied on value creation and to do so across the residence and market countries. Fixing the international tax nexus is an essential component of the required changes, in order to bring back corporate income taxation within the boundaries of inter-nation equity also in respect of the new business models and avoid unintended tax bias from the exploitation of cross-border tax disparities.

Once these changes will be introduced, the point remains as to whether turnover should replace income taxation for catching value created by corporate players. Answering this question is perhaps the most difficult challenge for this essay. On the one hand, new business models are often loss-making or generating ultra-low profits in order to allow a business to increase its global market share. From such a perspective, turnover may therefore be more suitable than net income to generate tax revenue. On the other hand, turnover is a less refined indicator of value creation and more difficult to coordinate with income taxation of the ultimate bearers of the ability to pay, i.e. individuals.

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Abstract

This chapter focuses on the international implications arising in connection with the uncoordinated exercise of taxing sovereignty by states. It uses the case of sectoral turnover taxes in Hungary and Poland to put forward the merits of coordination with income taxation and the international obligations that countries contract when signing international treaties in tax matters. The chapter acknowledges the growing popularity of those taxes, taking into account their valid policy rationale and their visible implications in the collection of revenue. However, it also stresses the undesirable repercussions arising from the lack of coordination at the international level. All these elements are meaningful components of a comprehensive reform of the international tax nexus, which should not lead each country to pursue just the maximisation of its tax revenue, but also and especially fairness in the allocation of taxing rights at the global level. The author includes arguments drawn from national constitutions and EU law, which support the need for developing this conceptual framework for the exercise of taxing sovereignty in the years to come.

Keywords: turnover taxes, tax sovereignty, EU tax law, Inter-country tax equity, ability to pay

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Kees van Raad[1]

Challenges in Teaching Tax Treaties

1. Introduction

Professor Włodzimierz Nykiel and I share an interest in teaching tax treaties. The body of international tax law has grown exponentially during the period that he and I have been teaching this particular area of tax law. And within this area, the specialized domain of tax treaties has gained much prominence in that period. When I was enrolled in the 1960s as a student in the first tax law specialization program at Leiden University, which offered two full years of tax law, within that comprehensive program the lecture that was given on tax treaties did not last more than two hours. In the mid 1970s, when I started teaching tax law at that university as an associate teacher, I was given permission to teach a brief course in international tax law, including tax treaties. Ten years later, Leiden University decided to create the first chair in the Netherlands (and perhaps beyond), exclusively for international tax law, at which I had the privilege of being appointed. Just over another ten years, after the International Tax Center ('ITC') Leiden had been established, the tax treaty course I offered within ITC's Adv LLM Program in International Tax Law quickly developed into a format that comprised close to 200 hours of lectures and workshops. While that number may seem quite large, as a matter of fact, even within that comprehensive course many aspects of tax treaty law could be dealt with only in a summary manner.

In this contribution honoring Professor Nykiel I would like to use my experience of many years teaching tax treaty law as a basis for

[1] Prof. Dr. Kees van Raad, Chair International Tax Center Leiden, professor emeritus at Leiden University, of counsel Loyens & Loeff, visiting professor at Central University of Finance and Economics, Beijing.

exploring a subject that may appear at first glance unproblematic but – as I discovered over the years – poses various issues that are challenging for teachers to fully explain and for students to quickly master. And one of these issues is the interaction between tax treaties and domestic tax law. Tax treaties take care of the overlap in taxation that occurs when a person that resides in one state derives from another state items of income that are taxed also by the latter state. Treaties aim at eliminating the resulting double taxation by distributing between the two states particular restrictions in the application of their domestic tax laws. These domestic taxing rules and treaty rules often use the same terms and that is where the problem lies, because the meanings of these terms, while usually quite similar, not rarely differ in important details. And, as we know, the devil is in the detail.

2. The interaction between domestic tax law and tax treaties illustrated on the basis of the notion 'permanent establishment'

Let us assume that a country with a domestic tax system that is in need of modernization not only wants to update its domestic taxing rules but also expand its tax treaty network. The country is fully aware that in treaty situations it can apply its domestic rules on the taxation of nonresidents only to the extent that the applicable treaty does not prohibit it from doing so. It therefore wants to keep the interaction between its (new) domestic taxing rules and the restrictions imposed by its tax treaties (typically based on the OECD Model) as uncomplicated as possible. With respect to business profits earned from its territory by nonresident entrepreneurs, it therefore wants to include in its domestic rules on taxation of nonresidents a provision that subjects the profits of nonresident entrepreneurs to tax only to the extent that such profits are earned through a local permanent establishment ('PE'), and define that term in its domestic tax law with exactly the same words as are used in the PE-definition of Art. 5 OECD Model.

This legislative move to keep things simple and effective seems smart but, as will be demonstrated below, it is – surprisingly perhaps – not. If one examines the PE definitions in the tax treaties concluded by a given country, even if the total number of those treaties is not very large, there will always be differences among the PE definitions. And those treaty definitions are important because for PE profits to be effectively taxable by the given state, the manner in which the business activities are carried on by a nonresident entrepreneur must not only meet the domestic PE definition (in order to be effectively taxable), but also the PE definition laid down in the applicable treaty (in order not to be restricted by the treaty). No matter how much a given country with respect to the PE definitions in its tax treaties would like to adhere to its own choices regarding the details of those treaty definitions (e.g., fully embracing the OECD Model or insisting on preferences regarding particular details), it will not succeed in having exactly the same PE definition in all of its treaties.

If the PE definition in a given treaty is not fully identical to the OECD Model definition, the treaty's definition may be wider or narrower than the OECD definition but will often be wider in some respects and narrower in other ones. To the extent the treaty PE definition is narrower than the domestic one, there will be instances in which the country in its role as PE state would like to impose tax under its domestic tax law but cannot effectively do so because of the restrictive PE definition in the applicable treaty. And the reversed situation will occur: the treaty includes a PE definition that is wider than the domestic definition, with the result that there will be instances where the activities in the PE state do not meet the domestic PE threshold while at the same time the pertinent treaty's PE definition is sufficiently broad to accommodate the PE state to tax if it could so under its domestic law.

Thus, the idea of avoiding issues by adopting a domestic law PE definition identical to the definition thereof in a country's tax treaties is a fallacy: it would only work if all those treaties would include a PE definition that is 100% identical to the OECD PE definition. And that will not happen: irrespective how hard a country will try in its treaty negotiations with other states to convince those states to fully adhere to the OECD definition, those countries will not be willing to give up their preference for particular adjustments of that Model PE definition.

A simple approach to avoid problems stemming from an incongruence in scope between the domestic threshold for taxing business profits earned by nonresident entrepreneurs and the treaty's PE definition would be to adopt a domestic PE threshold that is so low that it would accommodate virtually any thinkable treaty PE definition. Such a low threshold could e.g. read: 'engaging in business [in the given State] for more for than a single transaction'. The obvious consequence of this approach is that in cases where no tax treaty applies, such a low threshold will bring within the scope of the country's taxation a large number of marginal business undertakings, with all the drawbacks thereof, both for those businesses (which have to register as a nonresident taxpayer) and for the country's revenue service (which needs to administer all those nonresident taxpayers, many of whom will bring in very little if any revenue), and also possible adverse effects on the tax climate in that country for inbound business and investment.

An interesting alternative approach has been taken by France. In Art. 209 of its General Tax Code [*Code Général des Impôts*] it is provided with regard to tax liability of nonresident companies that '[…] subject to company tax are [also those] benefits […] in respect of which the taxation is attributed to France by an international double taxation convention'.[2] Thus, under this provision it is legally deemed that the French domestic taxing provisions cover all business profits derived from France by a nonresident company to the extent those profits are earned through a PE as defined in the applicable tax treaty. In other words, if a particular treaty would have an unusually wide PE definition that covers activities that would not be covered by the PE definitions that most countries have laid down in their domestic tax law, under the French rule that same wide treaty PE basis is assumed to be available under the domestic taxing rule.

Recently, a perhaps even better approach was adopted by the Netherlands. Since 2020 it is provided in various Dutch income tax statutes, that for taxation of business profits earned through a PE in the Netherlands by an individual or a company resident of a state with which the Netherlands has concluded a tax treaty, the (Dutch) PE notion is assumed to be identical to the PE definition in that tax treaty. Consequently, the Dutch domestic PE notion has become chameleonic: its meaning varies with the meaning the term has in the tax treaty applicable in the given instance. In this way there will, by definition, always be full congruence between the treaty and domestic PE notions. No issue can arise anymore with a domestic PE definition being wider than the applicable treaty definition (resulting in instances where income *may* be taxed under the treaty rule but *cannot* be taxed because of the short-falling domestic taxing rule) and the reversed situation (the treaty definition is wider, resulting in a missed domestic taxing opportunity).

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[2] Translation by Kees van Raad. The (complete) French text of the article (only the words in *italics* appear in the English translation) reads: 'Sous réserve des dispositions de la présente section, *les bénéfices passibles de l'impôt sur les sociétés* sont déterminés d'après les règles fixées par les articles 34 à 45, 53 A à 57, 108 à 117, 237 ter A et 302 septies A bis et en tenant compte uniquement des bénéfices réalisés dans les entreprises exploitées en France, de ceux mentionnés aux a, e, e bis et e ter du I de l'article 164 B *ainsi que de ceux dont l'imposition est attribuée à la France par une convention internationale relative aux doubles impositions*'.

3. Difference between tax treaty and domestic law definitions of individual income items

Tax treaties eliminate double taxation through their distributive rules (Arts. 6–22 of the OECD Model) and double taxation relief rules (Arts. 23A and 23B). There are individual distributive rules for particular types of income, such as dividends and interest. These two income types are defined in Arts. 10.3 and 11.3, respectively. The treaty definitions of 'dividend' and 'interest' may differ from the domestic law definitions of these terms. To illustrate the issue, let us consider as an example that profit-sharing interest is by a given state treated as 'dividend' for purposes of that state's dividend withholding tax. For purposes of the (OECD Model based) treaty, profit-sharing interest is labeled as 'interest' by the treaty definitions in both Art. 10.3 (Dividends) and in Art. 11.3 (Interest).[3]

Let us first look at the difference between domestic law and treaties with regard to the *reason* for making a distinction between dividend and interest. Under the *domestic law* rules of many countries, an obvious reason for distinguishing dividend from interest payments is that interest is for the payor deductible for computing taxable profits whereas a dividend payment is not. And in various countries an additional difference is that the withholding tax rate for interest differs from the rate applied to dividends. Further, in some countries, while an outgoing dividend payment is subject to a withholding tax, outgoing interest payments are not covered by such a tax. Thus, for domestic tax purposes it clearly matters whether a given income item earned by a nonresident recipient is interest or a dividend.

In *tax treaties* dividend and interest are also distinguished but typically for only a single reason: the applicable tax rate: in the current OECD Model it is 15 or 5% for dividends (Art. 10) and 10% for interest (Art. 11). If in the two articles the tax rate would be the same, there would be no reason to distinguish between the two provisions and they could be combined into a single article 'Dividends and interest'. But the rates are different and therefore two articles are needed. But because of the difference in purpose for distinguishing between the two types of income, the dividing line between the two in the treaty may be quite different from the line

[3] Article 10.3 OECD Model: 'The term "dividends" as used in this Article means *income from* shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or *other rights, not being debt-claims, participating in profits*, as well as […]'. Article 11.3 OECD Model: 'The term "interest" as used in this Article means *income from debt-claims of every kind*, whether or not secured by mortgage and *whether or not carrying a right to participate in the debtor's profits*, and […]'.

drawn in domestic law; like in the example above: profit-sharing interest is for domestic law purposes assumed to be covered by the dividend withholding tax whereas in the treaty it is included in the definition of interest (and expressly excluded from the definition of dividend).

It is in this situation that the issue arises whether – taking into account the restrictions imposed by the tax treaty – the taxing state, dealing with an income item that is defined as 'interest' in the treaty but in domestic law is treated as a dividend for purposes of that state's dividend withholding tax, may subject that item to its dividend tax. When faced with this issue, many students will intuitively tend to deny the applicability of Art. 11 (Interest) and its maximum rate (10% of the gross amount of the payment) to the imposition of a domestic dividend withholding tax. Students are likely inclined to read the pertinent treaty definitions (the payment is interest) as setting aside the domestic law rules (application of a dividend withholding tax).

At this point it should be stressed that tax treaty definitions are applicable only for treaty purposes. Both the Art. 10 definition of dividend and the Art. 11 definition of interest include the words 'as used in this Article': i.e., their application is restricted to the tax treaty rules themselves. One of the well-known mistakes made by novel students of tax treaty law is to confuse treaty definitions and domestic definitions. And because tax treaties are in practice typically used in the same language version as the national language of the given country, such a confusion is understandable, and could perhaps be avoided if the treaty would be available only in a foreign language.

The habit that students need to develop is to examine in treaty situations first the application of the domestic taxing rules to the given cross-border item of income, without paying attention to anything in the treaty. The domestic law examination will produce a particular outcome. This domestic outcome is then put aside, after which the facts of the case are put again on the table to be examined now by the student with her or his 'tax treaty glasses' on: the facts are looked at exclusively from the perspective of the treaty definitions, i.e., completely disregarding the findings made earlier for domestic tax purposes. The examination of the treaty's distributive rules to these facts will result in a particular distributive rule being applicable which prescribes whether a – and, if yes, which – restriction must be observed by the taxing state in its taxation of the given income item. This restriction is then applied to the domestic law outcome that was established earlier.

This approach can be illustrated by the following example in which the treaty and domestic approaches have intentionally been made quite divergent. We assume that under a country's domestic tax law mortgage interest that is earned by a nonresident from a loan secured by a mortgage on local immovable property, is subject to ordinary net-basis income taxation. If the gross amount of the mortgage interest is 100 and there are deductible expenses of 20, the resulting net income is 80. If this amount is subject to a 30% income tax rate, the tax would be 30% of (100 – 20 =) 80 is 24. Without a tax treaty being applied, this 24 would be the amount of tax due. If an OECD Model type of treaty is applicable, we put aside this domestic analysis and computation (but remember the outcome: tax of 24) and put the facts back on the table for being scrutinized now for application of the tax treaty rules. We then first examine the various distributive rules of the treaty to be found in Chapter III: Arts. 6–21. Of these provisions, Art. 6 deserves attention as it could be imagined that for treaty purposes mortgage interest (being interest on a loan secured by immovable property) would perhaps be covered by the same rule of Art. 6 as ordinary income from immovable property. As a matter of fact, that was effectively done in some of the pre-WW2 model treaties developed by the League of Nations.[4] But OECD Model Art. 6 definition of immovable property income does not include mortgage interest, while at the same time this interest is expressly included in the Art. 11.3 definition of interest ('[…] income from debt claims […] whether or not secured by mortgage'). Consequently, the restriction imposed by the treaty on this payment is provided by Art. 11 of the treaty: it amounts to 10% tax on the gross amount of the payment: 10% of 100 is 10. The result is that the tax liability of 24 under domestic law is restricted by the treaty to 10. The domestic law taxing provision and the tax treaty restriction each walks it own way through its own set of rules.

Thus, it is essential to remember that in a tax treaty the names of the income items in the headings of the distributive rules are *unimportant*. The only thing that matters is the definition of the income item as provided in the applicable distributive rule (or, if not provided in that rule: as established through the interpretation rule of Art. 3.2, on the meaning of treaty terms that are not defined in the treaty). Therefore, continuing the example in the preceding paragraph, when we deal with profit-sharing interest that happens to be covered by the domestic-law dividend withholding tax of the source state involved, the question to be answered under the treaty is: is the income item covered by treaty Art. 10 (question to be answered on the basis of the definition in paragraph 3 of

[4] This treaty practice was continued by various states, particularly those that also in their domestic tax law subjected to tax on a net basis mortgage interest earned by nonresident recipients (e.g., the Netherlands continued such a rule in its domestic tax law until 1992 and, e.g., its current treaty with Israel still classifies mortgage interest as income from immovable property).

what is covered by that article) or Art. 11 (similar question). If the item is covered by Art. 10, the restriction on the tax by the source state is 15% or 5%, and if covered by Art. 11, it is 10%. It does not matter what is in the headings of the two articles, and neither does it matter how the income item is named in the domestic tax law of the taxing state. The only things that matters are: what is the tax due under domestic law, and, next, which restriction does the treaty impose on that tax?

4. Simultaneous application of divergent income definition rules of two treaties and their interaction with domestic law application

Occasionally a given cross-border income item may be subject to the restrictions that are simultaneously imposed by two (or more) treaties. This will typically occur in instances where the recipient of the income is a dual resident and each of the two residence states of this recipient has concluded a tax treaty with the state from which the income is derived.

An interesting and instructive situation arises if the treaties these two residence states have entered into with the source state differ from one another: if they provide for divergent treaty classifications of the given item of income. As an example we assume that (dual resident) recipient company R ('R Corp') receives from State S a profit-sharing interest payment amounting to 100. Under the domestic tax law of State S the payment is subject to a 25% withholding tax. Because of its incorporation, R Corp is considered to be a resident of State R.INC where it was incorporated. At the same time, based on its effective management, R Corp is also a resident of State R.EM where the company is effectively managed. State S has concluded a tax treaty both with State R.INC (the *S-R.INC treaty*) and with State R.EM (the *S-R.EM treaty*). The difference between these two treaties is that under the S-R.INC's treaty the profit-sharing interest payment is covered by the distributing rule of Art. 10 (note that I do not mention what is in the heading of this article, as this may trigger misguided ideas), and that article is assumed to provide for a 15% tax restriction on State S taxation of the gross amount of the income item. At the same time, the profit-sharing interest payment is covered by the S-R.EM treaty. Under that treaty (some of whose rules differ from those of the S-R.INC treaty) profit-sharing interest payments are covered by Art. 11. This article restricts the taxation by State S to 10% of the gross amount of the income item. Combining the effect of the two treaties, the tax liability under State S' domestic tax law of 25 is restricted to not more than 15 under the one treaty *and* not more than 10 under the other treaty. In combination, the effective restriction is the lower of the two: 10.

The example illustrates how to proceed in cross-border situations that are covered by one or more tax treaties. In such situations, the taxing rules (domestic law) and the restrictive rules (treaties) apply simultaneously. Each set of rules (State S law, S-R.INC treaty, S-R.EM treaty) operates in its own 'tax language' using its own terms and definitions. The effect that each set of rules has on the fact patterns to which they are applied, is determined in the 'tax language' of that particular rule set. How these different rule sets operate (i.e., how they establish and look at the relevant facts) does not matter; the only thing that counts is the outcome of the application of each set of rules. With regard to the domestic rules: whether the income item is taxable; and with regard to each of the two sets of treaty rules: whether the effect of their rules is that a restriction is imposed on the State S domestic law taxation. And all of that is individually determined in the different tax languages of the three sets of rules.

5. Conclusion

Tax treaties are fascinating subjects to teach. Students typically have earlier been trained to understand and master the complex rules of their own country's tax system. They have learned, e.g., how to determine the tax residence of a company, how to distinguish between dividends and interest for tax purposes, etc. But when they start dealing with tax treaties they need to learn to drop what they earlier learned and look at the facts from the perspective of another 'tax language' where terms may have an entirely different meaning. It calls for a seemingly simple approach that, in practice, however, requires a continuing effort to avoid the pitfalls of persistent reflexes.

Abstract

This contribution deals with the interaction between domestic tax law and tax treaties. It provides an illustration of this interaction on the basis of the notion 'permanent establishment'. Further, it deals with the difference that may exist between tax treaty and domestic law definitions of individual income items. It concludes with an explanation of the issues that arise when divergent income definition rules of two treaties need to be applied simultaneously and how such application of treaty rules interacts with the application of domestic law.

Keywords: tax treaties, interaction tax treaties with domestic tax law, permanent establishment

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Michal Radvan[1]

Specifics of Tax Law Drafting on Selected Issues from the Czech Republic

Szanowny Panie Profesorze,
życzę wszystkiego najlepszego, zdrowia, szczęścia, 100 lat! Dziękuję za inspirację w dziedzinie badań i nauczania prawa podatkowego.

Z poważaniem,
Michal

1. Introduction and several remarks on the method of tax law

While drafting tax law, the legislator should be aware of a specific method of tax law. The general administrative law regulation method is based on the effect of public authorities on the recipients of public authority, in particular by means of the norms enforceable by public authorities and individual administrative acts. The norms are contained in normative administrative acts, i.e., in bylaws and ordinances issued by public authorities, implementing the law within limits stipulated by law (sub-statutory regulations). The individual administrative acts are the decisions of the public authorities authorized by law to make such decisions in the specific administrative matter. Just as public administration is gradually

[1] Doc. JUDr. Ing. Michal Radvan, Ph.D., Vice-dean and Associate Professor, Department of Financial Law and Economics, Faculty of Law, Masaryk University (Czech Republic).

absorbing the client model into its operations, where its activities fit the image of real public service in place of the more or less repressive authoritarian police administration of a traditional bureaucratic nature, the administrative law method is also gradually incorporating new elements closer to private law methods (the contract).[2]

The method applied in tax law is essentially a modified version of the administrative law method, namely with regard to the actions of public administration authorities and in relationships regulated by tax law. Statistics can demonstrate a lower level of applying sub-statutory regulations in tax law regulation than in administrative law; in other words, the law gives public administration authorities less space to carry it out. Very few sub-statutory regulations exist in this area; the vast majority of legal regulations in the area of tax law take the form of an act, primarily with regard to such a requirement stipulated in a constitution or a similar document (e.g., in the Czech Republic, such a rule is contained in the Charter of Fundamental Rights and Basic Freedoms,[3] which forms part of the constitutional system along with the Constitution[4]). Of the types of sub-statutory regulations, the most significant in the Czech Republic are the generally binding ordinances, which municipalities (or other local self-government units) use to "complete" the legal regulation of property taxation and local taxes (fees).[5]

Public administration authorities apply economic instruments to a greater extent in the area of tax law to affect recipients. These instruments generally include tax credits and other corrective elements, tax holidays, etc. Certain private law elements also modify the administrative law method (such as the options of lump-sum tax, postponing taxes, payment calendars, etc.) and certain administrative activities are also delegated to private law entities. We can even find typical private law relationships in tax law, such as the relationship of an employer who pays wages or salaries to an employee: their relationship is, without a doubt, a labor law relationship, although the employer is obliged to deduct a personal income tax advance payment as well as social security and health contributions and other levies stipulated by law from the employee's wages, and the employee is obliged to permit such conduct. The authority to withhold tax is thus delegated from the state to a private law entity. Many analogous relationships can be found in tax law (a bank withholds tax on the interest

[2] M. Radvan, *Czech Tax Law*, 4th ed., Masaryk University, Brno 2020, pp. 12–13.

[3] CZ, Charter of Fundamental Rights and Basic Freedoms of 16 December 1992 [*Listina základních práv a svobod*], Act No. 2/1993 Sb.

[4] CZ, Constitution of the Czech Republic of 16 December 1992 [*Ústava České republiky*], Act No. 1/1993 Sb.

[5] M. Radvan, *Czech…*, pp. 12–13.

accrued, a joint-stock company withholds tax on dividends, a seller collects VAT from a buyer along with the sale price, etc.).[6]

What is the most specific to tax law, however, is a principle known as self-application. In tax proceedings (unlike in administrative or financial law), the administrative negotiations do not take place between the administrative authority (tax administrator) and (tax) entity, but, rather, primarily assume the knowledge and orientation of the tax entity in the area of tax law. The taxpayer applies tax law norms to itself by determining the tax base using its knowledge, uses the relevant tax rate for itself, and applies the corrective elements. The taxpayer then delivers the completed tax return to the tax administrator, which assesses the tax tacitly, i.e., implicitly, provided that it has no reservations regarding the correctness and completeness of such a return. In most cases, therefore, there is no interaction at all between the tax administrator and the taxpayer.

We can state that tax law relationships certainly have a public law nature, reflecting the public interest's priorities in the given area. However, the mandatory nature is moderated in certain instances with an element of choice (lump-sum personal income tax, voluntary VAT payer, method of depreciation, lump-sum expenditures for income taxes).[7] Considering the above-stated specifics of the tax law regulation method, the tax law regulation must fulfill very strict quality requirements, respecting the terminology used in other branches of law. The legislator should be receptive to the economic aspects of private and business life. The regulation should not only be perfect but easy to understand and apply, i.e., cheap for both taxpayers and tax administrators.

The following text is dealing with some of the specifics of tax law drafting. It aims to show some problematic issues connected with tax law drafting in the Czech Republic in the last two decades and clarify tax law drafting principles. To achieve the objectives, it is necessary to define tax law drafting principles and sum up if the Czech legislator follows them. In case they are not respected, it would be necessary to give examples and describe and critically analyze the institutes affected by the ignorance of these principles. Based on the research and synthesizing the gained knowledge, this paper will summarize how some tax law drafting principles should be clarified.

While the general tax law principles are often analyzed in detail by most experts dealing with tax law, tax law drafting principles are often disregarded. However, there are outstanding publications by Mastalski,[8]

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[6] *Ibidem*.

[7] *Ibidem*, pp. 13–14.

[8] R. Mastalski, *Wprowadzenie do prawa podatkowego*, C.H. Beck, Warszawa 1995.

Etel,[9] Gomułowicz, and Małecki,[10] or Brzeziński[11] in Poland, Babčák[12] in Slovakia, Mrkývka[13] in the Czech Republic, or Thuronyi in general.[14] One of the essential sources for this paper is the book edited by Nykiel and Sęk[15] on tax legislation standards, trends, and challenges.

2. Principles of tax law drafting

Principles play an important role in the process of tax law drafting and application. They consider both the public interest and tax subjects' individual interests or interests of other tax law addressees. Although many of these principles are not of a normative nature, they allow the postulates of a rational tax system's functioning to be formulated.[16] When drafting the tax law, the legislator is limited by the boundaries of the catalog of basic legal principles given by the Constitution of the Czech Republic, but also by the principles generally valid for continental legal culture and the democratic rule of law. The following text deals with principles legislators should apply in the specific context of tax law drafting.[17]

The principle *nullum tributum sine lege* is the crucial one in the tax law drafting. It is applied by most of the constitutions worldwide. It should be stated that the principle is valid not only for the national acts but for the local bylaw, too. The other constitutional principle *lex retro non agit* means the prohibition of taxation of facts that occurred in the past, i.e., the obligation arising during the effectiveness of a particular regulation is governed by this regulation until its fulfillment. The principle of non-retroactivity might be broken only if the new regulation is advantageous for the obligated tax subject. While drafting the tax law, the legislator

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[9] L. Etel (ed.), *System prawa finansowego – Prawo daninowe*, Wolters Kluwer, Warszawa 2010.

[10] A. Gomułowicz, J. Małecki, *Podatki i prawo podatkowe*, LexisNexis, Warszawa 2010.

[11] B. Brzeziński, *Wprowadzenie do prawa podatkowego*, TNOiK, Toruń 2008.

[12] V. Babčák, *Dane a daňové právo na Slovensku*, Epos, Bratislava 2008.

[13] P. Mrkývka, *Determinace a diverzifikace finančního práva*, Masaryk University, Brno 2012.

[14] V. Thuronyi (ed.), *Tax Law Design and Drafting*, International Monetary Fund, Washington 1996.

[15] W. Nykiel, M. Sęk (eds), *Tax Legislation. Standards, Trends and Challenges*, Wolters Kluwer, Warszawa 2015.

[16] L. Etel, *System podatkowy (zarys wykładu)*, WSFiZ, Siedlce 2002, p. 47.

[17] Inspired by Brzeziński (in B. Brzeziński, *Zasady tworzenia prawa finansowego (próba sformulowania)*, "Państwo i Prawo" 1986, No. 5, pp. 66–76) and Nykiel and Sęk (in W. Nykiel, M. Sęk, *Standards, Trends and Challenges of National Tax Legislation*, [in:] *eidem* (eds), *Tax Legislation. Standards, Trends and Challenges*, Wolters Kluwer, Warszawa 2015, pp. 191–206).

should follow the EU law (especially in the field of indirect taxes which are widely harmonized) and international obligations of the state.

Every constitution requires to follow the principle of justice; in the area of tax law, the principle of tax justice. It is applied in two ways, as a horizontal tax justice and vertical tax justice. A horizontal tax justice means that the same objects of taxation should be taxed equally (income, property, or consumption of different persons should be taxed equally regardless of the nature of these persons, their legal status, etc.). A vertical tax justice expresses that an entity with higher incomes, higher valued assets, or higher consumption should pay a higher tax, but not in the sense that the tax rate will increase highly progressively with increasing tax base; the tax rate should remain the same or be progressive proportionally. To the concept of vertical tax justice, the principle of proportionality must therefore be maintained. The related principle of endurance states that the tax must not be of a liquidating nature. The fact that the tax does not have a choking effect is secured by corrective components. These components make it possible to respond to the disproportionate impact of taxes (exemptions, reliefs, etc., or deferral and waiver of the tax by administrative means). It is desirable that there is no double taxation, especially in the interstate tax system. Of course, it is necessary to protect the interests of the majority from the intrusion of different lobby interests.

Other principles are closely connected with the legal system in the country. Primarily, tax provisions should be included in separate legal acts. At the same time, it is necessary to follow a uniform terminology in law. The tax law should not provide tax-specific definitions, but the definitions from other branches of law should be applied, generally even without an express reference.[18] It is inappropriate to impose an unorthodox tax[19] or tax components. The taw law norms must be unambiguous to formulate the addressees' rights and obligations in an understandable and unambiguous form. Ideally, there will be no need to apply any of the contradictory principles *in dubio pro libertate* (*in dubio mitius*) and *in dubio pro fisco*. Concerning the self-application of tax law norms, the tax duties should be formulated briefly and clearly; they should consider the level of legal and economic knowledge of the taxpayers. The title of the legislative instrument must clearly suggest that it concerns tax matters. It is necessary to keep an adequate *vacatio legis* so that the taxpayers have enough time to get acquainted with the new law's content.

As the tax law is closely connected with the national economy, the primal sense of taxation is the fiscal effect for public budgets. This

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[18] W. Nykiel, M. Sęk, *Standards, Trends…*, p. 202.

[19] *Ibidem*, p. 203.

principle expresses that the tax must not be an instrument to achieve a purpose other than securing public funds. The tax is not a penalty for earned income, ownership of property, etc. In practice, the principle is often broken as taxes might have reduction and stimulation functions, too. However, the fiscal function must prevail and taxes should not be a tool for politicians to get votes.[20] The tax law drafters should respect the economic rules of a chosen economy model; they should follow the principle of an open market economy. They have to anticipate short-term and long-term consequences of tax law regulation, consider the legal regulation of related sections of public financial activities, limit the impact of fluctuations in the value of money on the stability of tax law, and be aware of the continuity of changes in the amount of taxes.

The last (but not least) tax law drafting principle is that professionals should professionally draft tax law: the proposals of the acts should be consulted with stakeholders, discussed by the professional committees, there should be an adequate explanatory report to the act, etc. I believe that government proposals fulfill most of the standards and follow the principles as described above. However, amendments by members of Parliament seem to be breaking many of these principles. The argument for amendments in the parliamentary procedure is democracy and the legislative power of the Parliament. Interestingly, in the United States (the cradle of democracy), tax bills are sometimes voted under so-called close rules, i.e., a "yes or no vote" without the possibility of introducing amendments.[21]

3. Selected Czech examples of bad practice

Based on the courts' findings, taxpayer and tax offices' experience, it is possible to sum up that the tax law drafting principles are generally followed. Of course, not in all situations. The following observations deal with what appears to be the most critical breaches of tax law drafting principles according to the author's opinion.

Concerning the unorthodox tax components, the Czech legislator was many times very innovative. The most specific tax component in the Czech tax law seems to be the super gross wage as the partial personal income tax base from incomes from dependent activities. The super gross

[20] So-called Christmas tree legislation. *Ibidem*, p. 200.
[21] *Ibidem*, p. 198.

wage was introduced in 2008 with a linear personal income tax rate of 15%. Until the end of 2007, the tax base was defined as income from dependent activity reduced by sums of social security and health contributions paid by the employee (12.5% of the gross income). However, the tax rate was progressive, up to 32%. As the promised tax rate of 15% would have meant a decrease in revenue, it was necessary to increase the tax base. That is why the super gross wage occurred, defined as income from dependent activity increased by sums of social security and health contributions paid by the employer (34%, later 33.8% of the gross income). The personal income tax was then paid not only from income but from other amounts. Moreover, at least social security might be seen as a tax *sensu lato* and being taxed by the income tax, it meant the breach of no double taxation principle.

The other unorthodox tax component might be the tax bonus. Taxpayers with children living in their households have the right to use so-called tax preferences for children: to deduct a fixed amount as the tax reduction. If the tax after this reduction would be in a minus, the tax preference is divided into two parts: tax reduction up to zero tax and tax bonus. If the taxpayer is economically active, the tax bonus should be paid back. It means that some taxpayers not only do not pay the tax, but they get tax from the state.

Mentioning the fixed amounts in tax law, they may breach the principle to limit the impact of fluctuations in the value of money on tax law. It is possible to include both fixed tax rates (e.g., the dog charge rate was changed in 2004 for the last time, while some motor vehicle tax rates have not changed since 1993) and fixed corrective components (especially tax reductions). If fixed amounts are used in tax law, it is necessary to ensure regular amendments.

With regard to the self-application, the tax law norms must be clear, understandable, and unambiguous. The title of the legislative instrument must clearly suggest that it concerns tax matters. However, e.g., the tax on acquisition of immovable property (where the object of taxation was the acquisition of immovable property) was to be paid by the seller and not the acquirer (buyer) for several years. For the proper self-application, the most problematic seems to be corrective elements. In my estimation, the Czech Income Taxes Act[22] includes some 400 corrective components (exemptions, tax reductions, etc.). One third of them might be useful or even necessary (e.g., exemptions of low irregular incomes, reductions for disabled persons, tax preferences for children); the others are to be canceled. However, the legislators are politicians needing votes to be re-elected. One

[22] CZ, Act on Income Taxes of 20 November 1992 [*Zákon o daních z příjmů*], No. 586/1992 Sb., amended.

of the easiest ways to address voters is to grant them tax exemptions (not only before Christmas, as the US experience mentioned above). The Ministry of Finance's newest practice when preparing the new Income Taxes Act is the Christmas tree strategy: the bill sent to the Parliament should have only minimum corrective components (a tree) while the MPs are expected to add a lot of additional ones (to hang decorations on the Christmas tree).

Taxpayers should have adequate time to get acquainted with the new legislation, i.e., the *vacatio legis* must be long enough given the complexity of the new arrangement and the number of changes. *Vacatio legis* differs a lot; there are several examples of good practice from Lithuania and Romania (six months), or Poland, where new income tax regulation must be published by the end of November to take effect on 1 January of the next tax year.[23] In the Czech Republic, the practice is to publish a new tax regulation only several days before starting a new taxable period. For example the amendments to many tax acts effective from the beginning of the tax year 2021 were published only on 31 December 2020.[24]

For the correct tax law interpretation and application, for the understanding of new regulations, the explanatory reports to the acts are beneficial. However, the explanatory reports are often somewhat misleading, especially regarding the reason for changes in tax regulation. Almost every explanatory report to the amendments of excise taxes states that the reason to increase the tax rates is the regulative function of the tax: people will smoke and drink alcohol less if the tax rates are higher and the prices of cigarettes, spirits, beer, and wine are rising. The fiscal function of the excise taxes is being suppressed. During the COVID-19 pandemic, the most popular reason to change (not only the tax) law is the SARS-CoV-2 virus.

The explanatory report is closely connected with the parliamentary procedures and the principles that should be followed in these procedures. The explanatory report is being prepared together with the bill. Both documents are usually prepared by the experts at the Ministry of Finance: legislators and tax professionals. There is an internal comment procedure within the Ministry and an external comment procedure with other ministries and stakeholders. Later, the bill is discussed at the specialized commissions of the Legislative Council of the Government including the commission for financial/tax law, and at the Legislative Council of the Government. After each stage, the explanatory report is specified according to the accepted changes. From this moment, only non-experts (with good exceptions of truly qualified members of Parliament, such as

23 W. Nykiel, M. Sęk, *Standards, Trends…*, p. 198.

24 CZ, Act of 22 December 2020 amending certain tax law acts and certain other acts [*Zákon, kterým se mění některé zákony v oblasti daní a některé další zákony*], No. 609/2020 Sb.

Prof. Nykiel) are involved in the legislative processes. The bill is accepted by the Government (still, the explanatory report is further specified if changes are agreed) and sent to the Parliament. Of course, members of Parliament have the right to amend the government bills, but there is no duty to explain the amendments or change the explanatory report. Most of the amendments are never discussed with the Ministry of Finance or any other experts. One of the best illustrative examples is the history of the act amending the tax law acts for the taxable period of 2021. The bill was prepared by the Ministry of Finance and accepted by the Government. However, as a member of Parliament, the Prime Minister prepared his own amendment to this act, canceling the super gross wage as the partial personal income tax base for incomes from dependent activities. The concept of the super gross wage was criticized for many years by many experts. However, I do not believe that the super gross wage should have been abolished this way and during the fiscal crises caused by the COVID-19 pandemic. As the Prime Minister's proposal meant a lower level of taxation, it was accepted. These changes meant the additional loss of public budget revenues in the order of tens of billions of CZK.

4. Conclusions

It is possible to conclude that the tax law drafting principles, as defined by many experts, including Prof. Nykiel, are generally followed in the Czech Republic. However, several cases are showing that this statement cannot be applied in all situations. Nevertheless, the principles' breach was not caused by a lack of principles or their lack of clarity. There is no need to clarify the principles of tax law drafting. To achieve a good quality of tax law, it seems to be enough to follow the principles. The practice should be changed mainly in several areas:

1. Fixed tax rates should be replaced by the percentage tax rates (if possible; probably only if the tax base is replaced, e.g., in the case of property taxes), or there should be specific rules in each act on how the tax rates should be changed with regard to inflation.

2. *Vacatio legis* for tax law must be incorporated, probably directly in the Constitution. In my opinion, three months is an adequate time for the taxpayers, paying agents, and tax administrators to get familiar with new regulations and be prepared for that change, technically and economically. The exceptions might be useful for implementing EU law or in the case of economic, social, or health crises. However, they must not be misused.

3. Theoretically, some tax bills should be voted under so-called close rules, i.e., a "yes or no vote" without the possibility of introducing amendments. Members of Parliament are the only laypeople in the whole legal environment. At the same time, judges, lawyers, notaries, prosecutors, tax advisers, members of legislative committees, etc., must have adequate training, experience, and examination to carry out their activities. I am aware that practically such a rule could never be constitutionalized. Nevertheless, it might become a good practice, and not only in tax law legislation.

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Abstract

The contribution is dealing with some of the specifics of tax law drafting. It aims to show some problematic issues connected with tax law drafting in the Czech Republic in the last two decades and clarify tax law drafting principles. To achieve the objectives, it defines tax law drafting principles and sums up if the Czech legislator follows them. In gives many examples and describes and critically analyzes the institutes affected by the ignorance of these principles. It is possible to conclude that there is no need to clarify the principles of tax law drafting. To achieve a good quality of tax law, it seems to be enough to follow the principles. The practice should be changed mainly in several areas: 1. Fixed tax rates should be replaced by the percentage tax rates, or there should be specific rules in each act on how the tax rates should be changed with regard to inflation; 2. *Vacatio legis* for tax law must be incorporated, probably directly in the Constitution; 3. Some tax bills should be voted under so-called close rules, i.e., a "yes or no vote" without the possibility of introducing amendments.

Keywords: tax law, tax law drafting, tax law principles

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Wolfgang Schön[1]

Public Country-by-Country Reporting: Corporate Law, Fiscal Law and the Principle of Unanimity

1. Introduction

On 1 June 2021, the Council of the European Union reached political agreement on a new directive[2] which shall oblige parent companies of corporate groups as well as standalone entities, whose annual turnover exceeds 750 million €, to disclose to the general public some key business numbers broken down to the countries where they have established business units. This includes sensitive proprietary information such as the number of employees, the level of pre-tax profits, the level of taxes accrued, and taxes paid and other items.[3] The final enactment of this directive in 2021 is not in doubt. The core element of this directive, the so-called "public country-by-country reporting", has been designed to prevent and to sanction corporate tax avoidance and in particular to expose those transactions inside a multinational firm, which disrupt the alignment between business profits and the real activities underlying those profits.[4]

[1] Prof. Dr. Dr. h.c. Wolfgang Schön, Managing Director of Max Plank Institute for Tax Law and Public Finance, Honorary Professor at Ludwig-Maximilians-Universität Munich (Germany).

[2] For the final text of the directive see: European Commission, Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches, Annex to: Council of the European Union, Interinstitutional File 2016/0107(COD), Permanent Representatives Committee, Outcome of Proceedings, 9 June 2021, 9547/21; for harsh criticism as to the territorial scope of the new obligation see: Eurodad, EU fails to introduce real public country-by-country reporting – www.eurodad.eu (accessed: 1.06.2021).

[3] See: Art. 48c of the draft directive.

[4] European Parliamentary Research Service, Briefing: EU Legislation in Progress: Public country-by-country reporting by multinational enterprises, 26 April 2019.

Technically, this legislation will amend the Accounting Directive, which itself dates back to 1978 and which was consolidated in 2013.[5]

The Portuguese Government, which brokered the final agreement during their Presidency of the EU in the first half of 2021, stated the following: "Corporate tax avoidance and aggressive tax-planning by big multinational companies are believed to deprive EU countries of more than 50 billion euros of revenue per year. Such practices are facilitated by the absence of any obligation for big multinational companies to report on where they make their profits and where they pay their tax in the EU on a country-by-country basis. At a time when our citizens are struggling to overcome the effects of the pandemic crisis, it is more crucial than ever to require meaningful financial transparency regarding such practices. It is our duty to ensure that all economic actors contribute their fair share to the economic recovery."[6]

The legislative process, which has led to this outcome, goes back about five years.[7] Following several communications issued in 2015,[8] the European Commission put forward in 2016 a first proposal for a directive on public country-by-country reporting[9] which was favorably received

[5] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and repealing Council Directives 78/660/EEC and 83/349/EEC, O.J. L 182 of 29 June 2013, p. 19.

[6] P. Siza Vieira, *Portuguese Minister of State for the Economy and Digital Transition*, statement of 1 June 2021, www.consilium.europa.eu/en/press/press-releases/2021/06/01/public-country-by-country-reporting (accessed: 10.07. 2021).

[7] For a comprehensive discussion of earlier initiatives see: M. Christians, *Tax activists and the global movement for development through transparency*, [in:] Y. Brauner, M. Stewart (eds), *Tax, Law and Development*, Edward Elgar Publishing, Cheltenham–Northampton 2013, p. 288.

[8] European Commission, Communication from the Commission to the European Parliament and the Council on tax transparency to fight tax evasion and avoidance of 18 March 2015 COM(2015)136 final, p. 5: "The Commission will assess whether additional public disclosure of certain corporate tax information should be introduced, in a way which goes beyond administrative cooperation and provides public access to a limited set of tax information of multinational companies"; European Commission, Communication from the Commission to the European Parliament and the Council of 17 June 2015: A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action, COM(2016)302, p. 13; see also: European Commission, Communication from the Commission to the European Parliament and the Council of 5 July 2016: Communication of further measures to enhance transparency and the fight against tax evasion and avoidance COM(2016/451)final, p. 3.

[9] European Commission, Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches of 12 April 2016 COM(2016/198)final.

by the European Parliament[10] but which ran into sharp resistance from a number of Member States. It became evident right from the start that it would be overly ambitious to hope for unanimous agreement by all Member States of the European Union. But it seemed possible to secure a solid majority of Member States to support the proposal. This led to the issue of which procedure to apply. Two legal bases came to mind:

1. One possible legal basis can be found in Art. 115 TFEU, which empowers the Commission and the Council in a general fashion to harmonize those existing laws in Member States, which affect the establishment and the functioning of the Common Market. There are two features, which render the underlying procedure "special": The European Parliament has a right to be heard under this procedure but no right to veto the proposed measure, and – even more important – legislation under Art. 115 TFEU requires a unanimous vote in the Council.

2. A more specific provision is Art. 50 Paras. 1 and 2 letter g TFEU, which is part of the chapter on freedom of establishment and deals with legislation in the area of corporate law. It enables the European institutions to secure equal safeguards for shareholders and other constituencies. This legislation follows the rules of the "ordinary procedure" where the consent of the European Parliament is required and a qualified majority of votes in the Council suffices to pass legislation.

The European Commission took the view that any legislation requiring large companies to disclose certain information to a wider audience – including the proposed legislation on public country-by-country reporting – would fall within the ambit of corporate accounting law, which has for more than fifty years been the object of legislation under Art. 50 Paras. 1, 2 letter g TFEU (and its predecessors).[11] The European Parliament where MPEs originally had "two differing interpretations of the proposal, seeing it either as a means of fighting tax evasion and avoidance, or simply as the public disclosure of information",[12] eventually sided with the Commission.[13]

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[10] European Parliament, Recommendation following the inquiry on money laundering, tax avoidance and tax evasion of 13 December 2017, P8_TA (2017)0491, Paras. 39–42 (under the heading "tax legislation").

[11] European Commission supra note 8, Explanatory Memorandum, p. 3, Para. 2.

[12] Council of The European Union, Interinstitutional File 2016/0107 (COD), Outcome of the European Parliament's proceedings, 17 July 2017, p. 2.

[13] European Parliament, Report on the proposal for a directive of the European Parliament and of the Council amending Directive 2013/43/EU as regards disclosure of income tax information by certain undertakings and branches of 21 June 2017, A8-0227/2017 (Rapporteurs: Hugues Bayet, Evelyn Regner), p. 40 et seq. The European Economic and

The legal service of the Council took the opposite view.[14] It emphasized the fact that public country-by-country reporting is meant to influence taxpayer behavior and to identify cases of tax avoidance. Therefore, it should be qualified as fiscal law, which can only be harmonized under Art. 115 TFEU and which is excluded from the ordinary procedure for Internal Market legislation under Art. 114 Para. 1 TFEU. This follows from the explicit carve-out for fiscal provisions under Art. 114 Para. 2 TFEU. A substantial minority of Member States in the Council formally supported this position.[15]

While these controversial legal issues have not been solved in an authoritative manner until today, political pressure finally led to the agreement achieved on 1 June 2021. This article does not deal with the substantive merits of the new anti-avoidance tool. Rather, the following considerations attempt to disentangle the legal issues underlying a search for an appropriate legal basis. This is not merely of academic interest, given the fact that the Commission would like the European legislature to move forward with additional disclosure requirements such as a future directive requiring companies to disclose their "effective tax burden".[16]

2. The Legislative History of Country-by-Country Reporting

The current initiative to introduce "public" country-by-country reporting is connected to two earlier strands of European legislation, each of which has a different background and a different legal basis.

Social Committee supported the Commission's proposal without commenting on the legal basis (*European Economic and Social Committee*, Opinion, Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches of 21 September 2016 (ECO/407)).

[14] Council of the European Union, Interinstitutional File 2016/0107 (COD), Opinion of the Legal Service of 11 November 2016, 14384/16.

[15] Council of the European Union, Interinstitutional File 2016/0107(COD), Joint Statement by Cyprus, Czech Republic, Estonia, Hungary, Ireland, Latvia, Luxembourg, Malta, Slovenia and Sweden of 28 November 2019, 14038/19.

[16] European Commission, Communication from the Commission to the European Parliament and the Council: Business Taxation for the 21st Century, 18 May 2021, COM(2021)251 final, p. 9.

2.1. EU Legislation on Country-by-Country Reporting

The first trajectory is informed by international tax policy. Action Item 13 of the BEPS Action Plan which was agreed by the G20/OECD and its Inclusive Framework in 2015 requires those countries which have signed up to the BEPS Action Plan to increase tax transparency with respect to some proprietary information relevant for tax assessments.[17] Multinational firms, whose annual turnover exceeds 750 million € shall supply their local tax authorities with a "master file" describing the overall business model and some general features of the firm, a "local file" supplementing details on the local business units and, last but not least, a "country-by-country report". This report is focused on some key numbers and indicators of profit generation, assets, payroll, etc., broken down on a per-country basis. This information is meant to be shared with other tax authorities around the world under bilateral or multilateral agreements for which OECD provided "model legislation".[18] While these country-by-country reports are not allowed to serve as the legally binding measuring rod for the allocation of taxing rights between countries[19] (which are solely governed by double tax conventions including the arm's length standard) they can serve as an informational tool for tax authorities, providing them with indicators as regards instances of profit shifting and base erosion.

Political agreement on this international exchange of information with regard to country-by-country reporting was only reached at the level of the G20/OECD because signatory states promised confidential treatment of any information conveyed to them by foreign tax authorities.[20] There was wide consensus that tax secrecy (and this was a major point particularly for the United States) is a building block of taxpayers' rights and tax legislation around the world, which should not be negatively impacted by newly established channels, which make country-by-country reports accessible to a large number of tax authorities. This original concept of country-by-country reporting, which belongs to mandatory "minimum standards" of the BEPS Action Plan, was implemented within the

[17] OECD, *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 – 2015 Final Report*, p. 29, https://www.oecd.org/tax/transfer-pricing-documentation-and-country-by-country-reporting-action-13-2015-final-report-9789264241480-en.htm (accessed: 12.12.2023).

[18] *Ibidem*, p. 37.

[19] *Ibidem*, Para. 25.

[20] *Ibidem*, Paras. 44, 45, 57; V. Chand, S. Piciarello, *The Revamping of Public CbCR in Europe: much ado about nothing?*, Kluwer International Tax Blog, 1 June 2021, http://kluwertaxblog.com/2021/06/01/the-revamping-of-public-cbcr-in-europe-much-ado-about-nothing/ (accessed: 10.07.2021).

European Union by an amendment to the Directive on Administrative Cooperation in 2016.[21] This directive was enacted under the "special procedure" on the basis of Art. 115 TFEU.

From a political point of view this legislative history leads to the question of whether the current move towards public country-by-country reporting undermines the efforts of G20/OECD to establish a global standard established for confidential treatment of those reports. From a legal point of view the issue seems to be whether mandatory public country-by-country reporting can be introduced on a different legal basis than "private" country-by-country reporting, namely Art. 50 Paras. 1 and 2 letter g TFEU.

2.2. EU Legislation on Sector-Specific Public Country-by-country Reporting

The second source of the current legislation is corporate social responsibility. Aggressive tax planning by multinationals is viewed as an instance of anti-social behavior which firms should be obliged to report about to their shareholders and to the general public.[22] In recent years, the European Commission increased substantially the obligations of (listed) companies to provide insights in their business models and, in particular, information with regard to the effect their operations have on environmental and social goals.[23] Against this background, in 2013, the European institutions enacted two directives, which introduced targeted obligations to publicize country-by-country reports in specific economic sectors. One is the extractive and logging industry[24] and one is the banking industry:[25]

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[21] Council Directive 2016/881/EU of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, O.J. L 146/8 of 3 June 2016.

[22] See below Fn. 56.

[23] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, O.J. L 330/1 of 15 November 2014; European Commission, Proposal for a Directive of the Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) N0 537/2014, as regards corporate sustainability reporting of 21 April 2021 COM(2021)189 final.

[24] For an overview of the legal and practical issues see: European Commission, Review of country-by-country reporting requirements for extractive and logging industries, Final Report, 2018.

[25] Article 89 of the Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential

1. As there is a palpable nexus between the profits derived by global extractive businesses and local instances of exploitation and political corruption in developing countries, the relevant firms are obliged to disclose country-by-country reports. This will enable the general public to form a judgment on the correlation between their profits and the political and economic situation in the countries where those profits have been generated.

2. For banks, the justification is a different one. Here, the fact that governments have provided (and still provide) implicit guarantees for the banking sector including large-scale bail-out programs plays a decisive role. The issuance of country-by-country reports in the banking industry has been justified in order to check whether those financial firms, which benefit from public funds, are willing to contribute their "fair share" to the government in return. Against this background, a major amendment to the Capital Requirements Directive includes a specific obligation for banks to disclose their country-by-country numbers to a wider audience to ensure trust in the financial system.[26]

In both cases, European legislation was built on Art. 50 Paras. 1 and 2 letter g TFEU. The Commission has taken the position that the current plan to introduce a generalized obligation for large firms to disclose their key tax numbers to the general public should not be characterized differently.

3. Background and Content of the Competing Treaty Provisions

Before we can form a judgment on the suitability of those two treaty provisions to serve as a legal basis for public country-by-country reporting it makes sense to describe in more general terms the aim and scope of each of those provisions.

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supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, O.J. L 176/339 of 27 June 2013.

[26] Recent empirical research indicates that the (unexpected) introduction of public country-by-country reporting for banks in 2013 did not trigger any noticeable reaction from investors, see: V.K. Dutt, C. Ludwig, K. Nicolay, H. Vay, J. Voget, *Increasing Tax Transparency: Investor Reactions to the Country-by-Country Reporting Requirement for EU Financial Institutions*, "ZEW – Centre for European Economic Research Discussion Paper" 2018, No. 18-019, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3165410 (accessed: 10.07.2021).

3.1. Article 115 TFEU

3.1.1. Legislating for the Common Market

Article 115 TFEU is one of the most ancient pillars of European legislation. Its wording goes back to Art. 100 of the Treaty of Rome 1957 and it has remained largely unchanged since: "Without prejudice to Article 114, the Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market."

While this provision allows for wide-reaching harmonization of national laws in order to create and complete the Common Market, it requires a proposal by the Commission and a unanimous vote by the Council to pass such legislation. This unanimity requirement is meant to secure full support by all Member States' governments as the European Union encroaches upon areas formerly governed solely by national legislation. As regards the scope of legislation under Art. 115 TFEU one must understand that this provision does not address a specific field of law. Rather, all areas of legislation can be addressed under Art. 115 TFEU – provided that the legislative action at the level of the EU is required from the perspective of the establishment or the functioning of the Common Market. Article 115 TFEU is therefore not designed to empower the European institutions to enact whatever they want to. They must show that the harmonization of national legislation is necessary to establish and protect the European Market. This requirement is corroborated by the principle of "conferral" laid down in Art. 4 Paras. 1 and 5 Paras. 1, 2 TEU, which explicitly prohibits EU action outside specific legal bases provided under the Treaties. The need to avoid overly intrusive legislation is also strengthened by the principle of "subsidiarity" enshrined in Art. 5 Paras. 1, 3 TEU, which emphasizes the necessity for the European institutions to show that the aims and goals of EU action cannot be fulfilled as effectively or less intrusively at the level of the Member States.

Against this background, matters of direct taxation have been on the agenda of EU legislation under Art. 115 TFEU since the inception of the European Economic Community. As early as 1962, the "Neumark Report"[27] prepared by a number of experts from EEC Member States proposed wide-

[27] Europäische Wirtschaftsgemeinschaft, Kommission, *Bericht des Steuer- und Finanzausschusses*, 1962.

reaching harmonization measures covering not only business-related issues, like the corporate tax, but also legislation affecting the individual income tax and even inheritance tax. Over the years, many proposals to harmonize direct tax issues under Art. 115 TFEU were issued by the European Commission in order to tear down the fiscal borders between the Member States of the European Union but most of them floundered in the face of Member States' veto rights awarded by the unanimity principle. Member States did not want to give up their fiscal sovereignty easily. Still, some major projects like the Parent Subsidiary Directive, the Interest Royalty Directive or the Merger Directive were enacted over time, opening the doors for national business firms to establish subsidiaries and branches all over the territory of the European Union. This set of legislation was very much inspired by the theory of efficient allocation of resources within the EU and is fully in line with the underlying goal of the creation and completion of the Common Market.[28]

In recent years, the European Commission has reformulated its policy agenda in the area of taxation. The traditional goal to set free the economic forces of private actors has been moved to the back burner while the protection of the Member States' fiscal interests has taken center stage.[29] The most prominent example is the Anti-Tax-Avoidance Directive of 2016 (amended in 2017), which mandates Member States to implement a specific set of legal tools in their national tax laws in order to fight aggressive tax planning.[30] From a scholarly perspective, one might hesitate to confirm the compatibility of these anti-avoidance measures with the requirements of Art. 115 TFEU.[31] It could be argued that EU legislation under Art. 115 TFEU can only be passed in order to foster the economic freedom of European citizens and businesses but not to enable tax authorities to constrain that freedom. Taking a closer look, this criticism is ill-founded. It is true that it is not the task of the European Union to protect Member States' budgets at all costs and in all respects. But it can be said that the

[28] As to the limitations of tax harmonization in the context of tax competition see: W. Schön, *Tax Competition in Europe: The Legal Perspective*, "EC Tax Review" 2000, No. 2, p. 90.

[29] 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, 17 June 2015, COM(2015)302 final; European Commission, Communication from the Commission to the European Parliament and the Council: Business Taxation for the 21st Century, 18 May 2021, COM(2021)251 final.

[30] Council Directive (EU) 2016/1164 Laying Down Rules against Tax Avoidance Practices that Directly Affect the Functioning of the Internal Market of 12 July 2016, O.J. L 193/1 of 19 July 2016.

[31] I. Lazarov, S. Govind, *Carpet-Bombing Tax Avoidance in Europe: Examining the Validity of the ATAD under EU Law*, "Intertax" 2019, Vol. 47, No. 10, p. 859.

benefits reaped by individuals and businesses in the Internal Market – namely, the freedom to allocate goods, services, capital and persons at wish within the European Union, justify some counterbalance when the use of those market freedoms leads to increased options for tax fraud and tax avoidance.[32] Against this background, European legislation enacted on the basis of Art. 115 TFEU can enable the Member States to fight tax fraud, tax evasion and tax avoidance, if this is linked to cross-border activities of individual or corporate taxpayers.[33]

Such reading of Art. 115 TFEU has been at the core of the directives on mutual assistance in fiscal matters ever since the first directive on administrative cooperation was enacted in 1977.[34] This directive has been amended many times since, in particular in the wake of the BEPS Action Plan 2015 which inspired the introduction of automatic exchange of information between tax authorities on rulings, arrangements and – last but not least – country-by-country reports submitted by large multinational firms.[35] This legislative practice has been undisputed for nearly 45 years now and it can be taken for granted that Art. 115 TFEU might also serve as a legal basis for other measures protecting public revenue – provided that they focus on cross-border business activities related to the Internal Market.

3.1.2. "Fiscal Provisions" under Art. 114 Para. 2 TFEU

When the European Economic Community was founded in 1957, Art. 100 EEC-Treaty (the predecessor to Art. 115 TFEU) was the only wide-reaching legal basis for European legislation on the Common Market. In 1987, Art. 100 EEC-Treaty was supplemented by Art. 100a EEC-Treaty, which is the predecessor to today's Art. 114 TFEU. This provision allows the European institutions to pass legislative measures related to the establishment or the functioning of the Internal Market under the "ordinary procedure" which requires the consent of the European Parliament and a qualified majority

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[32] W. Schön, *Interpreting European Law in the Light of the OECD/G20 Base Erosion and Profit Shifting Action Plan*, "Bulletin for International Taxation" 2020, Vol. 74, No. 4/5, pp. 286, 289.

[33] In this respect the ATAD deserves criticism as it also affects purely domestic cases; see: D. Gutmann, A. Perdelwitz, E. Raingeard de la Bletiere, R. Offermanns, M. Schellekens, G. Gallo, A. Grant Hap, M. Olejnicka, *The Impact of the ATAD on Domestic Tax Systems: A Comparative Survey*, "European Taxation" 2017, Vol. 57, No. 1, p. 2.

[34] EU, Council Directive of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, O.J.L 336/15 of 27 December 1977, recital 3.

[35] Supra note 20.

of Member States representatives voting for the legislative measure in the Council. Against this background, most matters related to the internal market are no longer subject to legislation under Art. 115 TFEU but are dealt with under Art. 114 Para. 1 TFEU.

This access to the "ordinary procedure" under Art. 114 Para. 1 TFEU is subject to a small number of "carve-outs" under Art. 114 Para. 2 TFEU. One of these exemptions refers to "fiscal provisions" which can still only be harmonized under Art. 115 TFEU.[36] Taking a bird's eye view, it can be said that Art. 114 Para. 2 TFEU both confirms and constrains the power of the European Institutions to legislate in the area of taxation. On the one hand, it clarifies that fiscal issues are not outside the remit of the internal market and can be harmonized if this is required by its creation or completion under Art. 115 TFEU. On the other hand, it rules out to legislate in tax matters on the basis of the ordinary procedure under Art. 114 Para. 1 TFEU. From this follows that the borderline between "fiscal provisions" as mentioned in Art. 114 Para. 2 TFEU and other provisions affecting the Internal Market turns out to be decisive for the procedure to be followed, the level of involvement of the European Parliament, and the majority required in the Council for the passing of European legislation.

In two landmark cases decided by the European Court of Justice in 2004[37] and 2006,[38] respectively, the issue at stake was whether European legislation on administrative cooperation had to be qualified as falling within the ambit of "fiscal provisions". The European Commission (and the European Parliament) argued that "fiscal provisions" are provisions dealing with substantive tax law. Those provisions, which delineate taxable persons, taxable events, the tax base and the tax rate eventually define the tax burden of individuals and firms and are therefore also decisive for the size of the Member States' public revenues and budgets. Only these legislative measures should require the full consent of all Member States. The Court took a broader view. The Court clarified that also purely

[36] This article cannot go into the intense debate on whether to abolish the carve-out for tax legislation. While the Commission clearly wants to introduce qualified majority voting in (some if not all) areas of tax legislation – European Commission, Communication from the Commission to the European Parliament, the European Council and the Council, Towards a More Efficient and Democratic Decision-Making in EU Tax Policy, 15 January 2019, COM(2019)8 final; M. van de Leur, *The European Union's Push to Abolish Unanimity on Tax Policy*, "International VAT Monitor" 2019, Vol. 30, No. 4, p. 141; R. Goulder, *Should the EU Scrap the Unanimity Requirement*, "Tax Notes International", 14 January 2019, p. 245, https://www.taxnotes.com/special-reports/tax-policy/should-eu-scrap-unanimity-requirement/2019/01/11/291kw (accessed: 10.07.2021); W. Schön, *Facilitating Entry by Facilitating Exit: New Paths in EU Tax Legislation*, "Intertax" 2018, Vol. 46, No. 4, p. 339.

[37] CJEU, judgment, 29 April 2004, *Commission* v. *Council*, C-338/01.

[38] CJEU, judgment, 26 January 2006, *Commission* v. *Council*, C-533/03.

administrative norms, which focus on the assessment and enforcement of tax claims, fall under the concept of "fiscal provisions" as they materially contribute to the effective levying of the tax, strike a balance between the power of the tax authorities and the protection of the taxpayer's individual rights, and therefore play a major role for the collection of public revenue just as much as substantive tax legislation.[39] Against this background, the statement in the preamble of the new directive – "Given that this Directive does not concern the harmonization of taxes but only obligations to publish reports on income tax information, Article 50(1) TFEU constitutes the appropriate legal basis"[40] – falls short of fully appreciating the wide scope of "fiscal provisions" as laid out in the Court's jurisprudence.[41]

From this line of the CJEU's jurisprudence it follows that the concept of "fiscal provisions" under Art. 114 Para. 2 TFEU is rather wide, including both substantive and procedural aspects of taxation. This statement also informs the interpretation of Art. 115 TFEU: Harmonization of fiscal law (both substantive and procedural), which is meant to contribute to the Common Market can be pursued on the basis of this treaty provision. It is hardly a surprise that the exchange of information between tax authorities as regards country-by-country reports has been based on Art. 115 TFEU.[42] Why should things be different for "public" country-by-country reporting?

3.2. Article 50 Paras. 1 and 2 letter g TFEU

Article 50 Paras. 1 and 2 letter g TFEU is ancient material of the 1957 EEC Treaty as well. But unlike Art. 115 TFE it is not placed in the chapter on common rules on the approximation of laws. It is part of the chapter on the freedom of establishment, which gives Art. 50 Para. 2 letter g TFEU its specific flavor. When the founders of the EEC declared the freedom of establishment for companies to be part and parcel of the Internal Market, they felt the need to introduce the option to legislate at the European level in order to strike a balance between the new freedom of companies and their management on the one hand, and the interests of shareholders and third parties on the other hand. Thus, they entrusted the European Parliament, the Council and the Commission to harmonize national legislation in the area of corporate law in order to achieve equal and substantial protection

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[39] CJEU, judgment, 29 April 2004, *Commission* v. *Council*, C-338/01, Paras. 63–67; CJEU, judgment, *Commission* v. *Council*, C-533/03, Para. 47.

[40] Supra note 1, recital 12.

[41] Opinion of the Legal Service, supra note 13, Para. 31.

[42] Supra note 20.

for shareholders and third parties to coordinate: "to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 54 with a view to making such safeguards equivalent throughout the Union."

Against this background, we have witnessed more than fifty years of ongoing European legislation in the areas of corporate law and accounting law based on Art. 50 Para. 2 letter g TFEU.[43] Starting with the First Company Law Directive in 1968 this line of legislation produced major landmarks of corporate law harmonization such as the Capital Directive of 1977, the Accounting Directive of 1978, the directives on domestic mergers and divisions as well as on single-member companies. In recent years, the focus of corporate law harmonization moved to cross-border situations, in particular the wide-reaching directive on corporate mobility,[44] which was enacted in 2019, and provides a common framework for cross-border mergers, divisions, and transformations within the European Union.

Nevertheless, both the underlying aims and the true boundaries of the scope of Art. 50 Para. 2 letter g TFEU have always been under debate. The focus of this debate relates to the constituencies, which are entitled to protective legislative measures under Art. 50 Para. 2 letter g TFEU. One thing is clear: Protection of shareholders (vis-à-vis the management of the firm or vis-à-vis the influence of blockholders) is at the core of this provision. They are the "members" explicitly mentioned in that treaty provision. But who are the "others" mentioned in Art. 50 Para. 2 letter g TFEU as well? Again, some groups evidently have to be named here: company creditors and employees whose legal and economic position is very much dependent on the wellbeing of the company. But does Art. 50 Para. 2 letter g TFEU go beyond these groups traditionally covered by the body of corporate law? The European Court of Justice answers this question in the affirmative. In a number of landmark cases related to the scope of protection administered by the accounting law directives, the Court held that any third party might benefit from harmonization acts under Art. 50 Para. 2 letter g TFEU. Thus, in *Daihatsu* the Court held that an association of car dealers was entitled to access the financial accounts of a foreign car manufacturer's local subsidiary, which supplied those dealers (the

[43] For an overview see: S. Grundmann, *European Company Law. Organization, Finance and Capital Market*, 2nd ed., Intersentia, Antwerp 2012.

[44] EU, Directive 2019/2121 of the European Parliament and of the Council of 27 November 2019 amending EU, Directive 2017/1132 as regards cross-border conversions, mergers and divisions, O.J. L 321/1 of 12 December 2019.

association itself not being a creditor or a supplier of this firm).[45] And in *Axel Springer* the Court went so far to state that even competitors of small and medium-sized firms were entitled to enforce the firms' obligations to file their financial accounts with the local commercial registers as provided under the Accounting Directive.[46] While this line of jurisprudence ran into heavy criticism,[47] the Court has never taken any step towards constraining the powers of the European institutions to increase disclosure obligations for businesses under Art. 50 Para. 2 letter g TFEU.[48]

It comes as no surprise that the European Commission[49] in their proposal to legislate in favor of public country-by-country reporting and the European Parliament in its report[50] refer to the Court's judgment in *Daihatsu* in order to justify its choice of legal basis. If Art. 50 Para. 2 letter g TFEU provides a legal basis for the protection of any interest group somehow related to the behavior of corporate firms, and if its scope is not limited to a selected set of addressees, the scope of this provision can also encompass the interest of the general public to learn about tax-related key numbers of that firm. On the other hand, the Legal Service of the Council stated convincingly that the interest of the general public to receive information on corporate behavior has to be distinguished from the interest of the state to protect and increase public revenue.[51] Even if these two perspectives are somehow interrelated, a directive that puts tax enforcement in the center falls outside the scope of Art. 50 Para. 2 letter g TFEU.

4. The Aim of Public Country-by-Country Reporting

Given the wide scope attributed to both Art. 115 TFEU and Art. 50 Para. 2 letter g TFEU by the European Court of Justice it can be assumed that an obligation of a firm to disclose certain tax-relevant information to a wider audience can be based on both provisions alike. But this brings to the fore

[45] CJEU, judgment, 4 December 1997, *Daihatsu*, C-997/96; see also: CJEU, judgment, 29 September 1998, *Commission* v. *Germany*, C-191/95.

[46] CJEU, judgment, 23 September 2004, *Axel Springer*, C-435/02; CJEU, judgment, 21 June 2006, *Danzer*, T-47/02.

[47] W. Schön, *Corporate Disclosure in a Competitive Environment – The Quest for a European Framework on Mandatory Disclosure*, "Journal of Corporate Law Studies" 2006, Vol. 6, No. 2, p. 259.

[48] CJEU, judgment, 26 September, *Texdata*, C-418/11, Paras. 53–54.

[49] Supra note 1, recital 12.

[50] European Parliament supra note 12, p. 43.

[51] Opinion of the Legal Service, Paras. 23–24.

the decisive question: Which provision is the right one given the context of the new directive? As the Court has reiterated time and again, this is an objective issue subject to judicial review. In the first place, one has to look at the aims and content of this act of European legislation.[52] Is the aim of public country-by-country reporting to protect public revenue, to enforce tax claims and to change taxpayer behavior? This would lead us to Art. 115 TFEU. Or is the whole exercise about informing the general public about anti-social behavior, making shareholders and investors aware of "irresponsible" strategies chosen by the firm's management? This would seem to allow legislation under Art. 50 Paras. 1 and 2 letter g TFEU. And what happens if the new legislation shall promote both corporate responsibility and fiscal claims? According to the Court, this depends on the predominant purpose of the legislation in question: "If examination of a Community measure reveals that it pursues a twofold purpose or that it has a twofold component and if one of these is identifiable as the main or predominant purpose or component whereas the other is merely incidental, the act must be based on a single legal basis, namely that required by the main or predominant purpose or component."[53]

From this starting point it is evident that the search for the "true" purpose of the legislation lies at the heart of the debate.

4.1. The Public and Academic Debate

Reading the political statements and the scholarly literature preceding the current legislation it becomes clear that all kinds of justifications have been put forward to motivate the introduction of public country-by-country reporting, some of them clearly linked to tax enforcement, some of them clearly linked to corporate social responsibility.[54]

A very obvious link to the field of corporate accountability can be established whenever it is proposed that shareholders should know about

[52] CJEU, judgment, 29 April 2004, *Commission* v. *Council*, C-338/0, Para. 54; CJEU, judgment, 26 January 2006, *Commission* v. *Council*, C-533/03, Para. 43; CJEU, judgment, 8 September 2009, *Commission* v. *Parliament and Council*, C-411/06, Para. 45; CJEU, judgment, 19 July 2012, *Parliament* v. *Council*, C-130/10, Para. 42; CJEU, judgment, 6 May 2014, *Commission* v. *Parliament and Council*, C-43/12, Para. 29.

[53] CJEU, judgment of 29 April 2004, *Commission* v. *Council*, C-338/01, Para. 55; CJEU, judgment of 8 September 2009, *Commission* v. *Parliament and Council*, C-411/06, Para. 46; CJEU, judgment, 6 May 2015, *Commission* v. *Parliament and Council*, C-43/12, Para. 30.

[54] For the U.S. debate see: J.D. Blank, *Timing and the tax authority. Thematic Report*, [in:] F. Barasan Yavaslar, J. Hey (eds), *Tax Transparency*, EATLP International Tax Series, "IBFD" 2019, Vol. 17, pp. 211, 223.

the attitude of "their" firm towards aggressive tax planning.[55] Aggressive tax behavior – so it is said – can contribute to adverse reputational effects damaging profit expectations and share value. In extreme cases, tax avoidance can even be related to illegal diversion of profits by the management to the detriment of the shareholders. In this context, public country-by-country reporting is meant to protect shareholders against management behavior, which directly diminishes the value of their investment. But it can be doubted whether shareholders will truly benefit from complicated fiscal information that is hard to digest and creates additional compliance cost at the level of the corporation.[56]

Going beyond this "enlightened shareholder approach", there exists the notion that shareholders and potential investors might be interested to learn about tax-related strategies of firms because they have a preference for pro-social behavior and would rather forgo extra profits from aggressive tax planning in order to comply with ethical standards.[57] This approach is very much in line with recent European legislation on corporate disclosure rules, which are meant to enable the shareholders and potential investors to make informed decisions about the management's attitude towards corporate social responsibility when they invest in firms.[58] Again, it seems possible to allocate this legislative goal to Art. 50 Para. 2 letter g TFEU.

The situation is less clear when one identifies as the goal of public country-by-country reporting the information to the general public about tax-related behavior of large firms. This goal seems to be at the heart of the current debate, and it goes far beyond issues related to the corporate form of a firm or the freedom of establishment under Art. 49 TFEU. Here we talk about a public debate on "big business", about "naming and shaming" and about additional support for and pressure on the fiscal authorities to prosecute illicit tax strategies with full force.[59] Moreover,

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[55] N. Noked, *Public Country-by-Country Reporting: The Shareholders' Case for Mandatory Disclosure*, "Tax Notes International" 2018, Vol. 90, No. 14, p. 1501.

[56] M. Lagarden, U. Schreiber, D. Simons, C. Sureth-Sloane, *Country-by-Country Reporting Goes Public – Cui Bono?*, "International Transfer Pricing Journal" 2020, Vol. 27, No. 2, p. 91; W. Schön, *Tax and Corporate Governance: A Legal Approach*, [in:] *idem* (ed.), *Tax and Corporate Governance*, Vol. 3, Springer-Verlag, Berlin–Heidelberg 2008, pp. 50–51.

[57] A. Johnston, K. Sadiq, *Beyond Country-by-Country Reporting: A Modest Proposal to Enhance Corporate Accountability*, "New Zealand Universities Law Review" 2017, Vol. 27, No. 3, p. 569.

[58] Supra note 22.

[59] R. Seer, *Purpose and Problems of Tax Transparency: The Legal Perspective*, [in:] F. Barasan Yavaslar, J. Hey (eds), *Tax Transparency*, EATLP International Tax Series, "IBFD" 2019, Vol. 17, pp. 17, 35; S. Stevens, *Cutting-Edge Techniques to Collect Information from Taxpayers*, [in:] F. Barasan Yavaslar, J. Hey (eds), *Tax Transparency*, EATLP International Tax Series, "IBFD" 2019, Vol. 17, pp. 97 and 145. In developing countries where tax authorities are weak,

there seems to be the notion that public country-by-country reporting can somehow contribute to the "public trust" in the national tax system as such, including full enforcement of tax claims.[60] It is clear that doubts have been raised as to the risk of misinterpretation of the published numbers.[61] And it seems challenging to promote these goals under Art. 50 Para. 2 letter g TFEU even if we accept a wide concept of the protection of "others" under this provision.[62] These political aims are rather related to tax enforcement in general which – as we learned from the Court – falls under "fiscal provisions" within the ambit of Art. 114 Para. 2, Art. 115 TFEU.

Last but not least it is clearly one of the goals of both private and public country-by-country reporting to change tax-related behavior of firms. The management of the firm shall be incentivized to "align" profit allocation with real economic activities. Whether illegal or not, strategies that move intangible or financial assets to low tax jurisdictions shall be exposed, giving rise to intensified scrutiny both by the general public (in particular, the press and NGOs) and by tax authorities. It is suggested that firms want to avoid this kind of scrutiny and rather shy away from aggressive tax planning irrespective of the limitations set by the tax law itself.[63] Again, the relationship of this purpose of disclosure to the interest of tax authorities to constrain taxpayer behavior is much stronger than the impact on society at large or to specific shareholder and investor perspectives.[64]

4.2. The Directive

The directive itself presents us with a strange mix of both a tax-related and a CSR-related approach. What is more disturbing, the preamble to the directive has changed its wording and its tone manifestly between

public country-by-country reporting may well contribute to the enforcement of taxing rights, see: A.W. Oguttu, *Curtailing BEPS through Enforcing Corporate Transparency: The Challenges of Implementing Country-by-Country Reporting in Developing Countries and the Case for Making Country-by-Country Reporting Mandatory*, "World Tax Journal" 2020, Vol. 12, No. 1, p. 167.

[60] H. Gribnau, A. van Steenbergen, *Handle with Care: Transparency as a Means to Restore Trust in Taxation*, "Tilburg Law School Working Paper", Para. 8.2, https://www.researchgate.net/publication/349467308_Handle_with_Care_Transparency_as_a_Means_to_Restore_Trust_in_Taxation (accessed: 10.07.2021).

[61] V. Chand, S. Piciarello, *The Revamping of Public CbCR in Europe…*, supra note 19.

[62] For a fundamental critique see: W. Schön, supra note 46.

[63] There is some evidence that the introduction of "private" country-by-country reporting did have an effect on the organizational structure of multinational enterprises (L. De Simone, M. Olbert, *Real Effects of Private Country-by-Country Disclosure*, http://dx.doi.org/10.2139/ssrn.3398116).

[64] Opinion of the Legal Service, supra note 13, Para. 32.

the original proposal of 2016 and the final version agreed upon in 2021. This is particularly irritating as the content of the legal provisions in the directive prescribing the personal and material scope of the obligations of large firms to disclose key tax numbers to the general public (in particular Art. 48c of the Directive) did not change substantially between the drafting of the original proposal and the enactment of the final version.

From the legislative history it becomes evident, that the legislative motivation laid out in the preamble has been adjusted dramatically from a more tax-related purpose to a more CSR-related agenda.[65] Some of these changes were effected in early 2019[66] and additional adjustments were made in late 2019. At this point in time, the Finnish Presidency of the European Union explicitly proposed a number of changes to the directive's preamble hoping that: "clarifying the aim and content of the proposal could alleviate concerns regarding the legal base of the proposal, and pave the way for further negotiations at the Council. Several delegations as well as the Council Legal Service also highlighted this approach at the Competitiveness Council as well as at Economic and Financial Affairs Council."[67]

The first change to the preamble that deserves being mentioned is the fact that the preamble in the original proposal dealt heavily on the challenges of international tax avoidance, the need to align profit allocation with real activities for tax purposes and to improve tax fairness and tax transparency.[68] The "challenge posed by corporate tax avoidance" was therefore emphasized right in the first recital of the preamble and was called "a major focus of concern within the Union and globally."[69] This focus would justify the application of Art. 115 TFEU.[70] But this conceptual starting point has been fully erased in the final version of the preamble and replaced with the rather bland statement that "transparency is essential for a smooth functioning of the Single Market."[71] The draftsmen evidently felt the need to avoid any language that might make it necessary to employ the "special procedure" under Art. 115 TFEU.

[65] See also the large number of proposed amendments to the preamble coming from the European Parliament's deliberations – Council of the European Union, Interinstitutional File 2016/0107(COD), Outcome of the European Parliament's proceedings of 17 July 2017, 10932/17, p. 4 et seq.

[66] Council of the European Union, Interinstitutional File 2016/0107(COD), Presidency compromise proposal – State of Play of 17 January 2019, 5134/19.

[67] Council of the European Union, Interinstitutional File 2016/0107(COD), Information from the Presidency of 20 December 2019, 15285/19.

[68] Supra note 8, recital 1.

[69] Supra note 8, recital 1.

[70] Opinion of the Legal Service, supra note 13, Para. 9.

[71] Supra note 1, recital 1.

This new tone sets the scene for the ensuing parts of the preamble. Both the original and the final version refer to demands expressed by the European Parliament. In recital 2 of the original version the necessity to counter international tax avoidance was stressed: "The European Parliament in its resolution of 16 December 2015 on bringing transparency, coordination and convergence to corporate tax policies in the Union acknowledged that increased transparency in the area of corporate taxation can improve tax collection, make the work of tax authorities more efficient and ensure increased public trust and confidence in tax systems and governments."[72]

This passage has been replaced in the final version with the following reference to a different statement of the European Parliament, which leaves out any visible link to the position of tax authorities and tax collection: "The European Parliament has stressed the need for an ambitious public country-by-country reporting as a means of increasing corporate transparency and enhancing public scrutiny."[73]

And there is more: The original preamble contained an extensive reference to the BEPS Action Plan and its implementation under the Anti-Tax Avoidance Directive as well as the transposition of Action 13 of the BEPS Action Plan on country-by-country reporting into the Directive on Administrative Cooperation and domestic law.[74] We cannot find this passage in the final text – an evident attempt to cut the obvious ties with the fiscal background of country-by-country reporting in general.

A similar change of paradigm can be found when it comes to the way the ultimate goals of public scrutiny regarding corporate tax information are described. In the original proposal, recital 5 of the preamble contained the following language, which justifies the application of Art. 115 TFEU:[75] "Enhanced public scrutiny or corporate income taxes borne by multinational undertakings carrying out activities in the Union is an essential element to further foster corporate responsibility, to contribute to welfare through taxes, to promote fairer tax competition within the Union through a better informed public debate and to restore public trust in the fairness of the national tax systems."[76]

Paragraph 2 of the final version of the preamble reads as follows:

"In parallel with the work undertaken by the Council to fight corporate income tax avoidance, it is necessary to enhance public scrutiny

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[72] Supra note 8, recital 1.
[73] Supra note 1, recital 2.
[74] Supra note 8, recital 4.
[75] Opinion of the Legal Service, supra note 13, Para. 11.
[76] Supra note 8, recital 5.

of corporate income taxes borne by multinational undertakings carrying out activities in the Union, as this is an essential element to further foster corporate transparency and responsibility, thereby contributing to the welfare of our societies."[77]

"Providing such scrutiny is also necessary to promote a better informed public debate regarding in particular the level of tax compliance of certain multinational undertakings active in the Union and the impact of this on the real economy. The setting of common rules on corporate income tax transparency will also serve the general economic interest by providing for equivalent safeguards throughout the Union for the protection of investors, creditors and other third parties generally, and thus contribute to regaining the trust of citizens of the Union in the fairness of the national tax systems".[78]

The following recital of the reframed preamble shows a similar ambiguous picture: "Public country-by-country reporting is an efficient and appropriate tool to increase transparency in relation to the activities of multinational undertakings, and to enable the public to assess the impact of those activities on the real economy. It will also improve shareholders' ability to properly evaluate the risks taken by undertakings, lead to investment strategies based on accurate information and enhance the ability of decision-makers to assess the efficiency and the impact of national legislations."[79]

Moreover, the legislators have proudly amended the original proposal by stating that: "by an unprecedented introduction of public country-by-country reporting (the Union) has become a global leader in the promotion of financial and corporate transparency"[80] and "[m]ore transparency in financial disclosure results in advantages for all since civil society becomes more involved, employees are better informed and investors less risk-averse. In addition, undertakings will benefit from better relations with stakeholders, which leads to more stability, along with easier access to finance due to a clearer risk profile and an enhanced reputation."[81]

These manifold explicit attempts to "modify" the aims and goals of the directive leave behind the impression of manipulation. Can it be true that a piece of legislation, which was not changed on its merits during the legislative process, and which was heavily attacked for lack of legal basis from inside and outside the Council, can be saved by a flurry of

[77] Supra note 1, recital 2.
[78] Supra note 1, recital 2.
[79] Supra note 1, recital 3.
[80] Supra note 1, recital 4c.
[81] Supra note 1, recital 4e.

changes to the preamble? By "cheap talk"? And what are we to make of the fact that the Portuguese Presidency of the European Union announced the final agreement as a major step to ensure hefty tax payments by big multinational companies who are called upon to "pay their fair share"?[82] Did they take their own words seriously? It seems advisable that the reference to the aims and goals of legislation in the preamble should not be the only decisive factor when it comes to the identification of the right legal basis.

5. The Content of Public Country-by-Country Reporting

In its jurisprudence, the CJEU has made clear that "the choice of the legal basis for a (Union) measure must rest on objective factors amenable to judicial review, which include the aim and content of that measure".[83] This prescription leads us to the "content" of the legislative measure, which did not change in the process of legislation. There are only some minor amendments, which try to accommodate the interest of businesses to protect commercially sensitive information and to accommodate fears not to create a competitive disadvantage for European firms when their global competitors are not subject to similar obligations.

The problem is that a closer look at the content of the mandatory disclosure provisions laid down in the new directive does not make us much wiser when it comes to the search for the right legal basis for public country-by-country reporting. It is pretty unclear – as *Hey* puts it – whether "legislative intention, the scope of published data and the effects of the publication match"[84] at all. As the information, which the company is obliged to disclose, will be accessible to shareholders, investors, the general public and tax authorities alike, one cannot draw a clear line from the content of the new provisions to the overall purpose and character of the new rules. While it is fair to say that tax authorities do not need that information as such (given the extensive information channels they control anyway, including "private" country-by-country reporting) it is evident that public pressure on taxpayers to accept full tax transparency

[82] Supra note 5.

[83] Supra fn. 50.

[84] J. Hey, *Transparency and Publicity*, [in:] F. Barasan Yavaslar, J. Hey (eds), *Tax Transparency*, EATLP International Tax Series, "IBFD" 2019, Vol. 17, pp. 193, 208.

will indirectly support the work of tax authorities substantially. Moreover, the behavioral changes brought about by the new rules might reduce tax avoidance and increase public revenue. But one big question remains: What do we actually know about the real-life implications of the new set of rules? Not much so far.

Against this background, analyzing the content of the directive will not enable us to make a final statement on the correct legal basis for the new rules on public country-by-country reporting.

6. The European Framework for Fiscal Legislation

In my view, one should approach the issue of the legal basis for this kind of legislation by taking a fresh look at the overall institutional framework of the European Treaties. In accordance with the principle of conferral, the European Union does not have the power to legislate freely in non-exclusive areas. It has to show a legal basis for its actions, and it has to respect the sovereignty of Member States in areas where the Member States have reserved the right to veto legislative action at the level of the EU. This has been the case for taxation law ever since 1957. Both Art. 113 (which governs the legislative powers of the European institutions in the area of indirect taxation) and Art. 115 (which governs the legislative powers of the European institutions in the area of direct taxation) guarantee each Member State the right to veto tax measures initiated by the Commission in the Council. This sovereign right has been retained and preserved under Art. 114 Para. 2 TFEU. This treaty provision carves out fiscal provisions from the field of application of the "ordinary procedure", which enables the Council to act under qualified majority voting.

As we have seen, the new rules for mandatory disclosure of key tax numbers easily fall within the ambit of the concept of "fiscal provisions" under Art. 114 Para. 2 TFEU. They affect the individual rights of taxpayers (both in their commercial behavior and as regards individual tax secrecy) and they affect the approach taken by Member States as to the way they go about tax assessments and tax enforcement. The new rules interfere massively with the relationship between the tax authorities and the taxpayers in the Member States of the European Union. This justifies the assumption that – when we compare Arts. 114 and 115 TFEU – one has to apply Art. 115 TFEU in just the same manner as Art. 113 TFEU in the field of indirect taxation.

Does this picture change because the new rules additionally fulfil a role in the context of corporate social responsibility? The Commission and the European Parliament are of the opinion that Art. 50 Paras. 1 and 2 letter g TFEU sidelines Art. 115 TFEU, given the "special" character of that treaty provision. But this argument is not persuasive. Article 50 Para. 2 letter g TFEU is just an emanation of the general legal basis for harmonization measures to be found in Arts. 114, 115 TFEU. It does not create institutional powers that would otherwise not exist under Arts. 114, 115 TFEU. One should rather assume that the carve-out formulated in Art. 114 Para. 2 TFEU for tax measures should be applied in the context of Art. 50 Para. 2 letter g TFEU as well. This is due to the fact that – and this is most important – the alternative between Art. 114 Para. 1 TFEU and Art. 50 Para. 2 letter g TFEU which are both following the "ordinary procedure" does not change the level of intrusion into the Member States' fiscal sovereignty at all. The fate of the directive's preamble shows this quite clearly: The principle of unanimity shall protect the Member States from interference by the European legislature in the field of taxation. This interference does not go away simply because the measure in question purports to pursue a second or even another predominant goal – namely, to promote corporate accountability. You cannot deprive Member States from their constitutional rights by changing the preamble without changing the material content of the legislation.

It is interesting to see that in the jurisprudence delivered by the Court in these matters, the Court regularly states that whenever a legislative measure touches upon two different areas simultaneously, and with equal relevance, one should apply both underlying procedures simultaneously.[85] But the Court does not give us a clear answer as to how to proceed if these two procedures are not compatible with each other, e.g., when both the ordinary procedure and the special procedure apply. The Court shows a tendency to favor the EU-friendly "ordinary procedure" over the "special procedure" as this path secures full involvement of the European Parliament and reduces veto rights for Member States.[86] In my view, the institutional framework of the European treaties demands in tax matters that the sovereignty of the Member States should be respected as far as possible. Against this background, the traditional principle of unanimity, which we still find in many places, including the flexibility

[85] CJEU, judgment, 29 April 2004, *Commission* v. *Council*, C-338/01, Para. 56; CJEU, judgment, 8 September 2009, *Commission* v. *Parliament and Council*, C-411/06, Para. 47; CJEU, judgment, 19 July 2012, *Parliament* v. *Council*, C-130/10, Para. 44.

[86] CJEU, judgment, 11 June 1991, *Commission* v. *Council*, C-300/89, Paras. 18–20.

clause in Art. 352 TFEU, should form the residual baseline. This leads us to Art. 115 TFEU, which – I respectfully submit – is the true legal basis for the upcoming legislation on public country-by-country reporting.

7. Conclusion

The hotly contested issue of whether public country-by-country reporting can be introduced on the basis of a majority vote or on the basis of unanimity in the Council, has so far been discussed by reference to the "true purpose" of this new set of rules. The perspective taken in the debate oscillates between fighting corporate tax avoidance and protecting public revenue on the one hand, and shareholder control and public scrutiny of big business on the other hand. One of the less beautiful aspects of this debate lies in the fact that the European institutions over time "adjusted" the preamble of the draft directive in order to comply with the less demanding procedural set-up. It seems much more advisable to take a close look at the effect of the new legislation on the division of powers between the European institutions and the Member States and to accept the protective dimension of the principle of unanimity in this respect. If the Commission and the European Parliament want to pursue policies in the area of taxation, they should take on the Council and try to establish a unanimous vote than to resort to tactical moves which will finally undermine the constitution of Europe and the legitimacy of European legislation.

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Abstract

The article deals with the reporting obligations laid down by the European Commission, Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU of 1 June 2021 (so-called "public country-by-country reporting") obliging certain corporate income taxpayers to disclose to the general public sensitive business information i.e., number of employees, level of pre-tax profits, level of taxes accrued, and taxes paid designed to prevent and to sanction corporate tax avoidance. The Author discusses whether such rules can be introduced based on the majority vote or on the basis of unanimity.

Keywords: Public Country-by-Country Reporting: Corporate Law, Fiscal Law, Principle of Unanimity

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Stafford Smiley[1]

The U.S. – Poland Income Tax Treaty

1. Introduction

During the 1990's and the early 2000's, the United States Treasury Department (hereafter: the "Treasury") undertook a program of renegotiating all of the U.S. income tax treaties that did not contain a limitation on benefits ("LOB") provision. By 2010, this effort was virtually complete: the two outstanding treaties that the Treasury was concerned about were the treaties with Hungary and Poland, both of which dated back to the 1970's and were concluded during the era of the Soviet Union's domination of Eastern Europe.[2] The Treasury, wielding the threat of abrogating these treaties entirely, negotiated new tax treaties with Hungary (signed in February 2010)[3] and Poland (signed in February 2013).[4] The new treaty with Hungary was submitted to the United States Senate for ratification

[1] Prof. Stafford Smiley, JD, Harvard Law School (1976), Professor, Graduate Tax Program, Georgetown Law Center, Washington, DC.

[2] United States – Poland Income Tax Convention, https://www.irs.gov/pub/irs-trty/poland.pdf (accessed: 21.03.2021); Tax Convention with the Hungarian People's Republic, https://www.irs.gov/pub/irs-trty/hungary.pdf (accessed: 21.03.2021).

[3] Convention between the Government of the United States of America and the Government of the Republic of Hungary for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-Hungary-2-4-2010.pdf (accessed: 21.03.2021).

[4] Convention between the United States of America and the Republic of Poland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-Poland-2-13-2013.pdf (accessed: 21.03.2021).

in November 2010[5] and the new treaty with Poland was submitted to the Senate in May 2014.[6] Almost a decade later, neither of these treaties has been ratified by the Senate.

2. The 2006 U.S. Model Convention

The starting point for the negotiations between the Treasury and Poland was the U.S. Model Income Tax Convention published by the Treasury in 2006 (hereafter: the "2006 U.S. Model Treaty").[7] A comparison of the text of the new U.S. tax treaty with Poland (hereafter: U.S. – PL DTC) with the text of the 2006 U.S. Model Treaty shows that the majority of the provisions of the Polish Treaty have been lifted verbatim from the 2006 U.S. Model Treaty.

Critically, the 2006 U.S. Model Treaty contained the Treasury's latest version of its LOB provision. This provision, embodied in Art. 22 of the 2006 U.S. Model Treaty, limits the benefits of the Treaty to taxpayers that are not only residents of the treaty partner, but "qualified" residents of the treaty partner. Thus, under Art. 22 of the U.S. – PL DTC, only Polish resident taxpayers that have an adequate economic connection to Poland are entitled to claim benefits from the United States. For example, a publicly traded corporation tax resident in Poland may claim benefits under the tax treaty if it is publicly traded on the Warsaw Stock Exchange or is managed and controlled from Poland. Also, a corporation tax resident in Poland may claim benefits under the tax treaty if it is owned and controlled by a limited number of Polish resident corporations which are themselves qualified to claim benefits from the United States under the tax treaty.

Treasury experience in negotiating treaties under the 2006 U.S. Model Treaty had led to three additional provisions that extended the definition of "qualified taxpayer" under the 2006 U.S. Model Treaty. All three of these provisions are included in the U.S. – PL DTC.

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[5] Message from the President of the United States transmitting Convention between the Government of the United States and the Government of the Republic of Hungary for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Treaty Doc. 111-7, 111th Congress, 2nd Session.

[6] Message from the President of the United States transmitting the Convention between the United States of America and the Republic of Poland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Treaty Doc. 113-5, 113th Congress, 2nd Session.

[7] United States Model Income Tax Convention of 15 November 2006, https://www.irs.gov/pub/irs-trty/model006.pdf (accessed: 21.03.2021).

First, the U.S. – PL DTC introduces the concept of "equivalent beneficiaries," that is, taxpayers who are entitled to benefits under another U.S. tax treaty with a European Union Member State that are at least as favorable as the benefits under the U.S. – PL DTC.[8] If a Polish resident corporation is owned and controlled by a limited number of equivalent beneficiaries, and if less than 50 of its gross income is paid to persons who are not equivalent beneficiaries, then the corporation is entitled to claim benefits from the United States under the tax treaty.

Second, the U.S. – PL DTC introduces the concept of a "headquarters company."[9] Under the U.S. – PL DTC, a corporation tax resident in Poland may claim benefits from the United States if the company owns and actively manages businesses in at least five different countries and earns less than 25% of its gross income in the United States.

Finally, the U.S. – PL DTC includes a rule that prohibits a Polish tax resident corporation from claiming benefits from the United States for income earned through a permanent establishment in a third country if the combined rate of tax in Poland and the third country is less than 60% of the Polish rate of tax that would apply if the income were earned in Poland.[10]

3. Variations from the 2006 U.S. Model Treaty

The most obvious difference between the U.S. – Poland DTC and the 2006 U.S. Model Treaty relates to the rate of withholding tax levied on interest and royalties. Under the U.S. – PL DTC, the country of residence may tax interest and royalties, but the country of source is limited to a withholding tax rate of 5%.[11] The 2006 U.S. Model Treaty prohibits the source country from imposing any withholding tax at all.

Interestingly, the U.S. – PL DTC does not adopt a related provision that has appeared in some recent U.S. tax treaties but was not included in the 2006 U.S. Model Treaty: namely, the elimination of the withholding tax on dividends paid by a subsidiary in one treaty country to its parent in the other treaty country. Under the U.S. – PL DTC, such dividends are subject to a 5% withholding tax comparable to the tax on interest and royalties.[12]

[8] United States – Poland Income Tax Convention, Art. 22, sec. 3, see: supra note 2.

[9] United States – Poland Income Tax Convention, Art. 22, sec. 5, see: supra note 2.

[10] United States – Poland Income Tax Convention, Art. 22, sec. 6, see: supra note 2.

[11] United States – Poland Income Tax Convention, Art. 11, sec. 2, and Art. 12, sec. 2, see: supra note 2.

[12] United States – Poland Income Tax Convention, Art. 10, sec. 2, see: supra note 2.

A variation of a different sort appears in Art. 7 of the U.S. – PL DTC, which adopts not the language of the 2006 U.S. Model Treaty, but, rather, the language of the OECD Model Convention on Income and Capital (hereafter: OECD MC) most recently issued by the Organization for Economic Cooperation and Development. The OECD MC language firmly establishes the principle that a branch of a company located in one treaty country must be treated AS IF it were a separate corporation from its home office in the other treaty country, and the arm's length principle applied to the two deemed corporations as it would between a parent company and its subsidiary. This probably does not mean a substantial change in U.S. treaty policy, but it puts in the past U.S. arguments that you cannot recognize transactions between a home office and its branch for purposes of applying the arm's length principle.

Finally, the U.S. – PL DTC does not adopt another provision that has been added to the OECD MC in a number of recent treaties, namely, a provision for binding arbitration of tax disputes between competent authorities. The U.S. – PL DTC maintains the competent authority provisions of Art. 25 of the OECD MC largely intact.

4. Information Exchange

Article 26 of the 2006 U.S. Model Treaty provides for information exchange between the competent authorities of the two treaty partners. Article 26 of the U.S. – PL DTC largely follows the 2006 U.S. Model Treaty. One change of note relates to the standard of what information is subject to exchange. The U.S. – PL DTC moves from the 2006 U.S. Model Treaty standard of "information as may be relevant" to the OECD MC language of "information foreseeably relevant" to the administration of the tax system of the requesting tax authority.[13] This does not appear to be a substantive change of any magnitude and was intended merely to bring the U.S. standard into line with the international practice as evidenced by the latest OECD pronouncement.

While information exchange is a long-standing element of all U.S. tax treaties, it is critical to note that the provisions of the U.S.'s existing treaties have to some extent been superseded by developments following the enactment of the Foreign Account Tax Compliance Act ("FATCA") in 2010. Specifically, the United States and Poland have entered into an

[13] United States – Poland Income Tax Convention, Art. 26, sec. 1, see: supra note 2.

intergovernmental agreement under FATCA under which the Polish tax authorities have agreed to provide the U.S. tax authorities with information of the type that would be deliverable under Art. 26 of the Model Treaty.[14] The United States and Poland have also entered into an agreement providing for exchange of their respective Country by Country reports as envisaged by the OECD Base Erosion and Profit Shifting ("BEPS") project.[15]

5. Efforts at Ratification

Poland completed the steps necessary to ratify the U.S. – PL DTC before the end of the calendar year 2013.

The history of the U.S. – PL DTC in the United States has been quite different. The Department of the Treasury published its Technical Explanation of the U.S. – PL DTC (the "Technical Explanation") in June 2014.[16] Meanwhile, the President had submitted the Treaty to the Senate for ratification and the Joint Committee on Taxation had prepared its Report on the Treaty for the Senate (the "JCT Report").[17] The Treaty was referred to the Senate Committee on Foreign Affairs, which held hearings on the Treaty in June 2014 and reported it out to the full Senate, with a favorable recommendation, in July 2014.[18] The Senate did not act on the Treaty before the end of the then-current session of Congress in December 2014. The Senate Foreign Relations Committee again held hearings on the Treaty in late 2015 and reported it out again to the full Senate with

[14] Agreement between the Government of the United States of America and the Government of the Republic of Poland to Improve International Tax Compliance and to Implement FATCA, https://home.treasury.gov/system/files/131/FATCA-Agreement-Poland-10-7-2014.pdf (accessed: 21.03.2021).

[15] Arrangement between the Competent Authority of the United States of America and the Competent Authority of the Republic of Poland on the Exchange of Country-by-Country Reports, https://www.irs.gov/pub/fatca/poland_competent_authority_arrangement_cbc.pdf (accessed: 21.03.2021).

[16] Department of the Treasury Technical Explanation of the Convention between the United States of America and the Republic of Poland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-Technical-Explanation-Poland-6-19-2014.pdf (accessed: 21.03.2021).

[17] Joint Committee on Taxation, Explanation of Proposed Income Tax Treaty between the United States and Poland, JCX-68-14 (17 June 2014).

[18] Tax Convention with Poland, Exec. Report 113-11, 113th Congress, 2nd Session.

a favorable recommendation in April 2016.[19] Again, the Senate did not act on the Treaty before the end of the then-current session of Congress in December 2016.

The reason for the failure of the Senate to act on the U.S. – PL DTC is a simple one: Senate procedures require unanimous consent to proceed to consideration of a treaty on an expedited basis, and Senator Rand Paul of Kentucky has objected to the consideration of any treaty that includes exchange of information provisions such as those found in the 2006 Model and the U.S. – PL DTC. Moreover, the Republican leadership of the Senate has been unwilling to devote effort and time to moving treaties through the ratification process required in the absence of unanimous consent.

6. Ratification and the BEAT

After the failure of the U.S. – PL DTC to gain ratification during the session of Congress that ended in 2016, neither the Trump Administration nor the Senate Foreign Relations Committee moved to bring the Treaty before the Congress in the years 2017–2019. The U.S. – PL DTC, and tax treaties with Switzerland, Luxembourg, Spain, Japan, Chile and Hungary, remained in legislative limbo.

The situation changed in mid-2019, reportedly because a Kentucky corporation owned by a Spanish parent corporation pressed the Senate Majority Leader Mitch McConnell of Kentucky, to facilitate ratification of the Spanish treaty that had been signed in 2013. At this time, at a meeting between officials of the Department of the Treasury and the Senate Foreign Relations Committee, the Trump Administration agreed to support the ratification of the four tax protocols that had been previously considered – those with Switzerland, Luxembourg, Spain and Japan – but declined to support ratification of the three treaties that were entirely new – those with Chile, Hungary and Poland.[20] The Trump Administration took the position that it would only support those three treaties if the ratification resolutions contained explicit statements that the ratification of the treaties would not override any inconsistent provisions of the Tax Cuts and Jobs Act of 2017 (the "TCJA") – the Trump Administration's signature tax cut.

[19] Tax Convention with Poland, Exec. Report 114-3, 114th Congress, 2nd Session.

[20] Foreign Relations Committee, *Menendez Asks Sec. Mnuchin to Explain Attempts at Changing International Tax Treaties*, 2019, https://www.foreign.senate.gov/press/ranking/release/menendez-asks-sec-mnuchin-to-explain-attempts-at-changing-international-tax-treaties (accessed: 21.03.2021).

The Trump Administration's primary concern was with the so-called BEAT provision, the Base Erosion and Anti-Abuse Tax, which has been widely criticized as inconsistent with the anti-discrimination provisions present in all U.S. tax treaties, including the U.S. – PL DTC. Under the U.S. rule that statutes and treaties are of equal status, and that the last in time prevails, ratification of these three treaties without such an explicit reservation could have had the effect of repealing anything in the TCJA inconsistent with the treaties and, arguably, preventing the enforcement of the BEAT against Chilean, Hungarian and Polish taxpayers.

Senator McConnell moved the four tax protocols to ratification by the Senate in July 2019, with the final ratification votes being almost unanimous in favor, excepting only Senator Paul and Senator Lee of Utah. The protocols with Switzerland, Luxembourg, Spain, and Japan have now entered into force. But the treaties with Chile, Hungary and Poland remain in legislative limbo due to the arcane procedural rules of the United States Senate.

7. The Biden Administration

The expiration of the 116th Congress on 3 January 2021, means that the process of ratifying the Polish and Hungarian treaties must begin again in the 117th Congress. The Biden Administration has indicated that it would like to move forward with the tax treaties with Poland, Hungary and Chile that remain pending in the Senate.[21] But Senator Paul remains in the Senate and retains his veto over the expedited process of obtaining Senate ratification of the treaties. So as of the date of this writing, February 2021, the status of the tax treaties with Poland and Hungary remains in limbo.

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[21] See question 24 at *Finance Committee Questions for the Record*, 2021, https://www.finance.senate.gov/imo/media/doc/Dr%20Janet%20Yellen%20Senate%20Finance%20Committee%20QFRs%2001%2021%202021.pdf (accessed: 21.03.2021).

Foreign Relations Committee, *Menendez Asks Sec. Mnuchin to Explain Attempts at Changing International Tax Treaties*, 2019, https://www.foreign.senate.gov/press/ranking/release/menendez-asks-sec-mnuchin-to-explain-attempts-at-changing-international-tax-treaties (accessed: 21.03.2021).

Abstract

The article deals with the U.S. program of renegotiating all the U.S. income tax treaties including the 2013 tax treaty between the U.S. and Poland. The Author discusses reasons why almost a decade later, neither of these treaties has been ratified by the U.S. Senate.

Keywords: tax treaties, ratification, U.S. Model

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Yusen Tan[1]

A Case Study to the Tax Arrangements Concerning China's Biggest Investment Project in Poland

1. Introduction

The newly signed China European Union Agreement on Investment (hereafter: "China-EU Investment Agreement") is expected to open a door for Chinese investors that intend to do business in the European Union market (hereafter: "EU market") within the industry category permitted by this investment agreement such as green energy and other industries open to China investors. In China's stock market, the stock price of some listed companies that specialize in green energy or have carried out business in the EU market (for instance, shipping transportation or railway transportation between China and the EU) increased significantly.

Since investment in the EU has become a hot topic recently, Chinese investors would like to ask one question: first of all, how to arrange a tax plan that fits my proposed investment in the EU market?

Fortunately, before the conclusion of the China-EU Investment Agreement, there have been some companies who entered the EU market and accumulated valuable experiences in dealing with the tax planning issues concerning their investment projects in EU member states.

Among the first companies to establish themselves in Poland, Liugong is the biggest Chinese investor in Poland, and established a subsidiary here. The company established itself by purchasing the Polish state-owned HSW Company, in 2012. Interestingly, the Chinese name of "Liugong" could be

[1] Dr. Tan Yusen, Ph.D. in Economics (2014), lecturer, Shanghai Lixin University of Accounting and Finance, China, former research fellow of the Centre of Tax Documentation and Studies of the University of Lodz, Poland.

divided into "Liu" and "Gong". The "Liu" represents the location of its parent company, the city of Liuzhou in the Guangxi Zhuang Autonomous Region; the "Gong" means manufacturing industry. Liuzhou is the biggest manufacturing base in Guangxi Zhuang Autonomous Region. Guangxi Zhuang Autonomous Region, a region dominated by the Zhuang minority, is located in south of China.

1.1. Previous Literature Review

In recent years, some tax law professors[2] and tax practitioners[3] in China conducted research or offered tax advice on the selection of an ideal jurisdiction for the establishment of an intermediary holding company for Chinese investors who intend to invest in the EU under the One Belt One Road Initiative. Several articles[4] focused on how to update, modify, or coordinate China's current international tax law (including tax treaties and domestic tax laws) to serve outward investments.

Some tax specialists[5] employed by these Chinese enterprises also released some articles on the tax planning arrangements. China's tax officials[6] provided advice to these enterprises on how to mitigate tax risks arising in outward investments or analyzed how to enhance international cooperation in tax administration to defend China's fiscal revenue.

Literature contributed by European authors focus on the anti-avoidance issues, such as the reform of Poland's thin capitalization rules[7] or the complexities and practical application of the Portugal thin capitalization.[8] One article[9] emphasizes the importance of coordinating

[2] 王素荣，付博，"一带一路"沿线国家公司所得税政策及税务筹划，财经问题研究, Vol. 1(398), January 2017, pp. 84–92.

[3] 德勤中国税务技术中心. 中国企业境外投资的税务安排, 2012, No. 08.

[4] 崔晓静，"一带一路"跨境融资贷款利息税收的法律协调. 法商研究，2020，Vol. 37, No. 3, pp. 30–43; 柳光强、李明扬、潘雷, "一带一路"倡议下促进企业"走出去"的税收政策探讨. 财政监督, 2020, No. 12, pp. 73–78.

[5] 李文江, 浅谈印度尼西亚工程项目外账税务筹划. 交通财会, 2020.10 (总第399期).

[6] 徐鸿、史永健、曹煜、刘春雨，"走出去"企业PPP模式下的涉税风险分析及建议. 税务研究, 2020, Vol. 8, pp. 102–105; 王伟诚, "一带一路"税收征管合作机制：特点、理论依据及世界意义. 国际税收, 2020, Vol. 6, pp. 8–12.

[7] M. Szafarowska, *Poland: Polish Thin Cap Rules to Change*, "International Tax Review" 2014, No. 9, p. 12.

[8] A. Martins, *Thin Capitalization and its Practical Application in Portugal: A Note*, "International Journal of Law and Management" 2012, Vol. 54, No. 4, pp. 274–283.

[9] A. Haufler, M. Runkel, *Firm's Financial Choices and Thin Capitalization Rules under Corporate Tax Competition*, "European Economic Review" 2012, Vol. 56, No. 6, pp. 1087–1103.

the diversified thin capitalization rules adopted by different countries in order to curb harmful tax competition since a thin capitalization rule is also a tax vehicle for countries to attract foreign direct investment. One Polish scholar[10] did a comparative study of Chinese and South Korean investment in Poland and tried to explain their differences in the motives of entering the Poland market.[11]

The previous literature is biased toward doing a theoretical analysis of the tax issues or conducting a general analysis to the practical application of tax planning techniques. In a long run, i.e., in 1980s, 1990s, 2000s, China was a net capital importer. Since the history of China investors' doing overseas investments is not long, the detailed and in-depth case studies to tax issues arising in China investors' investment in Europe were rare in previous literatures. However, without sufficiently detailed and in-depth analysis to a real investment case conducted by a Chinese investor in Poland, these investors could only rely on the general advice and theoretical analysis offered by the previous literature while the general or theoretical literature is mostly based on several implicit conditions: first, in order to make these articles fit a general situation or to simplify the theoretical analysis, the literature normally is founded on some common assumption:

1) simplifying China's corporate tax rate to a normal corporate income tax rate of 25% but actually China's corporate income tax rate is very diversified due to its complicated tax preferential policies;

2) assuming a Chinese investor is seeking global tax minimization by utilizing aggressive tax planning techniques and also seeking to offset their overseas investment costs as soon as possible;

3) the parent company is normally located in a high tax rate jurisdiction and intends to have its capital flow to a lower tax burden jurisdiction, etc.

1.2. Findings and Contribution of this Paper

However, the case study of Liugong's investment in Poland partly reverses the above stereotype. The parent company, namely Liugong Company, has the lowest corporate income tax rate compared to all its

[10] E. Kaliszuk, *Chinese and South Korean investment in Poland: a comparative study*, "Transnational Corporations Review" 2016, Vol. 8, pp. 60–78, https://scholar.google.pl/citations?view_op=view_citation&hl=pl&user=uc54uosAAAAJ&citation_for_view=uc54uosAAAAJ:1sJd4Hv_s6UC (accessed: 12.12.2023).

[11] *Ibidem*.

subsidiaries, inclusive of the intermediary holding companies and the Polish company located in the bottom tier of its holding structure. Liugong is a company listed on Shenzhen Stock Exchange and earns profits every year, thus it has sufficient money in hand and does not seem to have any motive to receive any dividend, interest income or royalty income from its overseas directly held or indirectly held subsidiaries. A nominal profit in the sense of an accrual accounting basis is sufficient to satisfy the parent company's expectation: the shareholders/investors on Shenzhen Stock Exchange merely expect a good-looking financial report that consolidates the profits earned by the listed company's overseas subsidiaries profits rather than a real receipt of a dividend from these overseas subsidiaries. Liugong is a listed company, and, as a result, it prefers to avoid tax risks, since any tax disputes, tax fines or penalties by foreign tax authorities would cause a decline of its stock price on the Shenzhen Stock Exchange. In this sense, aggressive tax planning for overseas investments is not suitable for Liugong. The characteristics of being a listed company also shape Liugong's investment strategy: seeking expansion and enriching its types and series of products and technologies and preferring to establish subsidiaries and branches in relatively developed countries to build up market channels. The comparable edge in raising capital in China stock markets such as Shenzhen Stock Exchange or Shanghai Stock Exchange by the parent company could also explain why the Chinese investor (as a listed company in China) is so keen on retaining its overseas subsidiaries' profits or funds in its investment destination, such as EU member states, to expand its business scale, rather than receiving these profits or funds from EU subsidiaries to cover its investment costs as soon as possible. Conventional tax theories and the aforementioned literature neglect these realistic factors even though these factors are frequently discussed by company governance theories.

In view of the above analysis, this paper's academic contribution is summarized as follows: it notices the details omitted by conventional tax planning theories and previous literature and tries to do an in-depth analysis on the real strategies chosen by a real Chinese investor in a real case, as well as explaining a Chinese investor's motives that determine the investor's tax approach.

1.3. Research Methodology and Source of Data

The research methodology for this paper is a case study, a detailed case study of the biggest investment project in Poland by a Chinese investor.

The data and information contained in this paper are mainly from the annual reports of Liugong, and partly from the decisions ratified by its board of directors, as well as the news or reports in the mass media, including the industry specific websites.

2. The Formation of a Tax Efficient Holding Structure

The formation of a tax efficient holding structure was the first tax issue Liugong China needed to consider prior to its acquisition of any assets or equities in Poland. Liugong China adopted a four-tier holding structure to be well prepared for its afterwards M&A deal with a Poland state-owned enterprise (see the chart in the following page).

2.1. The Process of Forming a Holding Structure

In May 2008, Liugong China invested USD 5 million to establish a wholly owned subsidiary in Hong Kong, Liugong (Hong Kong) Investment Limited Company (hereafter: "Liugong HK").[12]

According to the decision by the board of directors as of 28 October 2009, Liugong China decided to establish a joint venture in the Netherlands with its wholly owned subsidiary, Liugong HK. The name of this joint venture in the Netherlands is Liugong COOP (hereafter: "Liugong Netherland holding company"). Regarding the equity shares, Liugong HK holds 99% of this Dutch joint venture and Liugong China holds only 1% of the Dutch joint venture.[13] In other words, Liugong HK is the major shareholder and Liugong China is the minor shareholder. However, Liugong China still holds all the shares by directly holding 1% of the shares and indirectly holding 99% of the shares through its wholly owned subsidiary of Liugong HK. Up to the end of 2012, the direct shares

[12] 详见柳工2008年年度报告：根据柳工股董字 (2007) 第 13-2 号决议, 2008 年 5 月份, 本公司投资 500 万美元设立全资子公司 "柳工（香港）投资有限公司". 该公司已纳入本公司本报告期合并报表范围, Annual Report of Liugong China for year 2008, https://quotes.money.163.com/f10/ggmx_000528_401848.html (accessed: 26.11.2022).

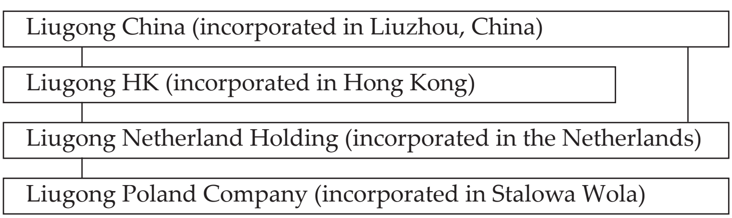
[13] 详细见2010年年度报告：本公司于 2009 年 10 月 28 日召开五届三十次董事会，会议决议（柳工股董字 (2009) 第 9-7号）：由柳工香港投资有限公司作为大成员 (99%), 本公司作为小成员 (1%), 在荷兰合作设立柳工荷兰控股公司 (Liugong COOP), 柳工香港投资有限公司作为主要回报收益人, Annual Report of Liugong China for year 2010, https://www.cfi.net.cn/p20110301000469.html (accessed: 26.11.2022).

held by Liugong China had increased to 87% and the indirect shares held by Liugong China via Liugong HK had decreased to 13%.[14]

On 16 March 2011, Liugong Netherland holding company established a wholly owned subsidiary in Stalowa Wola, Poland.[15] The name of this Polish subsidiary is Liugong Dressta Machinery Limited Company[16] (hereafter: "Liugong Poland Company" or "Dressta Poland"). The registration capital of Liugong Poland Company is PLN 100,500,000. The business scope of this subsidiary is research and development, production, sales and services of construction machinery products and spare parts.

On 31 January 2012, a finalised acquisition agreement was signed in Warsaw. It symbolized that through Liugong Poland Company (the M&A buyer), Liugong China (the ultimate buyer of this M&A deal) indirectly acquired the construction machinery unit (the M&A target) of Poland HSW Company (the seller of this M&A deal).[17]

Liugong China had a decision ratified by its board of directors on 26 August 2016, which concerned the contribution of more capital to its Poland subsidiary (also known as Dressta Poland) and upon this capital contribution, the Poland subsidiary increased its capital by USD13,700,000. Liugong China's indirect contribution of increased capital to its Poland subsidiary was in the form of cash through its four-tier holding structure set out as below:[18]



[14] 详细见2012年年报的合并范围和子公司持股比例, Annual report of Liugong China for the year of 2012, https://quotes.money.163.com/f10/ggmx_000528_1081766.html (accessed: 26.11.2022).

[15] 2016年08月31日《证券时报》, "广西柳工机械股份有限公司关于对全资下属公司增资的公告", http://finance.sina.com.cn/roll/2016-08-31/doc-ifxvitex9343909.shtml (accessed: 20.03.2021) (注：该公告的增资路径披露了柳工锐斯塔机械有限公司的控股架构).

[16] 柴喜男：柳工锐斯塔荣获 "2014波兰最佳中国投资大奖", http://news.cmol.com/2014/1021/45435.html (accessed: 20.03.2021).

[17] 见2012年年报：公司董事会2012年01月30日第六届第十八次（临时）会议决议, 审议通过《关于签署收购波兰HSW工程机械业务单元项目最终协议并执行收购的议案》. 至此, 公司关于收购波兰HSW公司工程机械业务单元项目圆满完成. 2012年1月31日收购双方在波兰华沙签订《最终收购合同》（FEAA）. 柳工机械（波兰）有限责任公司注册资本1亿波兰兹罗提, 自2012年1月31日起纳入合并财务报表范围, Annual report of Liugong China for the year of 2012, https://quotes.money.163.com/f10/ggmx_000528_1081766.html (accessed: 26.11.2022).

[18] 2016年08月31日《证券时报》, "广西柳工机械股份有限公司关于对全资下属公司增资的公告", http://finance.sina.com.cn/roll/2016-08-31/doc-ifxvitex9343909.shtml (accessed: 20.03.2021) (注：该公告的增资路径披露了柳工锐斯塔机械有限公司的控股架构).

2.2. Tax Benefits of the Holding Structure

Liugong Poland Company and Liugong Netherland Holding Company are both located in the European Union. Under the EC Parent-subsidiary Directive, the dividend income paid by Liugong Poland Company to Liugong Netherland Holding is qualified to enjoy participation exemption or credit method in the Netherlands for the purpose of eliminating double taxation. According to the Dutch domestic tax law, since Liugong Poland is a wholly owned subsidiary of Netherland Holding Company and also doing active business, the Netherland Holding Company is qualified to enjoy the participation exemption benefits for the dividend and capital gains sourced from Poland. Furthermore, the interest and royalty payments (if any) from Liugong Poland Company to Liugong Netherland Holding Company also enjoy the withholding tax exemption benefits under the EC Interest and Royalties Directive.

The tax treaty between Hong Kong and the Netherlands was effective since the fiscal year of 2012/2013 (the fiscal year of Hong Kong started from 1 April 2012 and ended on 31 March 2013). Unfortunately, the dividend payment from Liugong Netherland Holding Company to Liugong HK does not seem to meet the tax exemption conditions set out in the double tax treaty,[19] and it means the dividend payment should be subject to a withholding tax of 15% by the Netherlands. The Dutch Ministry of Finance released a tax revenue budget proposal on 19 September 2017, which included an expected modification to the Dutch withholding tax law for dividend income. As an application of the withholding tax treatment included in this proposal, the dividend paid to a HK company by a Netherland holding company with a formation of Coop is qualified to enjoy withholding tax exemption contained in this Dutch domestic tax law.[20]

Hong Kong applies source jurisdiction. It means offshore income earned by a Hong Kong tax resident is not subject to Hong Kong profits tax. Under this preferential tax treatment, the passive income from Liugong Netherland Holding Company to Liugong HK Company is exempted from HK tax. Hong Kong and the People's Republic of China (the PRC) has signed a double tax arrangement. Even though Arts. 10 (dividend) and 11 (interest) of this double tax arrangement set out a limitation rate for the withholding tax on dividend and interest, currently HK does not

[19] See: Art. 10 of the Hong Kong – Netherlands Income Tax Agreement signed on 22 March 2010, see: https://research.ibfd.org/#/doc?url=/data/treaty/docs/html/tt_hk-nl_01_eng_2010_tt__td1.html (accessed: 20.03.2021).

[20] 安永中国海外投资业务部: 荷兰税收政策变动概况, https://www.sohu.com/a/197952363_813488 (accessed: 20.03.2021).

apply the withholding tax on dividend and interest.[21] In other words, the dividend and interest (if any) paid by Liugong HK Company to Liugong China are not imposed withholding tax in HK. If the beneficial owner of royalties is a PRC resident, Art. 12 of this double tax arrangement limits the withholding tax rate for royalties up to 7%.

Interestingly, the parent company, Liugong China, enjoys the lowest corporate income tax rate among the four-tier group companies. Its applicable CIT rate is only 15%. Normally the CIT rate in China is 25%. Fortunately, since Liugong China is engaged in business categorized by the China government as "encouraged Industry" and situated in Liuzhou, and Liuzhou is located in the west of China. Liugong China is qualified to enjoy the preferential tax rate of 15% since it meets two conditions: first, its business falls within China's encouraged industry and the location of its headquarter is in the west of China.[22]

Compared with the ultimate parent company's low CIT rate, the profits tax rate for Liugong HK is 17.5%, the CIT rate for Liugong Netherland Holding Company is 25% (prior to and including 2019) and the normal CIT rate for Liugong Poland Company is 19%. Since these three subsidiaries of Liugong China have a higher tax rate than 50% of the Chinese normal CIT rate 25%, i.e., 12.5% (= 50% × 25%), China's CFC rules will not capture these controlled foreign companies. These subsidiaries may keep their profits for reinvestment purposes rather than paying dividends back to China on an annual basis.

3. The Financing Arrangements to Avoid Poland's Thin Capitalization Rule

From the very beginning, thin capitalization rules in Poland showed up in Art. 16(1) of the Corporate Income Tax Act (1992), only applicable to loans between cross-border related parties. The thin capitalization rules

[21] 国家税务总局：《中国内地居民赴香港特别行政区投资税收指南》, 第147页.

[22] 财税[2001]202号,《财政部、国家税务总局、海关总署关于西部大开发税收优惠问题的通知》规定：对设在西部地区国家鼓励类产业的内资企业和外商投资企业， 在2001年至2010年期间， 减按15%的税率缴纳企业所得税， https://www.ndrc.gov.cn/fggz/lywzjw/zcfg/200507/t20050718_1046893.html?code=&state=123 (accessed: 26.11.2022). 根据《中共中央 国务院关于深入实施西部大开发战略的若干意见》(中发 (2010) 11号) 的第十二条第三段规定， 对设在西部地区的鼓励类产业企业减按15%的税率征收企业所得税， http://jjhzj.wuhai.gov.cn/jjhzj/xgzc/755331/index.html (accessed: 26.11.2022). 广西壮族自治区地方税务局 2011 年 2 号公告, 从 2011 年 1 月 1 日起, 区内原已享受西部大开发鼓励类企业所得税优惠政策的企业暂按 15%的税率预缴企业所得税， https://pilu.tianyancha.com/regulations/7364261ed7222d42f71fec6530ad1417 (accessed: 26.11.2022).

set out the ratio of deductible debt: equity for Polish subsidiaries and also the limitation of the deductible interest expense amount. It also stipulates a requirement for arm's length interest rate.[23] The deductible debt is limited to no more than 3 times of the equity.

This earlier version of friendly thin capitalization rule provides an incentive for foreign investors to arrange more related party loans to finance their subsidiaries in Poland. Interestingly, Liugong China did not take advantage of this thin capitalization rule by arranging direct or indirect loans to Liugong Poland Company. As an alternative, upon the decision of the board of directors on 25 October 2012, it offered a guarantee to Liugong Poland Company to facilitate a USD 20 million loan.[24]

In 2014, Poland modified its thin capitalization rule again. The modified Art. 16(1) of the Corporate Income Tax Act came into force on 1 January 2015.[25] It decreased the ratio of deductible debt: equity from the previous 3:1 to 1:1 (under default regime), and also treated the loans provided by indirect shareholders as related party loans.[26] Unfortunately, Liugong Poland Company's "debt-to-equity" ratio in 2016 was around 2:1, exceeding the above deductible "debt-to-equity" ratio of 1:1. Liugong China decided to contribute more registration capital to its Polish subsidiary, Liugong Poland Company, upon the ratification by its board of directors on 26 August 2016; in Poland, it was seen as a response to this newly enacted thin capitalization rule. This capital contribution was in the form of currency and this time the increment of capital was USD 13,700,000. Obviously, this increment of registration capital could effectively reduce Liugong Poland Company's "debt-to-equity" ratio.

In 2016, Liugong China offered a guarantee of RMB 416,000,000 to Liugong Poland Company to facilitate its borrowing of loans from third party bank(s). This could be explained by its annual losses of PLN 24,650,000 in 2016. It also offered a guarantee to Liugong Poland Company in 2017 in the amount of RMB 440,570,000. Through this guarantee practice, there was no related party loans between the Chinese parent company and the Polish subsidiary arising in Poland but merely a guarantee offered by the Chinese parent company to the Polish subsidiary. This practice was effective in avoiding transfer pricing challenges triggered by the Polish tax authorities.

In order to implement the EU's Anti-Tax Avoidance Directive, Poland modified its thin capitalization rule once more. The new rule came into

[23] 国家税务总局：中国居民赴波兰投资税收指南, 第150-151页.

[24] 广西柳工机械股份有限公司：《关于为柳工机械（波兰）有限责任公司新增银行融资担保的公告》, 公告编号：2012-61, 2012年10月25日.

[25] Z. Kukulski, *Niedostateczna kapitalizacja w prawie podatkowym*, C.H. Beck, Warszawa 2006, pp. 208–210.

[26] 国家税务总局：中国居民赴波兰投资税收指南, 第150–151页.

force on 1 January 2018. The deductible interest expense within one tax year should not exceed 30% of the earnings before interest, tax, depreciation, and amortization (EBITDA). This rule is applicable to big enterprise taxpayers with a total financing expense of more than PLN 3,000,000 incurred after 1 January 2018, but this new rule is also applicable to all taxpayers' various financing transactions after 1 January 2019. Under this new rule, Liugong China's guarantee practice is no longer an effective approach to avoid this new thin capitalization rule. The new Polish thin capitalization rule coming into force since 2018 seems advantageous to Liugong Poland Company since it is a manufacturing company and has abundant fixed assets to generate depreciation expenses, and it has also conducted some R&D functions which might generate capitalized R&D expenses and thus also generate amortization expenses. Its high financial leverage characterized as a large size of debt also enhances its capability of making EBITDA. To some extent, this could explain why Liugong China did not contribute more registration capital to Liugong Poland Company despite the enactment of this new thin capitalization rule in Poland.

4. Good Practice to Ensure Tax Compliance under Poland's Complicated Tax Law Framework

Poland's tax law framework is very complicated. It has its domestic tax laws. It has signed 89 double tax treaties up to September 2019. What makes the tax compliance in Poland complicated is that foreign investment enterprises in Poland also need to follow the EU tax laws. The EU tax laws can be divided into several levels, the fundamental law and the secondary laws, such as VAT Directive, Merger Directive, Parent-Subsidiary Directive, Interests and Royalties Directive, etc.

Liugong Poland Company dealt with its tax compliance obligation very well. Its good practice was that it retained the Polish employees in the M&A deal (the acquisition of HSW Company's construction machinery Unit) for several years as agreed to in the obligation terms of the M&A agreement. These Polish employees are very experienced and well trained by their former employer, HSW Company. Polish employees are familiar with their laws, especially when it comes to taxes. That is why Liugong Poland Company could normally fulfill its tax compliance obligations after the M&A deal. In this sense, being nice to Polish employees is tantamount to being nice to Chinese investors.

5. Concluding Remarks

This case study illustrated how conventional tax planning, compliance theories and practicing good ethics in the workplace were big pluses for a major Chinese investor. With operations in Hong Kong and the Netherlands, intermediary holding companies, an arrangement of financing activities within the host state's thin capitalization framework and treating local workers well all contributed to the tax compliance regulations in a most positive way.

Interestingly, in this case, there were no dividend payments, royalty payments or interest payments to the parent company or intermediary holding companies. On the contrary, the parent company offered bank loan guarantee free of charge on behalf of its Polish subsidiary to facilitate its Poland subsidiary to obtain loans from banks and also allowed the subsidiary to use its logo or trademark Liugong free of any royalty fees. The parent company persistently offered guarantees to facilitate its Polish subsidiary's borrowings from a bank, and, in 2016, increased its contribution of capital to this subsidiary, regardless of the Polish subsidiary's continuous losses for years. This could be explained by the Chinese parent company's comparable edge in raising capital in Shenzhen Stock Exchange. In this sense, having a comparable edge in raising capital in the stock market to some extent shapes a Chinese investor's behavior – to care about long-term investment return rather than short-term investment return/losses. It is undoubtedly compatible to the goal of the recently signed China European Union Agreement on Investment. Also, the practice taken in this case would help to mitigate any possible tax disputes between the investment host country in the EU and the investment home country, in this case, China.

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Kukulski Z., *Niedostateczna kapitalizacja w prawie podatkowym*, C.H. Beck, Warszawa 2006.

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Abstract

This paper mainly studies the tax planning arrangements concerning China's biggest investment project in Poland, a China group's acquisition of a Poland's state-owned factory (HSW), and the establishment of a new Polish company to run the newly acquired business obtained from this M&A deal. This paper sheds some light to Chinese investors that intend to invest in the European Union under the newly signed China European Union Agreement on Investment from the perspective of tax planning. The detailed analysis contained in this paper also facilitate tax practitioners and tax authorities in Poland, or even in other EU member states, to deepen their understanding of Chinese investors' tax motives and concerns relevant to their investment and operation in the EU market. This paper's academic contribution is summarized as follows: it notices the details omitted by conventional tax planning theories and previous literatures and tries to do an in-depth study to a real Chinese investor's real behaviors under a real case in order to explain the underlying motives and concerns that determines the Chinese investor's tax relevant behaviors conducting in such manners.

Keywords: tax planning arrangements, China European Union Agreement on Investment, China's investments projects

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Edoardo Traversa[1]

New Own Resources for the EU Budget: Good Old Taxes Could also Do the Job

On April 2020, a group of EATLP professors, among whom Prof. Nykiel and myself, drafted a manifesto on the necessity of finding a better democratic way of financing the EU budget. The manifesto proposed to address the European financial crisis brought on by the COVID pandemic by acknowledging that the current EU budget is not only inadequate to support economic and social progress and by advocating the creation of genuine EU taxes.[2] The creation of genuine European taxes by EU institutions, whose revenues would flow into the EU budget, although desirable in the long term would however require a major overhaul of the EU Treaties, by granting the EU level a constitutional power to tax and would be *de facto* but also *de iure* transform the European Union into a full-fledged federation, like the United States of America. This perspective appears today to be a long shot. However, there is also space within the current Treaty framework for a broader range of less radical options for reform, through which the proportion of EU own resources derived from tax-based revenues would be significantly increased. Genuine EU taxes are not indeed the only way to make the own-resources system more dependent on tax resources and on this premise, the recent developments at the EU level as to the adoption of a new multiannual financial framework for the period 2021–2027 and the Next Generation EU instrument leave some room is for caution optimism. The Next Generation EU (hereafter: NGEU) program was politically approved, together with a new multiannual financial framework for 2021–2027, after a marathon of negotiations in July

[1] Edoardo Traversa, Professor of Tax Law, UCLouvain (Belgium).

[2] European Solidarity Requires EU Taxes – letter for EATLP members, April 2020, https://docs.google.com/forms/d/e/1FAIpQLScrDADzE69yLSceQKGdYUGohlcl2wRiAd1gJHczNKnT8-oEPA/viewform (accessed: 27.05.2020).

2020 and finally adopted on 17 December 2020.[3] To finance this programme, the EU Commission will issue bons up to 750 billion €. The repayment of NGEU will require additional own resources to the EU budget.

Reform towards new tax based own resources is certainly necessary and today more than ever. However, these resources should at the same time have a strong link with the European Union policies and, keeping an eye on the recent international debates on the digital economy,[4] with the European territory, and a not-too-tight link with the territory of single Member States to avoid fostering resentment between member states.

Previous studies[5] have discussed the pros and cons of introducing new own resources based on existing or new taxes, such as a value added tax, customs duties and other border levies, excise duties and special taxes on certain goods and services, corporate tax, transport tax, especially car taxes and air transport taxes, financial transaction tax, and carbon tax. Some scholars have also argued for the introduction of a Pan European wealth tax.[6]

[3] Council Regulation (EU, Euratom) 2020/2093 of 17 December 2020 laying down the multiannual financial framework for the years 2021 to 2027, OJ L 433I, 22.12.2020, pp. 11–22. The manifesto was also published in several EU and national general and specialized media, including in Poland: "Przegląd Podatkowy" 2020.

[4] See in particular the ongoing work of the OECD on the BEPS Action 1 and the Pillar I and II proposals – https://www.oecd.org/tax/beps/beps-actions/action1/ (accessed: 27.05.2020).

[5] See: European Parliament, *Working Document on improving the functioning of the European Union building on the potential of the Lisbon Treaty* (30 October 2015), Para. 42 and the works of The High-level group on own resources established in 2014 by Monti – European Commission, *High-level group on own resources*, http://ec.europa.eu/budget/mff/hlgor/index_en.cfm (accessed: 27.05.2020). Among scholarly literature, see: F. Heinemann, P. Mohl, S. Osterloh, *Reform options for the EU own resource system*, Research project 8/06 commissioned by the German Federal Ministry of Finance, 18 January 2008; I. Begg, H. Enderlein, J. le Cacheux, M. Mrak, *Financing of the European Union Budget*, Study for the European Commission, Directorate General for Budget, 29 April 2008; M. Lang, P. Pistone, J. Schuch, C. Staringer, *Introduction to European Tax Law on Direct Taxation*, Linde Verlag, Wien 2008; Ph. Cattoir, *Options for an EU financing reform*, Notre Europe, 2009, https://institutdelors.eu/wp-content/uploads/2020/08/eufinancingreformcattoirnedec09-1.pdf (accessed: 27.05.2020); M. Schratzenstaller, A. Krenek, D. Nerudová, M. Dobranschi, *EU Taxes as Genuine Own Resource to Finance the EU Budget: Pros, Cons and Sustainability-oriented Criteria to Evaluate Potential Tax Candidates*, "FairTax Working Paper" 3, June 2016, http://ec.europa.eu/budget/mff/Library/hlgor/selected-readings/40-DOC-COMM-EuTaxes-Schratzenstalle.pdf (accessed: 27.05. 2020); A. De Feo, B. Laffan, *EU Own Resources: Momentum for a Reform?*, European University Institute, 2016, http://ec.europa.eu/budget/mff/hlgor/library/selected-readings/01-DOC-COMM-EUORMomentumForReform-EUIDeFeoLaffan-Feb2016.pdf (accessed: 27.05.2020).

[6] C. Landais, E. Saez, G. Zucman, *A progressive European wealth tax to fund the European COVID response*, VOX, 3 April 2020, https://voxeu.org/article/progressive-european-wealth-tax-fund-european-covid-response (accessed: 27.05.2020).

In a resolution of 15 May 2020, the European Parliament reaffirmed its position supporting the Commission's previous proposals regarding the list of potential candidates for new own resources. Those were 'a common consolidated corporate tax base, digital services taxation, a financial transaction tax, income from the emissions trading scheme, a plastics contribution and a carbon border adjustment mechanism'.[7]

From a lawyer's perspective, future EU tax-based own resources should have certain characteristics that would ensure that they respect constitutional and legal principles whether based on EU law or on the common constitutional tradition of the Members States and that can be easily implemented, limiting legal uncertainty.

First, as the French say, *'Un bon impôt est un vieil impôt'* (a good tax is an old tax) tells, creating a completely new tax has always been quite a difficult task and was usually made possible by extraordinary events, such as wars.[8] Moreover, besides the – rather understandable – natural aversion that people and countries could show against the introduction of new levies (which prompted several revolutions), the administrative costs associated with the introduction of a new tax in 27 States should not be overlooked, also considering the significant disparities due to the different tax cultures. It should be borne in mind that the Commission, over the years, has unsuccessfully proposed a carbon tax,[9] a CO_2-based car taxation,[10] a financial transaction taxes (including under enhancement cooperation)[11] and, more recently, two types of digital taxes.[12] In this context, it would seem wise not to add administrative implementation hurdles with the already considerable political obstacle to the introduction of a direct

[7] European Parliament, Resolution of 15 May 2020, on the new multiannual financial framework, own resources and the recovery plan, P9_TA-PROV (2020) 0124 (15.05.2020). See also: European Parliament, Interim report of 14 November 2018 on the multiannual financial framework 2021–2027 – Parliament's position with a view to an agreement, P8 TA (2018)0449 (14.11.2018).

[8] See, for example, the adoption of the income tax in the United Kingdom in 1799 as a temporary tax to finance the Napoleonic Wars, or in France in 1914 to support the First World War effort.

[9] European Commission, *Proposal for a Council Directive introducing a tax on carbon dioxide emissions and energy*, COM(1992)226 final (2.06.1992).

[10] European Commission, *Proposal for a Council Directive on passenger car related taxes*, COM(2005)261 final (5.07.2005).

[11] European Commission, *Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC*, COM(2011)594 final (28.07.2011) and European Commission, *Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax*, COM(2013)71 final (14.02.2013).

[12] European Commission, *Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services*, COM(2018)148 final (21.03.2018).

transfer of tax revenue from the Member States to the Union and to adapt models already existing at the level of the Union or at least inspired by experiences common to all or at least a majority of Member States.

In addition, as already mentioned earlier, the resource should be able to provide the European budget with significant and stable revenue, to reimburse the loans taken by the Commission in the framework of the Next EU Generation, and yet there is always a haze of uncertainty regarding the revenue-raising capacity of 'untested' taxes.

One other element to be taken into consideration is the fact that a truly European tax-based own resource, by its very nature, cannot create territorial divisions that would foster resentment between Member States, as is currently the case when it comes to determining the net contributors and the net beneficiaries in the EU budget?

Therefore, trying to use an existing tax to transform it totally or partially into an EU tax based own resource seems to be the safest way forward from a legal perspective. For these reasons, plastic taxes, financial transaction taxes, digital taxes, but also corporate taxes (which given the disparity between Member States corporate income taxes, would require a considerable harmonization effort) cannot reasonably be first or even second-best choices in the short-term: before they can be considered workable options, significant issues need to be considered in the EU competence to adopt them, but also their implementation and administration will have to be properly addressed.

The two candidates that offer more reliability from a legal viewpoint are a (truly) VAT-based own resources and an own-resources based on an excise tax on certain services connected to the digital economy.

Aside from customs duties, value added tax is the most European tax and is already used as a basis to calculate one of the own resources. In comparison to all the other taxes, not much would be needed to make from it the most significant own resources, both in terms of yield and visibility for EU citizens. It is certainly worth remembering the solution devised in the Commission's 2011[13] proposal, which unfortunately remained a dead letter by the Member States. The idea concerned a slight modification of the current system of own resources in addition to a single innovation, which the Member States were not ready to discuss at the time, namely that of transforming the VAT resource into a (*quasi*) European tax, with the establishment of a specific European rate on top of the national one, with a maximum of 2%. This proposal by the Commission has merits in

[13] Proposal to the European Parliament of 29 June 2011, COM(2011)510 final. See the following link: https://ec.europa.eu/info/sites/info/files/about_the_european_commission/eu_budget/com-2011-510_2011_en.pdf (accessed: 27.05.2020).

terms of simplicity, feasibility, and a link with the internal market. The EU VAT system is indeed largely harmonized, instruments for cooperation between Member States exist, and a common VAT culture between national administrations is slowly developing. Moreover, the impact in terms of revenue of such a solution can be precisely estimated. Such a solution would certainly require changes, such as further harmonization as regards exemptions and exclusions (which could be achieved by amending the 2006/112/CE directive) and increased cooperation between Member VAT administrations and the EU Commission, as well as a modification of the structure of the VAT own resource in the own resource decision. But this would not constitute a legislative revolution, rather an evolution in a process that started decades ago. And last but not least – and even if that argument is often used against such a solution – VAT is a tax that is paid by everyone: every consumer, rich or poor, but also every business, in one way or another. A VAT-based own resource could give a stronger sense of European citizenship, in comparison to other, more sectoral, levies that would give the impression that the EU has been created for large businesses, such as digital companies or banks.

The second option would be an excise tax on certain services. Digital taxes are in the air. While some Member States have already adopted the digital service tax, intense discussions are taking place at the international level (Pillar 1 and Pillar 2 OECD initiatives). If there is no agreement at the OECD level, the Commission has announced that it would introduce a digital levy. The structure of that levy could be a top-up tax on certain transactions already subject to VAT (and using the same structure), without a right to deduct so as to cover both B2B and B2C services considered as a sort of excise on digital transactions), with a threshold for smaller providers. Alternatively, if the determination of the services subject to this new levy would prove to be too difficult, a small percentage of the total turnover of large multinational firms (which are those who benefit the most from the EU single market) could also be an option. There would be a precedent: for almost 50 years, the European Coal and Steel Community, which was created in 1951 and then later absorbed by the European Economic Community, has been financed through a levy on the production of coal and steel, at a rate (less than 1%) fixed by the High Authority – the forerunner of the European Commission and directly collected by it from undertakings active in those sectors.[14]

[14] Article 49 of the Treaty establishing the European Coal and Steel Community (ECSC), signed in Paris on 18 April 1951. See also: High Authority Decision No. 2-52 ECSC of 23 December 1952 determining the mode of assessment and collection of the levies provided for in Arts. 49 and 50 of the Treaty and High Authority Decision No. 3-52 ECSC

And if at the end, due the constitutional and legal constraints and/or political factors, a compromise on tax-based own resources would prove too difficult to achieve or if it would not yield enough revenues, it would be wise not to cast all the EU eggs in the same tax basket, and also develop other forms of EU financing. Alternatives outside the field of taxation exist, like resources based on the Emission Trading Scheme system[15] or setting up obligations to contribute to pan-European funds built with protection against specific risks, such as those linked to climate change, along the lines of the EU regulatory bank levy in the framework of the Single Resolution Fund.[16] The road towards a more solid financing of the European Union has never been straight, and side paths could turn out to be the smartest approach to continue the journey, waiting for the right time to get back on the main track.

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of 23 December 1952 on the amount of and methods for applying the levies provided for in Arts. 49 and 50 of the Treaty, www.cvce.eu (accessed: 27.05.2020).

[15] This appears to be the solution favoured by C. Fuest, J. Pisani-Ferry, *Financing the European Union: new context, new responses*, "Policy Contribution" 2020, No. 16.

[16] Regulation (EU) No. 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No. 1093/2010 (OJ 2014 L 225, p. 1). In 2019, the Single Resolution Fund (SRF) received €7.8 billion from 3,186 institutions and investment firms. It is important to stress that the calculation and collection of the contributions by the Single Resolution Board is subject to review by EU Courts – see for example: GCEU, 23 September 2020, Cases T-411/17 Landesbank Baden-Württemberg v. *Conseil de résolution unique* (CRU), T-414/17 Hypo Vorarlberg Bank AG v. CRU et T-420/17 Portigon AG v. CRU.

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Schratzenstaller M., Krenek A., Nerudová D., Dobranschi M., *EU Taxes as Genuine Own Resource to Finance the EU Budget: Pros, Cons and Sustainability-oriented Criteria to Evaluate Potential Tax Candidates*, "FairTax Working Paper" 3, June 2016, http://ec.europa.eu/budget/mff/Library/hlgor/selected-readings/40-DOC-COMM-EuTaxes-Schratzenstalle.pdf (accessed: 27.05. 2020).

Abstract

The paper deals with issues related to currently discussed reform within the EU focused on the proposals of establishing the new own tax-based resources for the EU and the possibility to use an existing tax to transform it totally or partially into an EU tax based own resource which in his opinion seems to be the safest way forward from a legal perspective, as well as the future EU tax-based own resources.

Keywords: new own resources, New Generation EU, EU budget

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Cristina Trenta[1]

Reflections on the Italian Tax Judiciary System from the Perspective of the European Convention on Human Rights[2]

1. Introduction

The aim of this paper is to examine the current Italian tax judiciary system under the lens of Art. 6(1) of the European Convention on Human Rights (ECHR),[3] and specifically in accordance with the principle contained therein that everyone is entitled to be judged by an independent and impartial tribunal established by law. The aim of this investigation is to help clarify the ongoing discussion on the future reform of the Italian tax judiciary system[4] and, in particular, the nature, status, and role of Tax Commissions and tax judges, and it will therefore focus only on those aspects of the current order that are in conflict with Art. 6(1).

Given its aim and delimitation, this paper will methodologically proceed using both an inner and outer perspective,[5] the latter used to

[1] Cristina Trenta is full professor of public law at Linnaeus University, Sweden. She has been appointed twice as a member of the European Commission's VAT Expert Group, and she's been a member of the Expert Group for the EU Observatory on the Online Platform Economy for the European Commission. The author is grateful to Prof. Włodzimierz Nykiel for his contribution to her PhD studies in European Tax Law at the University of Bologna (Italy).

[2] This paper was made possible by the financial assistance of the Torsten Söderbergs Stiftelse. The author is grateful to the foundation for their support.

[3] Council of Europe, Convention for the Protection of Human Rights and Fundamental Freedoms, as amended by Protocols No. 11 and 14, 4 November 1950.

[4] IT, The Senate of the Republic (Senato della Repubblica), *XVIII Legislatura Fascicolo Iter DDL S. 1243 Riforma della giustizia tributaria*, 6 December 2020.

[5] G. Samuel, *An Introduction to Comparative Law Theory and Method*, Vol. 11, Hart Publishing, Oxford 2014, p. 60 et seq.

reveal aspects of the Italian judicial tax system that the former might miss,[6] and to identify national sources and those incongruences or conflicts that are relevant for the analysis.[7]

2. Monistic versus dualistic approach

Italy presents an interesting case study in respect to the national application of the ECHR and tax law. The country signed the ECHR in 1950 and ratified it in 1955. With ratification, Italy should have ensured that its national legislation is in compliance with the obligations deriving from the ECHR. This conflicts with the considerable, and increasing, number of judgments for breaching human rights obligations deriving from the ECHR Italy has received through the years.[8]

Broadly speaking, international law doctrine distinguishes between two different approaches when it comes to the relationship between domestic law and international law: monism, and dualism.[9] In a monistic approach,[10] international and domestic law constitute one single legal system: if applied to our case, it would imply immediate application of the Convention's normative content, it being hierarchically superior to what national legislation mandates. A dualistic approach considers instead international law and domestic law as two different legal bodies[11] whose hierarchical position in respect to one another has to be determined independently in each national legal system: in our case, it would mean that the application of the ECHR within a state's legal system would be left to that state's own judgement.

Italy adopts a dualist approach,[12] and, because of this, the ECHR does not have preconstituted primacy over national legislation.[13]

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[6] *Ibidem*.

[7] J. Husa, *A New Introduction to Comparative Law*, Hart Publishing, Oxford 2015, p. 64, quoting M. Bogdan, *Komparativ rättskunskap*, Norstedts Juridik AB, Stockholm 2003, p. 28.

[8] Council of Europe, *Annual Report 2020 of the European Court of Human Rights*, 2020, p. 164.

[9] J.G. Starke, *Monism and dualism in the theory of international law*, "British Year Book of International Law" 1936, No. 17, pp. 66–81.

[10] A. Caligiuri, N. Napoletano, *The Application of the ECHR in the Domestic Systems*, "The Italian Yearbook of International Law Online" 2010, No. 20(1), pp. 125–159.

[11] *Ibidem*.

[12] C. Jonas, M. Rask Madsen (eds), *The European Court of Human Rights between Law and Politics*, Oxford University Press, Oxford 2011, p. v.

[13] O. Pollicino, *The European Court of Human Rights and the Italian Constitutional Court: No 'Groovy Kind of Love'*, [in:] K.S. Ziegler, E. Wicks, L. Hodson (eds), *The UK and European Human Rights: A Strained Relationship?*, Hart Publishing, Oxford 2015, pp. 361–377.

3. Tax Commissions and the judicial tax system in Italy

In Italy, tax law disputes fall currently under the competences of special judges and courts: the Tax Commissions (*Commissioni Tributarie*).[14] Tax Commissions have exclusive jurisdiction over tax matters. In 1992, Legislative Decrees No. 545 and No. 546 reformed tax litigation.[15] The reform entered into force in 1996. Legislative Decree No. 156,[16] approved in 2015 and containing measures concerning the legal framework for advance rulings and tax litigation,[17] introduces minor non-structural changes to Legislative Decree No. 545.

3.1. Issues concerning independence

If one considers the principle of independence and its case-law elaboration by the European Court of Human Rights (ECtHR), the organization of Tax Commissions can be deemed to be in breach of Art. 6(1) of the ECHR, since independence as such also encompasses the criterion that a court ought to show an appearance of independence.[18]

A brief historical note is necessary to understand how the current situation came into being. The Tax Commissions were first established in the late 19th century with Law 1830 of 14 July 1864,[19] but they were reformed under the fascist regime with Royal Decree-law No. 1639 of 7 August 1936 and Royal Decree No. 1516 of 8 July 1937.[20] The foundations

[14] The Revenue Agency, *Glossary of tax terminology*, "Commissioni tributarie", https://www.agenziaentrate.gov.it/portale/web/english/nse/glossary#C (accessed: 22.03.2021).

[15] Legislative Decree No. 545 of 31 December 1992 [*Decreto Legislativo*] and Legislative Decree No. 546 of 31 December 1992 [*Decreto Legislativo*], Official Gazette No. 9 of 13.01.1993, replacing Presidential Decree No. 636 of 16 October 1972 [*Decreto del Presidente della Repubblica*], Official Gazette No. 292 of 11 November 1972.

[16] Legislative Decree No. 156 of 24 September 2015 [*Decreto Legislativo*], Official Gazette No. 233, 7 October 2015.

[17] M. Leo, *La Riforma del Contenzioso Tributario: Cose Fatte e Cose da Fare*, "il fisco" 2015, No. 42, p. 4016 et seq.

[18] Council of Europe, Department for the Execution of Judgments of the European Court of Human Rights, DG1, *Thematic Factsheet, Independence and Impartiality of the Judicial System*, December 2020, p. 3.

[19] The Senate of the Republic (Senato della Repubblica), *XVIII Legislatura No. 759, Disegno di Legge*, 7 August 2018.

[20] V. Mastroiacovo, *Il Diritto Tributario alla Prova del Regime tra Urgenze di Guerra e Ambizioni di Sistema*, [in:] I. Birocchi, G. Chiodi, M. Grondona (eds), *La Costruzione della "Legalità" Fascista negli Anni Trenta*, Romatre Press, Roma 2020, p. 162.

of the Italian judiciary system were laid out in the years after World War II and enshrined in the Constitution of the Italian Republic.[21] The Constitution was enacted by the Constituent Assembly on 22 December 1947, and entered into force on 1 January 1948.[22] The Constitution establishes one of the fundamental characteristics of the Italian judiciary, that of the independence of judges.[23]

In line with this principle, Art. 102(1) of the Constitution states that the judicial proceedings are exercised by ordinary magistrates, and Art. 102(2) introduces a general prohibition of establishing extraordinary or special judges. The reason for this explicit interdiction resides in the routine appointment of special judges, called to decide on specific cases under the close audit of the executive,[24] by the Italian fascist regime during the war and pre-war years.[25] The newly constituted Italian Republic unsurprisingly laid out a judicial system based on civil, criminal, and administrative judges bound by the law and nothing more:[26] all other existing special roles, judges, and courts were to be terminated. But not the Tax Commissions.[27]

Their compliance with the Italian Constitution has been recognized in a number of judgments by the Italian Constitutional Court (ICC) on the grounds that Tax Commissions are indeed a special body of jurisdiction that predates the Constitution and is therefore fully compatible with it.[28] Recognitions of constitutionality by the ICC notwithstanding, the special nature of Tax Commissions places them in conflict with the standards of Art. 6(1) of the ECHR and its further elaborations by the ECtHR, both in terms of their mere existence, and in terms of their "appearance". In the *Ergin* v. *Turkey* case,[29] the ECtHR reaffirmed the United Nations' Human Rights Committee warning to Member States, in their General

[21] M. Greggi, N.Ž. Kovacevic, *Lights and Shadows on the Implementation of the Alternative Dispute Resolution (ADR) System in the Italian and Croatian Tax Trial*, "Zbornik Pravnog Fakulteta Sveucilista Rijeci" 2017, No. 1, pp. 377–396.

[22] M. Einaudi, *The Constitution of the Italian Republic*, "The American Political Science Review" 1948, No. 4, pp. 661–676.

[23] M. Greggi, N.Ž. Kovacevic, *Lights and Shadows…*

[24] G. Scarselli, *Ordinamento giudiziario e forense*, Giuffrè Editore, Milan 2010, p. 303.

[25] A. Kallis, *The Third Rome, 1922–43: The Making of the Fascist Capital*, Palgrave Macmillan, London 2014.

[26] Constitution of the Italian Republic of 27 December 1947 [*Costituzione della Repubblica Italiana*], Official Gazette No. 298 of 27 December 1947, Art. 108.

[27] M. Greggi, N.Ž. Kovacevic, *Lights and Shadows…*, pp. 377–396.

[28] See i.a. IT, Constitutional Court, judgment, 8 February 2010, No. 39, 2010; G. Gilardi, *La riforma della Giustizia Tributaria e l'"Unitarietà" della Giurisdizione*, "Questione Giustizia" 2016, No. 3, p. 74 et seq.

[29] ECtHR, judgement, 4 May 2006, *Ergin* v. *Turkey*, Application No. 47533/99.

Comment on Art. 14[30] of the International Covenant on Civil and Political Rights, that they should adopt care in creating and using special courts.[31] That same case, together with the *Zolotas* v. *Greece* case,[32] also sees the ECtHR cast doubts on the fact that, in consideration of their special status, Italian Tax Commissions can be upheld to the standard of appearance of independence for courts established in the ECHR.

3.2. Issues concerning impartiality

The principle of impartiality, descending from both Art. 111 of the Italian Constitution and Art. 6(1) of the ECHR, requires the absence of any prejudice or bias. According to ECtHR case law, the existence of impartiality must be evaluated not only according to a subjective test, involving the personal convictions and behaviour of a judge, but also according to an objective test, meant to assess whether a court and its composition display satisfactory guarantees to eliminate any legitimate doubt of partiality.[33] The principle also applies to Tax Commissions.

Article 111(2) of the Italian Constitution states that "the parties are entitled to equal conditions before an impartial judge in third party position". Italian doctrine clarifies "third party position" to mean a position of "absolute indifference and real equidistance from the convening parties" that also includes "having no interest in the case".[34] In the specific case of tax trials impartiality, this "third party position" implies that the judges should not belong to the tax administration,[35] since the tax administration is one of the two parties of any tax controversy.

As such, the management and organization of the tax judiciary system, including tax judges and Tax Commissions, should be outside of the sphere of influence of the tax administration and ideally directly handled by the Ministry of Justice or, alternatively, by the Presidency of the Council of Ministers. Nevertheless, in accordance with Art. 9 of Legislative Decree No. 545 of 1992, tax judges in Italy are appointed

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[30] United Nations, Human Rights Committee (HRC), *General Comment no. 32, Article 14, Right to Equality Before Courts and Tribunals and to Fair Trial*, CCPR/C/GC/32, 23 August 2007.

[31] UN General Assembly, International Covenant on Civil and Political Rights of 16 December 1966, United Nations, Treaty Series, Vol. 999, p. 171.

[32] ECtHR, judgement, 2 June 2005, *Zolotas* v. *Greece*, Application No. 38240/02, Para. 24.

[33] Council of Europe, Department for the Execution of Judgments of the European Court of Human Rights, DG1, *Thematic*…, p. 9.

[34] Treccani, "Terzietà", https://www.treccani.it/enciclopedia/terzieta/ (accessed: 25.03.2021). Translation from the Italian by the author.

[35] M. Villani, *I Compensi dei Giudici Tributari*, "Tribuna Finanziaria" 2008, No. 1, pp. 23–24.

by the President of the Republic upon a proposal of the Minister of Finance, who is not a third, independent party in the context of tax justice, but, rather, the top controller for the tax administration. The fact that consultation of, and deliberation by, the Board of Presidency of Tax Justice is required does not change the status of the Minister in the process.

The tax judiciary system ought to be independently managed and organized under its own administrative profile, and any and all administrative connections to the Ministry of Finance rescinded. The system will remain defective, and be subject to reasonable scepticism, if the independence of tax judges is considered to be relevant only at the moment of passing judgment, and not as an organizational value.[36]

On this specific point, it is worth noting that the ECtHR, in the *Miroshnik* v. *Ukraine* case,[37] maintains that a military tribunal financially dependent on the Ministry of Defence and whose judges were also appointed by same ministry, was not in compliance with the principle of independence.[38]

It is clear that a number of factors hinder a complete implementation of the principle of impartiality in the current Italian judicial tax system, which would require amendments in the way it handles both the management and organization of Tax Commissions and tax judges if it were to achieve the standards set by the ECHR: the existing process conflicts with both Art. 111 of the Italian Constitution and Art. 6(1) of the ECHR.

3.3. Issues concerning remuneration

In Italy, the appointment of tax judges is honorary in nature and does not constitute a formal relationship of public employment.[39] They receive a fixed monthly remuneration for the service they provide, plus an additional per-case handling fee.[40] This is problematic for at least two different reasons. On one hand, criteria for determining a reasonable decent pay are in fact lacking as the service is deprofessionalized for the

[36] A. Poddighe, *Giusto Processo e Processo Tributario*, Giuffrè Editore, Milan 2010, p. 23; S. Cantelli, *Cittadini-Contribuenti e Avvocati Tributaristi: Figli di un Processo Minore?*, "il fisco" 2014, No. 37, p. 3651 et seq.

[37] ECtHR, judgement, 7 November 2008, *Miroshnik* v. *Ukraine*, Application No. 75804/01, Para. 64.

[38] C. Buccico, *Verso la Riforma della Giustizia Tributaria nella Prospettiva della Terzietà e Imparzialità del Giudice*, "Giurisprudenza delle Imposte" 2019, No. 4, pp. 264–316.

[39] IT, Legislative Decree No. 545 of 31 December 1992…, Art. 11.

[40] IT, Legislative Decree No. 545 of 31 December 1992…, Art. 13.

reasons articulated earlier. On the other, compensation is also partially dependent on performance,[41] measured quantitatively in the number of cases. The professionalization of the role would also help ensure that tax judges have access to specialized training.[42]

According to Art. 6(1) of the ECHR, independence is connected to an appropriate remuneration. The Recommendation CM/Rec(2010)12 of the Committee of Ministers to Member States on Judges: Independence, Efficiency and Responsibilities[43] states that "judges' remuneration should be commensurate with their profession and responsibilities, and be sufficient to shield them from inducements aimed at influencing their decisions. Guarantees should exist for maintaining a reasonable remuneration in case of illness, maternity or paternity leave […] Systems making judges' core remuneration dependent on performance should be avoided as they could create difficulties for the independence of judges".[44]

The recommendation also associates "security of tenure" and "irremovability" with professionality and a guarantee of competence and independence. While it might be admissible to have a few honorary judges in charge of the administration of tax justice, it is not admissible that all tax justice is administrated by honorary judges only.[45]

Finally, as previously mentioned, Legislative Decree No. 156 of 24 September 2015 also contains amendments to tax trials and their organization.[46] However, the Decree fails to effectively address the foundational problems connected to independence, impartiality, and remuneration existing today in the Italian tax judiciary system.[47] It does not change the structure and organization of the tax judiciary system, which still remains under the supervision of the Ministry of Economy and Finance, nor introduces any changes concerning the current, problematic professional positioning and remuneration of tax judges.

[41] R. Lunelli, *Sulla Opportunità di Assegnare le Controversie di Modica Entità e non Particolarmente Rilevanti a un Giudice Tributario Monocratico*, "il fisco" 2014, No. 33, p. 3244 et seq. See also: M. Conigliaro, *Contenzioso Tributario: dalla Delega Fiscale una Timida e Alquanto Vaga Proposta di Riforma*, "il fisco" 2014, No. 20, p. 1979 et seq.

[42] S. Cantelli, *Cittadini-Contribuenti…*, p. 3651 et seq.

[43] Council of Europe, Recommendation CM/Rec(2010)12 of the Committee of Ministers to Member States on Judges: Independence, Efficiency and Responsibilities, adopted by the Committee of Ministers on 17 November 2010 at the 1098th meeting of the Ministers' Deputies.

[44] Council of Europe, Recommendation CM/Rec(2010)12…, Paras. 54–55.

[45] A. Poddighe, *Giusto Processo…*, p. 23.

[46] M. Leo, *La Riforma…*, p. 4016 et seq.

[47] *Ibidem.*

4. Conclusions

This paper investigated the application of the ECHR principles of impartiality and independence of tax judges in the Italian tax judiciary system and specifically in relation to their role in Tax Commissions. Italy adopts a dualistic approach that does not assign an automatic prevalence to international law over domestic law, not even when international conventions are signed and ratified, thus introducing problems of compliance. Because of this situation, the Tax Commissions, whose creation predates the republican Constitution of 1947, find themselves in a problematic relationship with the standards set forth by the ECHR in Art. 6(1), since their impartiality and independence is systemically hindered by the current organizational setup, lack of tenure for tax judges, and ministerial oversight.

In September 2014, with Order No. 280, The Provincial Tax Commission in Reggio Emilia, Italy, raised an issue of constitutionality of the law before the ICC for a possible violation of Art. 6(1) of the ECHR, providing similar arguments to those raised here. The ICC responded with Ordinance No. 227 of 20 October 2016, declaring the appeal inadmissible and replying that resolving such issues is the prerogative of the legislator. This has not happened yet, but it should soon: tax law is a field of law where national states strongly express their sovereignty, but said sovereignty should not come at the cost of the human rights of citizens.

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Abstract

EU law is applied uniformly in all EU Member States as a consequence of its supremacy in the hierarchy of legal sources. The same is not true of the European Convention on Human Rights (ECHR). This paper investigates the application of the ECHR principles of impartiality and independence of tax judges in the Italian tax judiciary system and specifically in relation to their role in Tax Commissions. Italy takes a dualistic approach that does not automatically give international law precedence over domestic law, even when international treaties are signed and ratified, causing compliance issues. The article identifies several crucial friction points between the current setup of the Italian tax judiciary system and the European Convention on Human Rights, most notably in respect to the principle of independency and impartiality of tax judges, and concludes suggesting that a reform in the field may be necessary.

Keywords: European Convention on Human Rights, ECHR, Italian tax judiciary system, principle of independency and impartiality

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Antonio Felice Uricchio[1]

The Taxation of Artificial Intelligence between New Taxes and Additional Incentives

1. Introduction

The profound changes that accompany the history of mankind appear to be largely dependent on the unstoppable strength of knowledge and innovation. Following some great discoveries such as the wheel, iron, engine, electricity, telephone, television, etc., the economy and social organizations have been deeply rethought, as have states' legal frameworks and instruments for the protection of individual rights. Indeed, the last decades of the twentieth century and the beginning of the new millennium appear to be characterized by a modification that is unparalleled in the history of mankind; the break-in of the network, digital technologies, and artificial intelligence in daily life, in real, financial, and virtual markets, as well as political institutions, has determined new ways of managing individual and collective data (big data), of governance of economic processes and activities, and above all has amplified the opportunities for communication and connection of both individuals and public administrations. The new models of social organization, in addition to giving rise to extensive changes in the processes of wealth production (transition from industrialism to information technology), have determined a new way of considering and perceiving the "real" market, no longer appreciated as a physical place for the exchange of proprietary rights according to the interaction of spontaneous forces such as supply and demand, but an open, borderless, and always connected place in which

[1] Antonio Felice Uricchio, Ordinary Professor of Taxation Law, former Rector of Aldo Moro University Bari (Italy), President of ANVUR (Italian National Agency for the Evaluation of Universities and Research Institutes).

you can easily and/or freely access and exchange information of any kind as well as goods and rights of enjoyment, temporary, and shared (so-called sharing economy),[2] giving life to new legal categories (digital goods) and new interests worthy of protection (data, privacy). As the economist Jeremy Rifkin pointed out in his book *The age of access. The Revolution of the New Economy*, the network gradually replaces markets with access, understood as the possibility of taking advantage of services, culture, information, relationships, wealth, the possibility of connecting and entering into existence and not being excluded from them, the possibility of somehow being actors of this reality that has replaced the material goods with the immaterial, the purchase with the momentary use, the traditional buyer-seller relationship with the provider-user relationship.[3] From this point of view, open access is contrasted with access on demand or limited and confidential access in which private contracts and advertising rules lay down conditions, limits, and methods of data and information protection. The Internet, cloud computing (understood as a mode of storage and management of data through virtual clouds by a provider), and artificial intelligence (or AI, from the initials of the two words, understood as a set of methodologies and techniques for the design of hardware systems and software program systems capable of providing the computer with performance comparable to those of human intelligence), open scenarios worthy of being investigated not only through cognitive techniques but also through the lens of law, economics, and taxation. At the same time, robotics and artificial intelligences bring about profound changes in production and service delivery patterns (with automated and interconnected productions), in the rethinking of the man-machine and machine-machine relationship (so-called Industry 4.0), in work organisation and even in everyday life.[4] In this view, "the fourth industrial revolution can act in two directions:

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[2] On the tax issues of the sharing economy, see: R. Schiavolin, *La tassazione della sharing economy attuata con piattaforme digitali*, "Rivista della Guardia di Finanza" 2019, No. 5, p. 1260, according to whom this expression means "the set of agreements between consumers with which one shares his good for temporary use by the other or uses his skills to provide him with a service, as an alternative to the use of the market through the intermediary of production or distribution chains". On the relationship between sharing economy and taxation see also: C. Buccico, *Modelli fiscali per la sharing economy*, [in:] D. Di Sabato, A. Lepore (eds), *Sharing economy. Profili giuridici*, Edizioni Scientifiche Italiane, Naples 2018; M. Allena, *The web tax and the taxation of the sharing economy. Challenges for Italy*, "European Taxation" 2017, No. 7, p. 7.

[3] J. Rifkin, *L'era dell'accesso. La rivoluzione della new economy*, Mondadori, Milan 2001, p. 1.

[4] The term Industry 4.0, projected in 2012 by a group of German academics and managers, is now "used in a current way to designate the measures of European governments to support the processes of economic transformation" in the transition to the fourth industrial revolution in accordance with four main guidelines: innovative

1) of an impact on the manufacturing world because the production of goods and services thanks to robots, artificial intelligence, communication technologies, and the cloud can be completely reformed and modified, 2) of the transformation of society because the entry of robots 4.0 will take place in our midst. The first trend will have disruptive effects, because the combination of a robot's physical and mechanical potential with an artificial intelligence cognitive system, its control system and the perceptual experience shared in the cloud, can overcome some substantial limitations of robots to make them truly capable of performing physical tasks – such as navigating unordered environments and manipulating objects – and able to perform both cognitive tasks, for example, the recognition of the objects themselves, their selection and understanding of their functionality, according to the functional specifications of a given task".[5] Through robotics, ubiquitous connections and the availability of a virtually infinite number of computer identities (especially with the new IPv6 protocol), economic operators and private entities carry out economic and social activities, digitally dialogue plants, and people, and, above all, achieve incomes and savings of expenditure in ever new ways; at the same time, users offer and use information, experience, documentation, knowledge, and more generally communicate with each other, allowing individuals as well as network lords to benefit and/or achieve cost savings. We need only to think, for example, of entrepreneurs who, by presenting their products on the network, can reach a higher number of consumers, achieving, on the one hand, higher revenues and, on the other hand, saving on advertising costs, on the costs of displaying goods in physical places, on the cost of employees (clerks and other sales agents) or para-subordinates (commercial agents, promoters, etc.). From a different point of view, one can think of the advantages, including in terms of cost reduction (travel, postage, research, etc.), that a private individual can derive from the

investments, enabling infrastructure, skills and research, awareness and governance. The plan has been adopted by many European countries (especially France and Germany). Even Italy, with full awareness of the rethinking of the relationship between man-machine and machine-machine, has introduced, through a national Industry 4.0 plan, tax incentives (deductions, tax credits, hyper and super depreciation) and measures to support venture capital, in order to stimulate private investment in research and innovation (according to estimates more than 10 billion euros of private spending). See: L. Beltrametti, N. Guarnacci, N. Intini, C. Laforgia, *La fabbrica connessa. La manifattura italiana (attar)verso Industria 4.0.*, goWare e Edizioni Angelo Guerini e Associati, Milan 2017, p. 28, according to whom with the fourth industrial revolution "all the elements that have to do with manufacturing operations (suppliers, plants, distributors and the products themselves) are digitally connected to each other giving rise to a highly integrated value chain".

[5] A.F. Uricchio, *Robot tax: modelli di prelievo e prospettive di riforma*, "Giurisprudenza italiana" 2019, No. 7, p. 1752.

acquisition of information or the saving of expenditure from which he can benefit by comparing goods and services of different operators on the global market and by purchasing goods on cheaper terms.

Yet, as the doctrine rightly pointed out, "the time is ripe for an organic foundation of robotics law, capable of consulting a manifest of legal mediation in the field of artificial intelligence, with particular reference to self-learning, the engine of the industrial revolution".[6] In rethinking and designing the regulatory models of robotic law, fiscal discipline, although too often towed with civil and commercial, can and must play a decisive role both in the promotion and dissemination of new models of production and social organization and in the taxation of new forms of wealth, also in the form of savings in expenditure, which the diffusion of new enabling technologies and that of data storage and circulation tools (big data) generate, speeding up transactions and expanding how the information is used. The promotion and stimulation of technological and digital innovation, both to acquire new revenues, taxing new manifestations of contribution capacity, is possible in full adherence to the principles of distributive equity. However, it is precisely fiscal policy and doctrine which have appeared rather "conservative", showing great resistance to the profound changes in production and social nature, caged in traditional taxation models (income and consumption taxation) and insensitive to the demands of the "production in the field of robotic law". However, in policy mix measures[7] (regulation, prohibitions, authorisations, controls), taxation can play a decisive role not only through new forms of levy, which are more in line with economic changes, but also through incentives of different kinds (deductions, tax credits for research and development, hyper and super depreciation which recognize a higher tax value than the cost of purchasing the property) and recipients (large companies, start-

[6] On the relationship between digital revolution, real economy, and law, see extensively: F. Gallo, *Il futuro non è un vicolo cieco. Lo Stato tra globalizzazione, decentramento ed economia digitale*, Sellerio Editore, Palermo 2019, p. 21.

[7] Cf. *ibidem*, p. 21, according to whom, "one should not tax technology itself and that is robots as Bill Gates argues but shift the levy from income from work and business to other types of income and over profits, to large assets and to the same economic added value as those digital enterprises that have very low marginal costs and a high, I would say almost disproportionate, stock market value. The reference is to the taxation of both financial assets, and real estate assets of a significant amount that give low returns and consequently produce small property incomes, both the use of non-renewable raw materials (the so-called internal European carbon tax and at borders) and above all the positions of rent, such as that of the digital economy, deriving from the collection and use of data and information against private individuals (the so-called web or digital taxes of the type of one on digital services recently introduced in Italy by Art. 1, Paras. 35–50 of the Budget Law for 2019, 30 December 2018, No. 145)".

ups, innovative companies), some of which have already been introduced. In this respect, it should be remembered that, at different historical stages, technological innovation has often enjoyed favourable tax rules motivated by the aim of not hindering its diffusion and development. This happened in the 1990s in the face of the spread of the network which for a long time to a large extent has been making use of a kind of tax moratorium (so as underlined by the European Commission Communication *A European Initiative in Electronic Commerce* of 16 April 1997,[8] the Bonn Declaration of 6 July 1997 signed by the ministers of the Member States of the European Union,[9] and an announcement made by 132 members of the World Trade Organization in May 1998, along with the 1998 Internet Tax Freedom Act in the United States[10]). This is still the case today because the diffusion and use of robots (still in the development phase) is not targeted by specific taxes and on the contrary can benefit from measures to mitigate the tax burden through the ordinary instruments of depreciation of capital goods (or hyper depreciation of Industry 4.0.) or deduction of costs according to the rule of inherence, typical of business income.

The break-in in the different production, social and domestic structures of robots able to carry out more diverse functions and activities raises the theme, the subject of the first reflections, of new tax models (robot income tax, dedicated capital taxes, possession tax, etc.) that appreciate their production capacity (also through comparison with human work), which measures the savings in expenditure that they can generate or the intrinsic value. It is therefore time to establish and apply new forms of levy aimed at striking at the different forms of wealth that the network, the cloud, artificial intelligence, and the new enabling technologies can generate, thus giving a new structure to taxation, preferably shared at the international and European level.[11] Referring to the new forms of

[8] European Commission, *Communication to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions: A European Initiative in Electronic Commerce*, Brussels, 16 April 1997, COM(97)157 final.

[9] Final Declaration of the European Ministerial Conference in Bonn (6–8 July 1997).

[10] *Internet Tax Freedom Act: Internet Access Taxation*, 2019, https://dor.sd.gov/media/qmbavimi/internet-tax-freedom-act.pdf (accessed: 30.03.2021).

[11] This need was clearly felt by the European Commission in its Communication *A European Initiative in Electronic Commerce*. See, in this regard, also: S. Cipollina, *I confini giuridici nel tempo presente*, Giuffrè, Milan 2003, p. 278, according to whom "the solution shared and participated in by all States is sought directly in the international arena, so that the homogeneity and congruence between the nature of the problem and that of the relative solution guarantees the efficiency of the latter […] The objective of this global dialogue is to identify principles that protect the fiscal sovereignty of States and ensure the correct distribution between them of revenue from electronic commerce, avoiding the risks of double taxation".

taxation on "free data collection by companies in the digital economy", the importance is reiterated of new forms of taxation, not sufficiently considered, often opposed and considered unconstitutional for violation of the principle of qualified contribution capacity. At times such as these, of the state's fiscal crisis, they would have the advantage of achieving the objective of helping to ensure an adequate level of welfare state funding and, at the same time, of reducing the tax burden on income and certain types of assets. Network access and navigation, artificial intelligence and big data storage and processing, transmission of information, along with experience and knowledge that express an economic value are likely to be subject to taxes of a different nature, even of a new institution, or expanding the sphere or methods of application of existing ones[12] (think of the rules for the location of the income produced or those in the field of electronic commerce, direct or indirect).

2. The delimitation of the phenomenon of artificial intelligence: possible legal implications

Of particular interest is the distinction between weak AI, which encompasses systems capable of simulating certain cognitive functions of humanity without, however, achieving the intellectual abilities typical of people (i.e., in a broad outline, problem-solving programs able to replicate some human logical reasoning to solve problems, make decisions, etc., as in the game of chess) and strong AI which is capable of becoming wise (or even self-conscious). According to the European Commission's definition of AI, it includes "systems that exhibit intelligent behaviour by analysing their environment and carrying out actions with a certain degree of autonomy,

[12] On this issue, see also: V. Ficari, *Regime fiscale delle transazioni telematiche*, "Rassegna Tributaria" 2003, No. 3, p. 870, for whom "a survey of the tax profiles of the so-called electronic commerce and, more generally, of the economic transactions that take place through and in the world of the web requires to verify the applicability of the rules and legal categories already known to the interpreter and, in hypothesis, the possible regulatory innovations if the regulatory data turns out, in this case, to be inadequate. In other words, the alternative, not necessarily rigid in the light of the different tax systems involved […] is between tax law and the new economy and tax law of the new economy". In different opinion, see: C. Garbarino, *Nuove dimensioni della transnazionalità dell'imposizione*, [in:] *L'evoluzione dell'ordinamento tributario italiano*, Atti del Convegno *I settanta anni di Diritto pratica tributaria*, Cedam, Padova 2000, for whom "the internet taxation does not address radically new problems, but old problems in a radically new context […] the one constituted by the Internet network and by the interactions that take place in it".

to achieve specific objectives. AI-based systems can be purely software-based, acting in the virtual world (e.g. voice assistants, image analysis software, search engines, speech and face recognition systems) or AI can be embedded in hardware devices (e.g. advanced robots, autonomous cars, drones or Internet of Things applications)".[13] The European Parliament, in its report of 27 January 2017,[14] has also defined intelligent robots, identifying their main characteristics: obtaining autonomy through sensors or other ways to facilitate the exchange or analysis of data, self-learning through experience or through interaction, adaptation of one's own performance and actions to the environment, at least physical support and the absence of life in the biological sense. Depending on the level of diffusion, it is possible to identify as "emerging" and therefore already applicable solutions in language processing areas, related to language processing for translation and text production independently from data; demand forecast, for the planning of production demand and the planning of materials and warehouse capacities; predictive maintenance, i.e. the ability to predict conditions that are about to occur on the machines; image processing, for the recognition of objects and people's faces; machine learning algorithms, able to identify suspicious transactions, bringing significant increases in the ability to identify fraud; recommendations, which aim to address the user's preferences, interests, and decisions based on information provided directly or indirectly; virtual assistant/chatbot solutions, able to provide services to a human interlocutor by interacting through writing and speech, already quite widespread; content design, analysing the data available to create new content or design new services or products; self-driving vehicles capable of perceiving the external environment and identifying the correct manoeuvres to do.

3. Impact of artificial intelligence on the labour market: prospects for the use of tax and social security leverage

In the face of the inevitable repercussions of the spread of artificial intelligence on the labour market, being able to penetrate the domain of tasks that until recently were only human, such as reasoning, detection,

[13] See: European Commission, *Communication to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions Artificial Intelligence for Europe*, Brussels, 25 April 2018, COM(2018)237 final.

[14] European Parliament, *Report of 27.1.2017 with recommendations to the Commission on Civil Law Rules on Robotics*, 2015/2103 (INL).

data analysis, and decisions, it is necessary first of all to analyse the reduction of the workforce as a result of the replacement by intelligent robots or a modification of the production system with a growing demand for workers with technological knowledge in dealing with such revolutionary change (this is the phenomenon of so-called technological unemployment, investigated by many scholars). The reduction in the number of employees could also have significant effects in terms of the sustainability of the tax and social security system if tax measures are not adopted in time to ensure economic and financial balance, which is elevated to a constitutional principle.[15] In this sense, a recent work, significantly titled *In your place. So web and robots are stealing work*,[16] signals both the risks of desertification of the traditional manufacturing enterprise and the loss of non-countervailable jobs with work units with technological or IT skills that could find a place in the current labour market. Again, a recent study warns that robotics and artificial intelligence lead in the short term to an increase in corporate profits and a reduction in unskilled jobs and that in terms of revenue, it is difficult to tax the largest profits generated by businesses using the robotic workforce. The taxation of

[15] On this topic, see: M. Bergo, *Pareggio di bilancio 'all'italiana'. Qualche riflessione a margine della Legge 24 dicembre 2012, n. 243 attuativa della riforma costituzionale più silenziomente degli ultimi tempi*, "Federalismi.it Rivista di diritto pubblico italiano, comunitario e comparato" 2013, No. 6, p. 22; G. Napolitano, *I nuovi limiti all'autonomia finanziaria degli Enti territoriali alla luce del principio del pareggio di bilancio*, "Rivista giuridica del Mezzogiorno" 2013, No. 1–2, p. 91; E. Jorio, *L'efficacia della Costituzione non è differibile*, www.astrid-online.it (accessed: 24.10.2012); F. Bilancia, *Note critiche sul c.d. "pareggio di bilancio"*, "Rivista trimestrale di diritto tributario" 2012, No. 2, p. 350; D. Morgante, *La costituzionalizzazione del pareggio di bilancio*, "Federalismi.it Rivista di diritto pubblico italiano, comunitario e comparato" 2012, No. 14, p. 1; G. Rivosecchi, *Il c.d. pareggio di bilancio tra Corte e Legislatore, anche nei suoi riflessi sulle regioni: quando la paura prevale sulla ragione*, "Rivista AIC" 2012, No. 3, p. 1; D. Cabras, *Su alcuni rilievi critici al c.d. "pareggio di bilancio"*, "Rivista AIC" 2012, No. 2, p. 1. See also: E. De Mita, *Il conflitto tra capacità contributiva ed equilibrio finanziario dello Stato*, "Rassegna tributaria" 2016, No. 3, p. 563, according to whom "the replacement of the expression 'budget balance' with 'balance' represents the legislator's intention to allow flexibility in the management of public finance that would otherwise be precluded. It should be recalled that Art. 5 of Constitutional Law No. 1/2012, which at letter f) provides for the assignment to the chambers, with due respect for their autonomy, of an independent body to which the tasks of analysing and verifying public finance trends and observing budget rules shall be assigned. Article 5 regulates in detail the criteria that must be observed and which exclude the possibility that the budget review can be reduced to a consideration of the amount of a single tax. Budgetary balance is an overall judgement which concerns, first and foremost, expenditure and which is directed, primarily, to the government. It cannot be limited to a single item, that of a tax, even if it is high, divorced from an overall assessment of revenue and expenditure".

[16] R. Staglianò, *Al posto tuo. Così web e robot ci stanno rubando il lavoro*, Einaudi, Turin 2016.

robots could thus compensate for the loss of income deriving from the reduction in taxable wages and support the cost of the social safety nets which society will have to face. Faced with these risks, it is necessary for the state to intervene with active labour policies, supporting the training and retraining of human capital, or by adopting fiscal measures for new recruitment, training of new skills, or retraining of staff who have lost their jobs (tax credit, deductions, etc.) and, in any case, reducing labour costs. The recovery of the regulatory favour towards this category of income can be effectively pursued by introducing measures like those provided for in the Industry 4.0 programme, adopted by the Italian State, for new generation machinery (super and hyper depreciation) to exploit human capital, providing for a greater deduction of costs. In this context, fiscal measures capable of subjecting new and different manifestations of wealth specific to the economy of the future become necessary and inevitable both to cope with the lower revenue that could result from the reduction in the number of workers and the appropriate reduction in the tax burden on labour. The question then arises whether by "work" we should mean only the human activity carried out using physical or intellectual energies to obtain an economic advantage and, with it, a personal satisfaction, or whether even the activity carried out by intelligent robots can be considered as such, with determination of the related income on the basis of the normal value of the activity carried out, regardless of whether the consideration qualifies as taxable income. In the current tax framework, work is posing as a legal environment suitable to produce value that can only be carried out by a human being which, in turn, is the subject of the contractual obligation to work and which ensures that those who provide it have the right to remuneration or other economic benefits, ensuring a free and dignified existence (Art. 36 of the Italian Constitution).[17] Rethinking the taxation

[17] Conceived for a long time only as a bargaining chip, work has taken on a much deeper meaning over time as a higher expression of personality and human dignity. This does not mean that the employment relationship, although it concerns the person of the worker and is of social importance, cannot be configured as an exchange relationship since it is characterized by the burden and the consideration of the benefits. On the contrary, the obligation to pay work appears to be interdependent with that of remuneration (Article 2094 of Italian Civil Code). For a complete examination of the different concepts of work expression and employment relationship in legal experience, see: U. Prosperetti, *Lavoro (fenomeno giuridico)*, [in:] *Enciclopedia del Diritto*, vol. XXIII, Giuffrè, Milan 1973, p. 332; P. Tosi, F. Lunardon, *Subordinazione*, [in:] *Novissimo digesto italiano*, vol. XV, Utet, Turin 1998, p. 256. See also: G. Persiani, M. Prola, *Contratto e rapporto di lavoro*, Cedam, Padua 2001, p. 3, who observe: "Human work is taken into account by the legal system, and is regulated by it, as it is capable of producing an economically useful result and, therefore, of being the subject of an obligation. The fulfilment of the obligation to work involves, however, necessarily the person of the debtor himself, with the consequence that the discipline of

models, also assuming a kind of robot liability where it ensures economic benefits to those who can dispose of the activity provided by these yields must not constitute a heresy but a perspective worthy, therefore, of being investigated and perhaps tested. At the same time, a compensatory social security levy on intelligent robots replacing human labour can lead to a better sustainability of the social security system.

4. Proposals for the introduction of web taxation

In warning of the importance of this issue, international and European institutions, even if only in recent years, have considered that the adoption of fiscal measures in the digital and technological economy, as well as the definition of rules for the allocation of powers of taxation between states, also in the light of the economic globalisation drive that the digital market favours and accelerates, can no longer be delayed. From this point of view, the definition of common principles by European and international institutional bodies through which to express guiding principles about models and criteria for the taxation and combating of harmful competitive practices seems inescapable.

In particular, the OECD, in launching the Base Erosion and Profit Shifting (BEPS) project, defined Action 7 (preventing the artificial avoidance of permanent establishment status), Action 6 (preventing treaty abuse) and Action 15 (developing a multilateral instrument), helping to define the concept of a "virtual" or "digital permanent establishment", with consequences on actions to combat the evasion and avoidance phenomena of the web economy. In particular, Action 1 (*Addressing the tax challenges of the digital economy*) recommends an analysis and identification of the main

capital aspects often combines with that intended to achieve the protection of the person of the worker". See also: M. Persiani, *Contratto di lavoro e organizzazione*, Cedam, Padua 1966, p. 5, which favours the configuration of the employment relationship as a fundamental situation in the life of the relationship and as a prerequisite for the foundation of the entire system of protection of labour law. See also: M. Grandi, *Rapporto di lavoro*, [in:] *Enciclopedia del Diritto*, vol. XXXVIII, Giuffrè, Milan 1990, p. 313, which, in emphasizing the particularly broad content of the employment relationship "going beyond the limits of the individual relationship based on the contract", considers that it is not "useful or justified to have a concept of relationship understood as a phenomenal element of social reality, since it radically goes beyond the explanation of the constitutive cause of the genetic and functional link in which they are linked (according to the logic of the sources of the mandatory relationship ex Art. 1173 of Italian Civil Code the qualifying obligations of the respective subjective positions of the worker and the employer)".

points of friction between the forms and strategies of the new economy and the rules of international tax law to be carried out, both in the field of direct and indirect taxation. The analysis should focus on "the evanescent territorial interconnections of the digital presence of companies, on the ways of creating value in this specific area, on the identification and classification of income deriving from new business models and on the collection of VAT with regard to cross-border supplies of digital goods and services".[18]

The European Union has also intervened several times mainly with regard to the problems of e-commerce with the so-called "e-commerce VAT package", adopted on 5 December 2017, consisting first of Council Directive 2017/2455/EU, amending Directive 2006/112/EC and Directive 2009/132/EC, with regard to VAT obligations for the provision of services and distance supplies of goods[19] and of the Council Implementing Regulation 2017/2459/EU, amending Regulation 2011/282 laying down implementing provisions for Directive 2006/112/EC.[20] The European Commission Communication of 21 September 2017 on *A fair and effective tax system in the European Union for the digital single market*,[21] addresses the tax challenges posed by the digitalisation of the global economy by highlighting the need for a fair, effective, and adequate taxation system. In its conclusions of 5 December 2017, the ECOFIN Council also welcomed the Commission's proposals, considering the OECD's approach, which was central to the challenge of taxing the digital economy, with particular reference to the definition of a permanent establishment, rules on transfer prices, and the allocation of profits. The ECOFIN Council also invited the European Commission to investigate possible temporary measures and in particular a contribution on digital revenue in the European Union (equalization levy). On 21 March 2018, the Commission therefore presented a package of measures for the fair taxation of the digital economy, consisting of a communication, a recommendation, and two proposals for directives.[22] At the meeting

[18] OECD, *Action Plan on base Erosion and Profit shifting*, OECD Publishing, Paris 2013.

[19] EU, Council Directive (EU) 2017/2455 of 5 December 2017 amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods, Official Journal EU L 348, 29 December 2017, p. 7.

[20] EU, Council Implementing Regulation (EU) 2017/2459 of 5 December 2017 amending Implementing Regulation (EU) No 282/2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, OJ L 348, 29 December 2017, p. 32.

[21] European Commission, *Communication from the Commission to the European Parliament and the Council. A fair and effective tax system in the European Union for the digital single market*, COM(2017)547 final, Brussels, 21 September 2017.

[22] The proposals for directives (European Commission, *Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence,*

of 21 March 2018, the initiative for new rules to tax digital activities was promoted through the proposal of directives subjecting to a temporary levy of 3% revenues from online advertising, social activities, and the sale of data by the network's multinationals (companies with at least EUR 750 million worldwide and EUR 50 million at the European level) and a levy at full capacity to profits where generated (using one of the following parameters as location criteria: at least EUR 7 million annual turnover in a Member State; at least 100,000 users in a Member State during a given tax year; at least 3,000 commercial contracts in a Member State). Although there is still no full consensus, the comparison within the European Union seems to be evolving towards solutions that adapt the regulatory frameworks to the transformations of the economic circuit produced by digital technologies. The recommendation[23] proposes that Member States

COM(2018)147 final, Brussels, 21 March 2018; European Commission, *Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services*, COM(2018) 148 final, Brussels, 21 March 2018) constitute the implementation of Action 1 of the BEPS project, although not fully aligned with the conclusions of Action 1. As part of the BEPS project, the aim was to bring the power of taxation back to the place where the economic substance of the operation manifests itself. In March 2018, the OECD also issued an interim report on measures being adopted at country level, entitled *Tax challenges arising from digitalization: Interim Report 2018*. See: D. Pellegrini, *Annotazioni a margine di una sentenza di merito in tema di esterovestizione societaria: la nozione di residenza fiscale delle società tra episodi giurisprudenziali interni e direttrici evolutive BEPS*, "Diritto e pratica tributaria" 2017, No. 3, p. 1148: "It first takes into account how one of the overriding objectives for the implementation of the Base Erosion and Profit Shifting project is to anchor taxation at the place where the economic substance of the operation is located. The aim is to identify the growing difficulty in identifying the state as the source of income, given both the dematerialisation of wealth due to the growing affirmation of new digital economies and the multifaceted structures of corporate groups". To comment on the BEPS proposals on tax residence, in particular their compatibility with EU law, please refer, i.a., to P. Braumann, M. Tumpel, *The tie breaker for dual resident companies, the holding period for intercompany dividends and the modification to Article 13 of the OECD Model*, [in:] M. Lang, P. Pistone, A. Rust, J. Schuch, C. Staringer (eds), *Base Erosion and Profit Shifting (BEPS). The proposals to revise the OECD Model Convention*, Linde Verlag, Vienna 2016, p. 303. Assonime Circular No. 17/2016 examined the changes to the definition of permanent establishment contained in Action 7 of the BEPS Project, with regard to the "personal" permanent establishment, the notion of "preparatory and/or auxiliary activities", and the so-called antifragmentation rule; on the point see: D. Avolio, D. Sencar, *Stabile organizzazione and Action 7 of the OECD BEPS Project*, [in:] S. Mayr, B. Santacroce (eds), *La Stabile Organizzazione delle Imprese Industriali e Commerciali*, IPSOA, Milan 2016, p. 87. In a critical sense of some recent legislative proposals with anti-elusive purposes, see: D. Stevanato, *Elusione fiscale e abuso delle forme giuridiche, anatomia di un equivoco*, "Diritto e pratica tributaria" 2015, No. 5, p. 5.

[23] European Commission, *Commission Recommendation of 21.3.2018 relating to the corporate taxation of a significant digital presence*, COM(2018)1650 final, Brussels, 21 March 2018.

adapt double taxation agreements concluded with third countries in order to extend the concept of permanent establishment to the "significant digital presence", by means of which a company carries on all or part of its business. Pending definitive international solutions (OECD), the EU Commission proposes, albeit as a provisional solution, a common system of tax on revenues from the provision of certain digital services. The proposal for Directive COM(2018)148 final focuses on the concept of "value creation" by users, in coordination with the provisions of the proposal for a directive on a comprehensive solution and the recommendation to Member States to include the latter in international conventions on double taxation.

The "interim solution" appears to be oriented towards business models in which users' contribution to value-building is "more significant". DST (tax on digital services) is a tax on the risks generated by the provision of certain digital services, characterized by the fundamental contribution of user participation in digital activity, i.e. those provided by business models, which could not exist in their present form without the participation of users. In essence, taxation concerns revenues from the processing of user contributions, not user participation per se. The taxable amount of the DST is the company's gross revenues received in exchange for the provision of digital services, as outlined above, net of VAT and other "similar" taxes. The nature of indirect taxation is evident, with similar profiles to the tax assumption and the tax base of IRAP (regional tax on productive activities): the "value produced" by the contribution of users in the use of services, provided by a "self-organization" of the enterprise, through a digital platform.

5. The robot tax also in the light of the constraints of constitutional nature

As the Constitutional Court has made clear, "the ability to contribute, as a suitability for the tax obligation, which can be deduced from the economic assumption to which the tax is linked, must, in principle, be identified in any wealth-detecting index, according to assessments reserved for the legislature, except for the control of constitutionality from the point of view of arbitrariness and irrationality". It follows that the search for new taxable cases and new taxation criteria not only must not be arbitrary, but must reflect the criterion of eligibility for the contribution of the case and of the person obliged in the light of economically appreciable situations.[24] In this sense, the Committee on Legal Affairs of the European Union on 31 May 2016 published a report (then accepted by the European Parliament on 1 January 2017) on the growing importance of the use of robots in modern society in which it highlights how the cognitive skills of robots make them like subjects ("more and more similar to agents that interact with their environment and are able to alter it significantly").[25] The report adds, "in this context, major changes to the current legal system could be contemplated, such as granting robots a sort of 'electronic personality' and the possibility to be liable for actions, not to mention aspects related to privacy, intellectual property or criminal law." In this respect, the concept of smart robots is proposed, since it cannot extend subjectivity to computers or software, nor to tools such as driverless cars that remain self-driving (so-called "weak artificial intelligences").

Decisive for a future recognition of tax subjectivity is the robot's ability to make decisions independently and to increase its skills and knowledge

[24] See, in this regard, IT Constitutional Court, judgement, 22 April 1997, No. 111, which finds in the concept of contributory capacity the prohibition of arbitrariness and irrationality of the legislator's choices and the constraint on the specific aptitude to contribute according to the economic premise, since not every phenomenon of social life, provided with an economic substratum, can be taken as the basis of taxation. In doctrine, see, on this subject, P. Boria, *Il bilanciamento di interesse fiscale e capacità contributiva nell'apprezzamento della Corte Costituzionale*, [in:] L. Perrone, C. Berliri (eds), *Diritto tributario e Corte Costituzionale*, Edizioni Scientifiche Italiane, Napoli 2006, p. 64, who, after pointing out the self-limiting nature of the Constitutional Court's review in tax matters to the advantage of the ordinary legislator's margin of appreciation, notes that "the balancing between the two constitutional values of the tax interest and the ability to pay must be sought through mediation on the basis of the criterion of internal consistency and rationality of the regulatory system". In this regard, L. Antonini, *Dovere tributario, interesse fiscale e diritti costituzionali*, Giuffrè, Milan 1996, observes that, in the light of the consolidated orientation of jurisprudence, "the only element potentially suitable to limit the discretion of the legislator seems, therefore, to reside in the 'absolute arbitrariness or irrationality of the measure of taxation', thus resulting in the establishment of a delimitation that tends to exhaust the review of constitutionality within Art. 53 of the Constitution, with respect to which the profiles of constitutionality relating to the right of property do not seem to find entry. Given this premise, the further problem of establishing when the aforementioned hypotheses ('absolute arbitrariness or irrationality') can be considered to be concrete remains open, with respect to which, although it is evident that it is difficult to reach a prior definition, disconnected from concrete cases, it is nevertheless possible to note that the main criterion followed by the Court was that inherent in the internal consistency of the individual taxes, or rather the need for the structure of the tax to be consistent with its economic premise".

[25] See: European Parliament, Committee on Legal Affairs, *Draft Report with recommendations to the Commission on Civil Law Rules on Robotics (2015/2103 – INL))*, 31 May 2016, https://www.europarl.europa.eu/doceo/document/JURI-PR-582443_EN.pdf (accessed: 30.03.2021).

("hard artificial intelligence"). To distinguish intelligent robots from those with mere materiality, the European Parliament, in its resolution of February 2017, attached particular importance to the autonomy of the robot, understood as "the ability to make decisions and implement them in the outside world, regardless of an external control or influence",[26] with a level varying according to the degree of complexity with which human-machine interaction was designed. According to the European Parliament, "the more autonomous robots are, the less they can be considered as mere tools in the hands of other actors (such as the manufacturer, operator, owner, user, etc.)". The "autonomous machine" is then defined using characteristics such as "obtaining autonomy through sensors and/or through the exchange of data with its environment (interconnectivity) and the exchange and analysis of such data", "self-learning from experience and through interaction", and "adaptation of one's behaviour and actions to the environment".[27] It is also worth mentioning the suggestion, included in a European Parliament resolution on the proposal of the Luxembourg MEP Mady Delvaux, of the Group of the Progressive Alliance of Socialists and Democrats, which requires companies that choose to automate their production to pay training courses for workers who lose their jobs. The sums to be allocated for these purposes could be configured as a purpose levy, the amount of which could be matched to the higher profits made through automated robots. Indeed, however difficult it may be to assess the models of tribute on artificial intelligences also for the technical and scientific profiles involved and for the difficulty of appreciating its present and future economic effects, it seems necessary to adopt shared choices at least at the European or international levels also in order not to give rise to market distortions to the detriment of local companies, thus also

[26] European Parliament resolution of 16 February 2017 with recommendations to the Commission on Civil Law Rules on Robotics (2015/2103 – INL) (2018/C 252/25), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017IP0051&rid=9#:~:text=C%20252%2F241-,Thursday%2016%20February%202017,conflict%20with%20the%20First%20Law (accessed: 20.03.2021).

[27] Cf. S. Dorigo, *La tassa sui robot tra mito (tanto) e realtà poca*, "Corriere tributario" 2018, No. 30, p. 2368, according to which the set of "favourable tax regimes, which cumulatively create a discipline that is defined in practice as Industry 4.0, denotes the propensity of our system for regimes that favour, through a tax advantage, the technological modernisation of companies and production processes, which also implies the use of robots and procedures based on artificial intelligence. The Italian legislator has therefore, for the time being, adopted the liberal approach in favour of encouraging the robotization of companies, in the knowledge that the return in terms of a greater tax base will help to offset the imbalances in the labour market and social structure that are linked to this process. The overriding objective is to maintain the competitiveness of our economy in a global context where competition, including technological competition, is becoming increasingly fierce."

preventing further relocation. In a devolved perspective, the robot tax, adopted at the European level, could also finance the Union's budget, allowing the acquisition of resources for redistributive purposes or for research and development.

6. Prospects for the enhancement of artificial intelligences in a facilitating function

Of course, taxation could also take place on a presumptive basis, according to reasonable criteria, estimating the economic benefits of using a robot. However, there is a risk that corrective action should be taken to prevent double taxation of the company's profits and of the economic benefits (profits or lower costs) produced by robots used within the simplest enterprise.

At least at an early stage, a capital tax could be introduced on intelligent robots, differentiated according to the capacity for data accumulation and knowledge. Such a levy, insisting on a separate assumption from income taxes, would not give rise to any problem of double taxation. It would be easily ascertainable, since the presence of the intelligent robot is traceable and recognizable. Its experimental adoption could make it possible to counter, at least at an early stage, the distorting effects that the spread of intelligent robots could have on the labour market, as well as allow for more revenue to be made available, without discouraging development and innovation.

From a broader point of view, it cannot be considered that the provision of automation incentive tools through the Industry 4.0 package or with other instruments can be considered incompatible with the introduction of robot taxes. On the contrary, it is precisely the set of new taxes and incentives that can best adhere to processes of profound economic transformation, characterized by the emergence of new manifestations of wealth and meritorious activities, which are different. This is the direction of a recent Italian bill on tax concessions for the use of artificial intelligence systems in the production of goods – presented on 3 August 2017 – which states that, "in the face of the increasing use of artificial intelligence, tax intelligence seems to be the best lever: this bill intervenes, in fact, on corporate income tax (IRES) increasing the rate by one percentage point if the production activity is carried out and managed directly by intelligent machines. This increase in taxation does not start, however, if the company invests 0.5% of its revenues (i.e., half the amount of IRES it would have paid at the increased rate) in projects for the retraining of its employees or in corporate welfare tools. There are two aims intended to be achieved: the first is to discourage the brutal replacement of the human workforce with a robotic workforce; the second, already partly illustrated, is to encourage companies to retrain their human workforce and, at the same time, to equip workers with the knowledge and skills to guarantee them a place in the labour market (despite the evolution of production processes)."[28]

The European Union also fully appreciates the facilitating dimension of innovation, not least since the productivity it stimulates is now an asset of strong competitiveness, as well as a factor in the multiplication of wealth. In fact, it points the way to the "nexus approach" understood as a condition for the recognition of tax concessions for research and development in the presence of a direct relationship between expenditure and beneficial economic results. It seems very difficult to determine whether investment in innovation can generate positive results in terms of growth, development, and employment, as well as in terms of profitability for the company that makes it; in this area, more than in others, predicting the future is particularly difficult, even because of the high risks of its failure. Here, too, we can recall the "paradox of innovation" in which it is pointed out that over time those who make more mistakes who therefore collect failures in the first phase (the examples are infinite) win.

So, the question that must be asked at a time when financial incentives and concessions are being introduced in favour of private research applied: is it right that profits should be privatised and losses should be socialised? It is precisely the answer to this question that leads to the development of levy models designed to tax the new manifestations of

[28] As stated in the explanatory report of the bill, "it represents a now peaceful acquisition for which, in just under twenty years, many professionals, especially in the industrial and manufacturing sectors, will be replaced by intelligent robots which will perform the same tasks at a much lower cost; all this with immediate negative effects on employment. Of course, we cannot consider halting scientific progress or neglecting the positive effects of such developments, but it is considered essential to prevent and reduce the negativities that such changes, especially if not governed, can produce on the labour market and, above all, on employment levels. The massive use of robots can, in fact, create a sudden and uncontrolled contraction in the demand for human labour in large sectors of industry and it would, of course, be only the workers who would suffer, who would not be able to compete at all with robotic production systems. It is therefore necessary to ensure that the increasing use of artificial intelligence systems follows the widespread conversion (and updating) of the human workforce, creating new professional figures connected and not conflicting with the presence in the company of intelligent robots or updating the worker's skills, so that he continues to be indispensable to the production structure. Finally, this measure does not entail additional burdens for the state budget or for that of local authorities".

wealth that technological development produces at a time when it is being supported by tax concessions and public expenditure on research. It is clear, in fact, that while innovative investment produces wealth, economic development, employment, and the social use of research products, positive externalities outweigh the costs incurred even when socialized through the financing of research. To this must be added that the new wealth is subject to taxation (although it may enjoy some initial facilitation) with the consequence that the taxation of innovation guarantees a full return on public investment, according to a circular taxation model attentive to the processes of growth and development, and fully sustainable,[29] promoting innovation, selecting its planning, along with areas of intervention, and assessing its repercussions in terms of growth and social returns. This does not mean, however, returning to government-controlled models, without the freedom of research; it means, on the other hand, making the provision of the incentive conditional on an early assessment of the relationship between investments and possible relapses, which can legitimise and justify that type of investment, avoiding unnecessary waste of public resources or "gifts" to friends on duty. The monitoring of investment in innovation and the traceability of forward results are also crucial.

Returning to possible facilitating models, in addition to existing measures such as those of the Industry 4.0 package, which may also cover applications of various kinds of intelligent robots, it is necessary to recall other possible interventions that the legislator could introduce, both in favour of companies, in favour of families, or to pursue meritorious objectives such as the protection of the environment and health. In this regard, tax deduction measures can be recalled, already contemplated today, in the field of disability (Law of 5 February 1992, No. 104) regarding machinery of various kinds (artificial limbs), intelligent agents (software agents), or robots. According to the report of the World Economic Forum (2018) *Harnessing Artificial Intelligence for the Earth*,[30] the potential of using artificial intelligence to counter the planet's

[29] On the comparison between the model of taxation in the linear sense, i.e. taxation that maximises revenue because it has to maximise expenditure and sometimes waste, and "circular taxation" that knows how to promote development and how to balance the instruments of taxation with those of incentives, and therefore succeeds, through an effective mix of taxation and tax breaks, in also generating development, see: A. Uricchio, *Percorsi di diritto tributario*, Cacucci Editore, Bari 2017. Moreover, the so-called circular taxation promotes the circular economy, which is one of the other strong assets of the innovation economy, i.e. the economy of the future (reuse, environment, green economy), but at the same time it does not leave "social waste" and, therefore, it also knows how to combine technological innovation with social innovation.

[30] World Economic Forum, *Harnessing Artificial Intelligence for the Earth*, Geneva 2018, https://www3.weforum.org/docs/Harnessing_Artificial_Intelligence_for_the_Earth_report_2018.pdf (accessed: 30.03.2021).

environmental emergencies is immense. More specifically, the report refers to six different areas of action which may also be of interest to the tax legislator through appropriate eco-incentives: climate change, the preservation of biodiversity, the protection of the oceans, water safety, protection against air pollution, and the prevention of catastrophic events. The use of artificial intelligences in promoting the efficient use of resources against waste appears fundamental, trying to guide production and consumption, making them aware of the scarcity of the earth's resources and respect for the ecosystem. Here, too, the possible measures are of a different nature,[31] both of a tax nature ("landfill taxes" or taxes on food waste) and of facilitating, precisely linking them to the use of artificial intelligences to reduce or rationalize consumption or prevent the formation of waste.

[31] F. Gallo, F. Marchetti, *La tassazione ambientale*, "Rassegna tributaria" 1999, No. 1, p. 115, who highlight how "the protection of the environment is an objective – political, cultural, social – by its nature extra-fiscal. As long as it is considered that the tax instrument should be used for the protection of the environment, it will never be possible to have an environmental tax in which the environmental good is placed within the tax case. Environmental protection is an effect, hoped for, resulting from the introduction of a levy, including a tax, which, by increasing the cost of the good or the polluting activity, will lead the consumer to turn to other goods with less environmental impact. The shift of the link between tribute and the environment, from the protection of the environment – the latter extrafiscal purpose – to the polluting physical unit, has allowed the doctrine to be able to elaborate the theory presented, in terms of environmental assumption, reversing the traditional theory on the extrafiscality of the environmental toll". See also: A. Dagnino, *La potestà normativa delle Regioni e degli Enti locali in materia di fiscalità ambientale*, "Rivista di diritto tributario internazionale" 2004, No. 2–3, p. 329, for whom the *divisio* trace has significant implications of a dogmatic nature, which deserve to be deepened. Taxes "with an environmental function" (whether taxes or charges) may have two different connotations. First, all those "purpose" levies, the proceeds of which are, by law, intended in whole or in part for the construction of environmental protection and/or restoration works, may play an environmental role. The environmental function is highlighted, in a mediated way, because of the specific allocation of revenue, provided for by law. Secondly, those taxes within which penalising tax institutions are introduced, intended for the pursuit of extrafiscal objectives, of environmental policy must be considered. Taxes with an environmental function therefore tax traditional indices of ability to pay (income, wealth, consumption, production, business) but contain a discipline which hits more severely (penalisation) cases in which there is a link between the ability to pay and the performance of an activity harmful to the environment. This increased taxation leads to a difference in tax treatment between cases affected by the levy, which presupposes the adoption of an environmental *tertium comparationis*. In other words, the situation of those who make a certain unit of taxable amount by not polluting is assessed differently, for the purposes of taxation, from that of those who produce the same amount of wealth and harm the environment. The theoretical justification for such charges is, *mutatis mutandis*, the same as that which underlies the facilities by which activities which are the subject of promotion and/or protection based on constitutionally relevant principles are favoured. In the case of taxes for environmental purposes, the principle which is considered, to justify the most burdensome treatment, is that referred to in Art. 32, Italian Constitution.

We should also not forget the use of artificial intelligence in tax assessment procedures, already planned and partly carried out in France and the subject of study by the Italian Revenue Agency, which already uses tools for collecting and interchanging information, including big data (Report Registry and Data Interchange System – SID). Particularly sophisticated is the one used by the Revenue Agency to acquire information related to balances and movements of current accounts as well as other types of reports, by financial intermediaries. The technological characteristics of the system will allow the progressive extension to other types of flows that are characterized, mainly, by the large volumes of data exchanged. Fundamental in this context is the role of SOGEI (General Society of Informatics, an IT company fully-owned by the Italian Ministry of Economy and Finance) in charge of managing and organizing information systems on behalf of the Ministry of Economy and Finance (and also of the Court of Auditors), also through thematic databases to be used for "intelligence activities", tax verification, and economic policy decisions. In this context, SOGEI has developed control methodologies to give greater effectiveness to actions to prevent and combat evasion and to improve the quality of controls and checks in the access phase and in the reconstruction of income and business volumes, reporting the elements to be detected, and the documentation to be acquired. The tools available are integrated and respond to the regulatory and organizational framework provided for the "intelligence" activities of the tax administration and allow to carry out the controls and to provide support to the phases of contradiction with the taxpayer and tax assessment.

From these first remarks, it is all too clear that new scenarios are opening that deserve to be investigated without hesitation and fear. Experimenting with fiscal instruments combined with unstoppable technological developments may therefore offer solutions which the policymakers will be called upon to evaluate and, at some point, introduce.

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Abstract

The profound changes that accompany the history of humanity seem to depend largely on the unstoppable force of knowledge and innovation. The diffusion of robotics and artificial intelligence has had a significant impact on the processes of wealth production, with inevitable repercussions also on the labour market: today intelligent robots can carry out activities that were only human until recently. In this view, following the growing importance of the use of robots in modern society, the theme of the "robot tax" has assumed no small importance. The essay examines the various solutions imagined, evaluating the proposals to recognize the tax subjectivity of robots or to define the taxable case, assuming, depending on the case, as a prerequisite for the tax, the ability to accumulate data and knowledge, the property value of the robot-good or the greater profits deriving from the activity carried out using it.

Keywords: Artificial Intelligence, forms of taxation, additional incentives

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Anna Vartašová[1]

Buildings and Structures as the Object of Real Property Taxes in the Countries of the Visegrad Group[2]

1. Introduction

Real property tax (RPT), as a type of property tax,[3] is a direct tax[4] of a recurrent nature with a long-standing tradition.[5] It is applicable also in the countries of the Visegrad group (V4) comprising Slovakia, Czechia, Hungary, and Poland, which was established on 15 February 1991 in the Hungarian town of Visegrad[6] and thus is celebrating its 30th anniversary.

In Slovakia and Czechia, RPT has a form of one tax regulated in Slovakia by the Act on Local Taxes and Local Charge[7] and in Czechia by the Immovable Property Tax Act,[8] while in Hungary it is created by the tax on land and tax on buildings, both regulated by the Act on Local

[1] Dr Anna Vartašová, PhD in Law (2012), senior researcher, Department of Financial Law, Tax Law and Economics, Faculty of Law, Pavol Jozef Šafárik University in Košice (Slovakia), https://orcid.org/0000-0002-1366-0134

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[6] K. Jasiecki, *The Role and Importance of Economic Cooperation of the Visegrad Group Countries in the European Union*, “Online Journal Modelling the New Europe” 2020, No. 33, p. 26.

[7] SK, Act No. 582/2004 Coll. on local taxes and fees for municipal waste and minor construction waste [*Zákon o miestnych daniach a miestnom poplatku za komunálne odpady a drobné stavebné odpady*], amended.

[8] CZ, Act No. 338/1992 Coll. on Immovable Property Tax [*Zákon o dani z nemovitých věcí*], amended.

Taxes.[9] In Poland, there is one local RPT regulated by the Act on Local Taxes and Fees,[10] nevertheless, there are two other taxes – agricultural tax and forest tax that need to be taken into account in this context. All of these RPT systems comprise taxation of buildings and/or structures, however, their approaches vary.

Following our previous research on RPT in Slovakia,[11] partial comparison with other V4 countries,[12] the broader context,[13] and the work of academics on the topic,[14] this paper aims to present the differences between the determination of objects of real property taxes, as regards buildings and structures, in particular, applied in the V4 countries upon their primary analysis and comparison. Due to the limited range of this paper, the exclusions from taxation and exemptions were not subject to the analysis.

2. Legislation of the V4 countries

In Slovakia, RPT is a three-tier system (tax on land, tax on buildings, and tax on apartments and non-residential premises). As regards the buildings, subject to the buildings tax are constructions in the territory of the Slovak Republic which have "one or several above-ground storeys or underground storeys[15] and are connected to the ground by a solid

[9] HU, Act No. C of 1990 on Local Taxes [*Törvény a helyi adókról*], amended.

[10] PL, Act of 12 January 1991 on Local Taxes and Fees [*Ustawa o podatkach i opłatach lokalnych*], Official Gazette [*Dziennik Ustaw*] 1991, No. 9 heading 31, amended.

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[12] *Eaedem*, *Real Property Tax in the Countries of Visegrad Group – Comparative View*, "Studia Iuridica Lublinensia" 2022, No. 1, pp. 191–211; A. Vartašová, *Uplatňovanie inštitútu miestnych daní v krajinách V4*, [in:] D. Cevárová (ed.), *Interpolis 2020*, Belianum, Banská Bystrica 2020, pp. 500–508; *eadem*, *Komparácia systémov miestnych daní v krajinách Vyšehradskej štvorky*, [in:] K. Liptáková (ed.), *Miestne dane v krajinách Vyšehradskej štvorky*, Leges, Prague 2021, pp. 127–186.

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[14] E.g.: L. Etel, *Systems of Immobile Property Taxation in the States of the Visegrad Group*, "Analizy i Studia CASP" 2019, No. 8, pp. 1–13.

[15] The storey of the building is defined as a part of the interior of the building delimited by the floor and the ceiling structure. If the building does not have a ceiling structure, the floor is considered to be a part of the building delimited by the floor and the roof structure.

foundation or anchored by piles". These are divided into several categories (residential buildings, cottages, garages, industrial buildings, etc.), among which the act refers to the Building and Planning Act to provide the definitions only as regards residential buildings and small buildings that have additional functions for the main building.[16] Inclusion of the building into the relevant category is governed by the purpose of its use as of 1 January of the taxation period, and the tax liability is not affected by the fact that the building has ceased to be used. An uncompleted building is taxed as a part of the building plot until the certificate of building compliance becomes final.

Apartments and non-residential premises are subject to tax on apartments if they are situated in residential buildings in which at least one apartment or a non-residential premise has been acquired by a natural person or legal entity (the building itself is not subject to tax in such a situation).

Since the Czech Republic divides the RPT into the tax on land and tax on buildings and units, the subjects of the latter tax are:

1) taxable buildings and their parts located in the territory of the Czech Republic, which are completed or already used, covering: a) buildings as defined by the Cadastral Act[17] and b) engineering structures listed in the annex to the Act on Immovable Property Tax;[18] and

2) taxable units and parts thereof if they are completed or in use, located in the territory of the Czech Republic.

An above-ground storey is defined as any storey that does not have a floor level or part thereof lower than 0.80 meters below the highest point of the adjacent terrain in a zone 5.00 meters wide around the perimeter of the building.

[16] Residential buildings are defined by the Building and Planning Act as buildings in which at least half of the floor area is intended for housing and include three categories (apartment houses; family houses; and other residential buildings, such as orphanages, student dormitories, retirement homes, and shelters for the homeless), however, for the purpose of the RPT, the Local Taxes Act only refers to apartment buildings and family houses – SK, Act No. 50/1976 Coll., on Spatial Planning and Building Regulations (Building and Planning Act) [*Zákon o* územnom *plánovaní a stavebnom poriadku (stavebný zákon)*], amended, Art. 43b(1).

[17] Defined as an above-ground structure connected to the ground by a solid foundation, which is spatially concentrated and externally mostly enclosed by perimeter walls and a roof structure – CZ, Act. No. 256/2013 Coll., on the Real Estate Cadastre (Cadastral Act) [*Zákon o katastru nemovitostí (katastrální zákon)*], amended, Art. 2(l).

[18] This covers: 1) transmission towers, retransmission towers, and telecommunication masts, 2) towers, masts, tower tanks for mining, and extraction of raw materials, 3) cooling towers for energy, 4) chimneys and flues for energy, 5) towers, masts, and tower tanks of chemical companies, 6) metallurgical and heavy industry construction (except buildings) (blast furnaces), 7) towers, masts, and tower tanks for other industries, and 8) industrial chimneys for other industries.

A taxable building itself in which there are taxable units is excluded from taxation. A taxable building that is not separate immovable property shall be regarded as an immovable object owned by the person who owns the property of which the building is a part.

In Poland, besides land, the RPT covers buildings or parts thereof and constructions or their parts related to the conduct of business. The Act on Local Taxes and Fees defines the building as "a building object within the meaning of the provisions of the Construction Law,[19] which is permanently connected to the ground, separated from the space by means of building partitions and has foundations and roof" and the construction as "a construction object within the meaning of the provisions of the Construction Law,[20] which is not a building or a small architecture object, as well as construction equipment within the meaning of the provisions of the Construction Law[21] related to a construction object, which enables the use of the object in accordance with its intended purpose". The tax applies to buildings and structures (or parts thereof) from 1 January of the year following the year in which the building/structure was either finished or started to be used even before its completion.[22]

[19] Articles 3(2) and (2a) of the Construction Law (PL, Act of 7 July 1994 the Construction Law [*Ustawa z 7 lipca 1994 r. Prawo budowlane*], Official Gazette [*Dziennik Ustaw*] 2021, item 2351, amended) define a building as a building object that is permanently connected with the ground, separated from the space by means of building partitions and has foundations and a roof and, separately, a single-family residential building as a free-standing building or a semi-detached, terraced or group building, serving to meet housing needs, constituting an independent unit structurally, in which it is allowed to separate no more than two residential premises or one residential premise and one business premise with a total area not exceeding 30% of the total area of the building.

[20] Construction is defined by Art. 3(3) of the Construction Law as any construction object which is not a building or a small architecture object, such as linear structures, airports, bridges, viaducts, flyovers, tunnels, culverts, technical networks, free-standing antenna masts, free-standing plates permanently attached to the ground, advertising devices, earthworks, defence (fortifications), protective, hydro-technical structures, tanks, free-standing industrial installations or technical devices, sewage treatment plants, waste landfills, water treatment plants, retaining structures, over-ground and underground pedestrian crossings, land utilities, sports facilities, cemeteries, monuments, as well as construction parts of technical devices (boilers, industrial furnaces, nuclear power plants, wind farms, and other devices) and foundations for machines and devices, as technically separate parts of objects making up the usable whole. A linear object (Art. 3(2a)) should be understood as a construction object, the characteristic parameter of which is the length, in particular a road with exits, railway line, water supply, channel, gas pipeline, and others there mentioned.

[21] Construction equipment is defined by Art. 3(9) of the Construction Law as a technical device related to the construction object, ensuring the possibility of using the object in accordance with its intended purposes, such as connections and installation devices, including those for the treatment or collection of sewage, as well as crossings, fences, parking yards, and places for garbage containers.

[22] Article 6(2) of the Act on Local Taxes and Fees.

In Hungary, instead of one RPT, there are two separate taxes – a tax on land and a tax on buildings. Among the constructions in the area of competence of the local government, the dwellings and non-residential buildings and parts thereof are taxable. The tax liability covers all premises of the building, regardless of its purpose or utilization. Dwelling is defined by the Act on Local Taxes (Art. 52(8)) as a residential house, residential building,[23] flat, castle, villa, manor house, registered as such or awaiting to be indicated as such following the provisions of special regulations,[24] and the non-residential building is defined in Art. 58(11) as the building or part of a building that does not qualify as a dwelling according to Art. 52(8) of the Act on Local Taxes. The building is defined by Art. 52(5) of the Act on Local Taxes as a structure or part thereof according to the Act on the Formation and Protection of the Built Environment,[25] which forms an artificially separated, partially, or completely artificial space from the surrounding external space and thus ensures the conditions of permanent or temporary residence or use, including also a stand-alone installation that is partially or completely below the surrounding connecting ground level with its internal height.

3. Discussion and conclusions

There are several differences found, however, for the limited range of this paper, we will discuss only a few of them.

From the above-presented legislation, especially the definitions, it is clear that the most limiting regulation is the one in Slovakia. The strict binding of taxable buildings only to those having a storey (limited by the floor and ceiling or roof) disqualifies the taxation of any other structures, especially those used in industry and other economic activities. The Polish

[23] Residential (or apartment) building is defined by Art. 52(60) of the Act on Local Taxes as a building where at least 50% of the useful floor area serves as dwellings.

[24] These provisions define the categories of dwellings according to the comfort levels (all-comfort, comfort, semi-comfort, non-comfort) and emergency dwellings – HU, Act No. LXXVIII of 1993 on Certain Rules Concerning the Renting and Alienation of Dwellings and Premises [*Törvény a lakások és helyiségek bérletére, valamint az elidegenítésükre vonatkozó egyes szabályokról*], amended, Art. 91/A(1–6).

[25] Which defines a building as a structure, typically intended for human habitation, which encloses, in whole or in part, a space, room, or group of buildings with its structures for a specific purpose or activity related to its purpose, or for regular work or storage – HU, Act No. LXXVIII of 1997 on the Formation and Protection of the Built Environment [*Törvény az épített környezet alakításáról és védelméről*], amended, Art. 2(10).

regulation, on the other hand, covers a large scale of structures and linear objects which enlarges the coverage of RPT. Czechia may be found in between since it uses a similar definition of a building ("mostly enclosed by perimeter walls, and roof structure"), however, covers at least some roofless structures (towers, chimneys, masts, etc.), yet M. Radvan speaks for a broader scope of taxation.[26] Hungarian definitions are not that strict; the definition of a building covers even "a stand-alone installation that is partially or completely below the surrounding connecting ground level with its internal height", which serves as the basis to tax advertising media (e.g., billboards).[27] Even though the buildings tax does not cover linear objects, these, however, are subject to other tax – Public Utility Lines Tax,[28] which is destined to the state budget unlike the tax on buildings, as this one is a local tax accruing to the budgets of municipalities. This range of buildings and structures as the potential scope of objects of taxation makes a difference, especially in terms of the fact that the V4 countries acquire the majority of the RPT revenues from buildings/structures rather than land.[29] In favour of taxing buildings and structures the "Polish way" instead of the "Slovak way" speaks also the comparison of the overall RPT revenue to GDP ratio (Slovakia: 0.41%; Czechia: 0.22%; Hungary: 0.46%; Poland: 1.18%),[30] which confirms that the RPT is the most important property tax in Poland.[31]

The approach towards the setting of definitions varies as well. While Czechia does not define the notions and fully refers to the Cadastral Act (even though only as regards the buildings), the Slovak approach is to define some notions in the act of tax law with only a limited direct reference to act of the building law. On the contrary, the Hungarian Act on Local Taxes comprises vast and detailed definitions with a very limited reference to other laws (beyond the tax law). In Poland, the definition

[26] M. Radvan, *Major Problematic Issues in the Property Taxation in the Czech Republic*, "Analysis and Studies CASP" 2019, No. 2, p. 20.

[27] I. Hoffman, *Only a Theoretical Possibility of the Ad Valorem Property Tax System – the Regulation on Immovable Property Taxes in Hungary*, "Analysis and Studies CASP" 2019, No. 2, p. 65.

[28] HU, Act No. CLXVIII of 2012 on Public Utility Lines Tax [*Törvény a közművezetékek adójáról*], amended.

[29] The buildings and flats tax creates on average (2010–2019) 73.99% of the overall RPT revenues in Slovakia and 85.28% in Hungary. In Poland, the tax on buildings and structures makes on average (2018–2019) 82.11% of the overall RPT revenues. Data for the Czech Republic were unavailable. Data source: own processing based on the data of ministries of finance (Slovakia, Poland) and central statistical office (Hungary).

[30] Data source: own processing based on the data of the Ministry of Finance of the Czech Republic and as mentioned above.

[31] M. Sęk, *Other taxes: Immovable property tax*, [in:] W. Nykiel, M. Wilk (eds), *Polish Tax System. Business Opportunities and Challenges*, Wolters Kluwer Polska, Warszawa 2017, p. 216.

pattern shows the combination of own – tax law definitions and references to the Construction Law's definitions. Such an approach, as was pointed out by R. Dowgier,[32] creates more space for the legislative body to bypass the amending of tax legislation by the amendment of building legislation instead, or to accidentally change the tax legislation through such an amendment, as was stressed by W. Morawski.[33] The question is whether the lack of direct definitions or reference to the definition of other laws does not create even more space for uncertainty or has, actually, the same effect (since some definitions of other branches of law still need to be used in case of doubt).

Another important difference is the determination of the point in time when the (un)completed building/structure becomes subject to taxation, where the regulation, in our view, speaks again in favour of the Polish and Czech regulation[34] compared to the Slovak one.

Based on these initial findings and the limited range of this paper, we have to conclude that the similarities and differences between the analysed taxation systems of the V4 countries as were identified here definitely create the basis for a deeper analysis of the regulation, its interpretation by local academics, practitioners, and case law, and will be subject to further research.

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[33] W. Morawski, *Wpływ zmiany definicji obiektu budowlanego na zakres przedmiotowy podatku od nieruchomości – przypadkowa rewolucja?*, "Przegląd Podatkowy" 2015, No. 6, p. 23 et seq.

[34] "Such a broad definition enables to cover de facto all buildings constructed legally and illegally" – M. Radvan, *Místní dane*, Wolters Kluwer, Prague 2012, p. 173.

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Abstract

In this paper, the author compares the legal regulation of real property taxes applied in the Visegrad countries (Slovakia, Czechia, Hungary and Poland) in terms of the means of determination of part of its object, namely the buildings and structures. Based on the analysis of these national regulations, the author concludes that, despite all the analysed states apply taxation of buildings and/or structures within their real property tax(es), there are conceptual differences among the particular states' policy in determining the objects subject to tax. While the author concludes on the broadest range of taxable objects to be in Poland and the narrowest in Slovakia, there is a lot of room for inspiration and for legislative adjustments for the Slovak legislation.

Keywords: real property tax, Slovakia, Czechia, Hungary, Poland

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Stef van Weeghel[1]

Reflections on Separate Enterprise vs. Formulary Apportionment

1. Introduction

The international system for the taxation of business profits is broken. That is the premise on which the OECD project 'Addressing the tax challenges arising from digitalisation of the economy' is based.[2] Pillar One of the project encompasses a formulary approach for the allocation of taxing rights to countries. To the extent applied – not all profits will be subject to the Pillar One system – it would mean a reversal of the current practice, that reflects the separate enterprise method.[3] In this contribution I will lightly explore the development of the current system, and highlight how formulary apportionment became objectionable which, against the background of Pillar One, is remarkable. I conclude that formulary apportionment merits renewed attention.

Some of the points in this contribution have been made or alluded to by others, including Scott Wilkie, Stanley Langbein, Richard Collier and Joseph Andrus. In preparing and then delivering the IFA Travelling Lecture in Canada in 2020, on which this contribution is based, I was inspired by the works of these authors. As Wilkie noted, today's discussion bears resemblance to some of the discussions that took place in the 1920s

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[1] Prof. Dr. Stef van Weeghel, is professor of international tax law at the University of Amsterdam, chair Board of Trustees IBFD, and immediate past-chair Permanent Scientific Committee IFA.

[2] OECD, *Action 1 Tax Challenges Arising from Digitalisation*, n.d., https://www.oecd.org/tax/beps/beps-actions/action1/ (accessed: 12.08.2021).

[3] OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint*, 2020, https://www.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-report-on-pillar-one-blueprint_beba0634-en (accessed: 12.08.2021).

and 1930s when the International Chamber of Commerce and the League of Nations worked on the international tax architecture. Indeed, some of the language then used could easily be copied in one of the recent OECD reports.

2. From the present to the past and back to the present

At the IFA/OECD Seminar 2018, Pascal Saint-Amans, Director of the OECD's Centre for Tax Policy and Administration, said that there was a political crisis in tax policy making: "[A]t a political level, there is no trust to build consensus". He added: "The OECD is agnostic on the ALP, but the largest economy in the world seems to have passed a vote of no confidence in the current system." Of course, Saint-Amans referred to the US Base Erosion and Anti-Avoidance Tax (BEAT) but this is only part of the story. The real driver behind the current discussion is the discomfort caused by tax planning and digitalisation of the economy. The lack of confidence in the system is understandable. The interaction of current nexus rules and the allocation of taxation rights under income tax treaties, and the lack of international coherence between tax systems, have led to widespread tax planning that has led to base erosion, tax deferral and a belief that the system is broken. In addition, the 'scale without mass' challenge needed to be addressed; it is now possible to significantly participate in the economy of a country without having nexus that would give rise to taxation of the business profits connected with the presence in that country. Looking at the OECD revenue statistics as they relate to corporate income tax since 1965, and the projected revenue gains resulting from the BEPS project, one could question whether the international tax system indeed is broken. Corporate income tax as a percentage of total revenue has remained remarkably stable despite substantial cuts in the statutory rate across the OECD, and the projected revenue resulting from the BEPS project is rather modest. The Pillar One proposal can therefore not be based on the argument that it would address diminishing revenue, other than through what is now known as the 'counterfactual', i.e., if the system is not repaired, unilateral taxes will proliferate, resulting in lower economic growth and revenue. However, even if one would believe that there is no problem, the perception that there is a problem has become the problem. The main driver of the project seems to be the wish to end the discussion and the proliferation of unilateral revenue-based taxes, and also to satisfy the popular demand that digital giants be taxed where they generate revenue. If Pillar One is adopted, it would mean that the current separate enterprise method would be combined with formulary apportionment in a fashion that is exceedingly complex, and which fails to identify the principles on which it is based. Of course, when one would test a solution against principles, there are two sets of useful principles. In the first place there is the question where jurisdiction to tax originates: What is its basis in international law? What is the relevant nexus, nationality or territoriality, and, as regards the latter, residence and source are the relevant nexus points? When it comes to design principles, Adam Smith, in 1776, showed the way: fairness, certainty, convenience, efficiency. It does not take a genius to see that, in its current incarnation, Pillar One would not score well on certainty, convenience, and efficiency. As to fairness, the question is whether inter-nation equity is served better with the continuation of the existing system, with the introduction of a hybrid system that continues with the separate enterprise method, and adds to that formulary apportionment, or with a total switch to formulary apportionment.

The above musings are perhaps more interesting when they are put in a historic context.

We know that today the OECD is agnostic as to the solution that would result from the current discussion, as long as there is a solution. That is a fairly recent development. In 2002, the OECD Observer cited John Neighbour, then Head of Tax Treaties, Transfer Pricing & Financial Transactions at the OECD: "Applying transfer pricing rules based on the arm's length principle is not easy […]. But replacement systems suggested so far would be extremely complex to administer.

The most frequently advocated alternative is some kind of formulary apportionment that would split the entire profits of an MNE among all its subsidiaries, regardless of their location. But proponents of such alternatives not only have to show that their proposals are theoretically "better" but that they are capable of winning international agreement. Not easy, since the very act of building a formula makes it clear what the outcome is intended to be and who the winners and losers will be for a given set of factors. […]. Questions like how to apportion intellectual capital and R&D between jurisdictions would become contentious. Such problems would make it very difficult to reach agreement on the inputs to the formula, particularly between parent companies in wealthy countries and subsidiaries in poorer ones.

ALP avoids these pitfalls as it is based on real markets. It is tried and tested, offering MNEs and governments a single international standard for agreements that give different governments a fair share of the tax base of MNEs in their jurisdiction while avoiding double taxation problems.

Moreover, it is flexible enough to meet new challenges, such as global trading and electronic commerce. Governments so far appear to agree: much better to update the existing system than start from scratch with something new."

I will address the rejection of formulary apportionment in the OECD transfer pricing guidelines later but first go back almost a century to explore a bit the direction of the thinking in the League of Nations, thinking that was much less hostile to formulary apportionment. A few more citations will follow, but I believe that each of these will give a good insight into considerations at the time that remain valid today. First, there is the report by the four economists in 1923: "Practically, therefore, apart from the question of nationality, which still plays a minor role, the choice lies between the principle of domicile and that of location or origin. Taking the field of taxation as a whole, the reason why tax authorities waver between these two principles is that each may be considered as a part of the still broader principle of economic interest or economic allegiance, as against the original doctrine of political allegiance. A part of the total sum paid according to the ability of a person ought to reach the competing authorities according to his economic interest under each authority."

Clearly the mentioned principles of economic allegiance and political allegiance correspond with territoriality and nationality, respectively, as the foundation for taxation, the jurisdiction to tax. Also, the single taxation principle emerges from the work of the four economists: "The ideal solution is that the individual's whole faculty should be taxed, but that it should be taxed only once, and that the liability should be divided among the tax districts according to his relative interests in each. The individual has certain economic interests in the place of his permanent residence or domicile, as well as in the place or places where his property is situated or from which his income is derived."

Nexus and attribution were challenging themes at the time: "The problem consists in ascertaining where the true economic interests of the individual are found. It is only after an analysis of the constituent elements of this economic allegiance that we shall be able to determine where a person ought to be taxed or how the division ought to be made as between the various sovereignties that impose the tax."

And the four economists recognized that there are practical problems related to the allocation of taxation rights as well: "There may be a conflict between the fiscal principle arrived at on purely theoretical grounds and the desirable financial or economic expedients, having regard to the state of the national budget in each country. In other words, what ought to be done may be quite clear; but what it may be practically possible for a Government to give up in the way of revenue in the light of its historical development may be quite another thing."

And finally, the four economists considered that any practical plan needs a theoretical underpinning: "When, however, it comes to the consideration of the taxation of pure income, it is difficult to establish that such an analysis can have great practical value; at any rate modern income is such a composite product and such a complex conception that even theoretically it is not easy to assign in a quantitative sense the proportions of allegiance of the different countries interested. Unless in theory the quantitative assignment can be made, it obviously is difficult to make it the basis of any practical plan."

Following the work of the four economists, technical experts worked on draft treaty provisions in which the concepts of permanent establishment, separate enterprise method and formulary apportionment were visible. In Art. 5 of a draft of a bilateral convention, in 1927, the following language appeared: "Should the undertaking possess permanent establishments in both Contracting States, each of the two States shall tax the portion of the income produced in its territory. In the absence of accounts showing this income separately and in proper form, the competent administrations of the two Contracting States shall come to an arrangement as to the rules for apportionment."

A 1933 draft was a bit more specific on formulary apportionment:

"Article 3

[…]

If the methods of determination described in the preceding paragraphs [on the basis of the accounts – SvW] are found to be inapplicable, the net business income of the permanent establishment may be determined by a computation based on the total income derived by the enterprise from the activities in which such establishment has participated. This determination is made by applying to the total income coefficients based on a comparison of gross receipts, assets, number of hours worked or other appropriate factors, provided such factors be so selected as to ensure results approaching as closely as possible to those which would be reflected by a separate accounting."

Finally, the 1933 Mitchell B. Caroll Report identified the separate enterprise method and formulary apportionment as the two theories of taxing foreign enterprises with local establishments:

"The two underlying theories of taxing foreign enterprises with local establishments are:

1. That the local establishments should be taxed on the basis of separate accounts and treated in so far as possible as if they were independent enterprises.

2. That the enterprise is an organic unity and consequently the tax should be assessed on that part of the enterprise's total net income

(computed in accordance with the law of the taxing country) which corresponds to the relative economic importance of the local establishment. This method is known as unlimited fractional apportionment. The advocates of this method contend that, in a unitary business which, for example, produces raw materials, manufactures them into finished products and then sells them, no profit is realised by the enterprise as a whole until the goods have been sold. They contend furthermore that it is impossible to determine accurately what part of the profit is attributable to each function or establishment of the business and consequently the profit can only be apportioned on some empirical basis – for example, an arbitrary apportionment formula. Moreover, they say it is the only way of applying the fundamental principle of taxing the enterprise in accordance with its capacity to pay."

The Mexico and London draft conventions that emerged in the 1940's showed an interesting divergence. For sufficient nexus, the Mexico draft did not require a permanent establishment. The relevant question was whether an enterprise had carried out its business or activities in a foreign country not merely in the form of isolated or occasional transactions, whereas the London draft required that the enterprise would have a permanent establishment in a country to become subject to the income tax laws of that country.

In the context of today's discussion, the Commentary on Art. 7(4) of the 1963 OECD Model Convention (which still allowed formulary apportionment) makes for interesting reading: "24. The essential character of a method involving apportionment of total profits is that a proportionate part of the profits of the whole enterprise is allocated to a part thereof, all parts of the enterprise being assumed to have contributed on the basis of the criterion or criteria adopted to the profitability of the whole. […]. It is fair to say that the criteria commonly used can be grouped into three main categories, namely those which are based on the receipts of the enterprise, its expenses or its capital structure. […]; the appropriateness of any particular method will depend on the circumstances to which it is applied. In some enterprises, such as those providing services or producing proprietary articles with a high profit margin, net profits will depend very much on turnover. […]"

Following the controversy surrounding unitary taxation in the United States and the introduction of the 1968 US transfer pricing regulations, the separate enterprise method, culminating in the transfer pricing guidelines and the authorized OECD approach, reigned supreme and formulary apportionment was rejected in forceful terms. The 1979 OECD report on transfer pricing and multinational enterprises states the following: "14. Proposals for radical reformulations of the approach to intra-group transfer pricing which would move away from the arm's length approach towards so-called global or direct methods of profit allocation, or towards fixing transfer prices by reference to predetermined formulae for allocating profits between affiliates, are not endorsed in this report. The use of such alternatives to the arm's length principle is incompatible in fact with Articles 7 and 9 of the OECD Model Double Taxation Convention. Such methods would necessarily be arbitrary, tending to disregard market conditions as well as the particular circumstances of the individual enterprises and tending to ignore the management's own allocation of resources, thus producing an allocation of profits which may bear no sound relationship to the economic facts and inherently running the risk of allocating profits to an entity which is in truth making losses (or possibly the contrary).[4]"

The 2017 OECD transfer pricing guidelines for multinational enterprises and tax administrations contains five pages of reasoning to explain why global formulary apportionment should be rejected, and then rejects it.[5]

The most significant concern with global formulary apportionment seems to be the difficulty of implementing the system in a manner that would both protect against double taxation and ensure single taxation. Reaching agreement, the guidelines state, would be time consuming and extremely difficult and it would be far from clear that countries would be willing to agree to a universal formula. Moreover, the guidelines recognize that the transition to global formulary apportionment would present enormous political and administrative complexity and require a level of international cooperation that would be unrealistic to expect in the field of international taxation. And the guidelines mention that global formulary apportionment would present intolerable compliance costs and data requirements. Finally, global formulary apportionment would have the effect of taxing an MNE group on a consolidated basis and, as a consequence, would not recognize important geographical differences, separate company efficiencies and so forth.

Even with global formulary apportionment as the only system, the above complexity was anticipated. Complexity indeed emerges in Pillar One, including the political complexity. The administrative complexity, however, to a large degree is caused by Pillar One itself. It follows from the desire to combine the separate enterprise method with formulary apportionment for

[4] OECD, *OECD Transfer Pricing Guidelines (1979)*, 1979, https://tpguidelines.com/oecd-transfer-pricing-guidelines-1979/ (accessed: 18.08.2021).

[5] OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 2017, https://read.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2017_tpg-2017-en#page3 (accessed: 18.08.2021).

a subset of global businesses with super profits. Some of the complexity feared in the transfer pricing guidelines could potentially be removed with some of the features of Pillar One. In the Mitchell B. Carroll Report, part of the complexity derived from the fact that, even with formulary apportionment, apparently each country would use its own tax rules to determine the global tax base. The transfer pricing guidelines see the complexity in the process of reaching consensus about a uniform tax base and the apportionment formulae. In fact, most of the objections in the transfer pricing guidelines relate to process and the perceived impossibility of reaching consensus and show stark contrast with the optimism currently radiated by the OECD that consensus can be reached. The real complexity in the current Pillar One blueprint is the combination of the separate enterprise method and formulary apportionment, and the challenges related to sourcing, scoping and segmentation. But differing tax bases are not the problem.

3. Concluding observations

It is unfortunate that the international tax architecture cannot be drawn on a blank slate. The current architecture has so many vested interests, both in governments and in business, including tax and transfer pricing practitioners, that explain why the current debate sometimes comes across as a religious war. However, the arm's length principle as it emerges from the separate enterprise method is not a principle carved in stone. Rather, it is a set of agreed rules that has functioned reasonably well for decades. But if the starting point would be economic allegiance and the principles enunciated by Adam Smith, there is no reason to not consider a complete shift from the separate enterprise method to formulary apportionment. The EU may be moving in that direction failing consensus at the OECD/Inclusive Framework, and we know that the system functions well for state tax purposes in the United States. Depending on the elements of the formula, formulary apportionment may also render Pillar Two superfluous.

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Abstract

This contribution contains reflections on the international system for the taxation of business profits and puts the current discussion regarding the OECD Pillar One project in a historic context. The OECD transfer pricing guidelines imply that global formulary apportionment is to be rejected, but the Pillar One project in fact would introduce that system as an overlay to the existing separate enterprise method.

Keywords: OECD Pillar One project, business profits, global formulary apportionment, separate enterprise method

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Bertil Wiman[1]

Tax Aspects of Leaving the European Union

1. Introduction

It is a great honour to participate in a Festschrift for Professor Wlodzimierz Nykiel. He has been a good friend and colleague within our EUCOTAX group and, despite his many other duties, such as Rector of University of Lodz, he participated in our yearly Wintercourse program.

In this contribution, I will discuss some income tax aspects, in particular corporate tax issues of the United Kingdom[2] leaving the European Union, from a Swedish perspective. However, I think our experiences are of a general nature and can be useful also for colleagues in other member states. The United Kingdom (UK) left the European Union (EU) on 31 January 2020 after being a member since 1973. It had adjusted its domestic tax laws to EU law, and so had Sweden. In its income tax laws, Sweden took for granted that the UK is, and will continue to be, an EU member. When the current tax treaty between Sweden and the United Kingdom was negotiated and finally concluded in 2015, the United Kingdom was still a member of the European Union, and, at least subconsciously, this was in the minds of the treaty negotiators.

The Agreement on the withdrawal of the United Kingdom and Northern Ireland from the European Union and the European Atomic Energy,[3] entered on 24 January 2020, generally known as Brexit agreement, dealt with the conditions for the withdrawal but also regulated the transitional period until 31 December 2020.

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[1] Professor emeritus at Uppsala University, Sweden, and former director of the research foundation Uppsala Center for Tax Law.

[2] I will use the short form United Kingdom, or UK, instead of the United Kingdom of Great Britain and Northern Ireland.

[3] EUT L 29, 31 January 2020.

At the end of 2020, a trade and cooperation agreement between the European Union and the United Kingdom was concluded. The trade agreement went into effect in 2021, but there seems to be no provisions affecting income taxation in that agreement.

The income tax landscape has been altered because as a member of the EU and the European Economic Area, EEA, a state is bound by both EU primary law (primarily the Treaty on European Union, TEU, and the Treaty on the Functioning of the European Union, TFEU) and as a member of the EU, bound by EU secondary law (e.g. the corporate tax directives, such as the Merger Tax Directive[4] and the Parent-Subsidiary Directive[5]). When the United Kingdom no longer is a member of the European Union the binding effects of EU law disappears. This affects both the United Kingdom and the remaining EU member states, in my case Sweden.

The provisions in TFEU on free movement of goods (Art. 34), freedom to provide and receive services (Art. 56), free movement of capital and payments (Art. 63), free movement of EU citizens (Art. 21) of workers (Art. 45) and freedom of establishment (Art. 49) as well as state aid (Arts. 107 and 108) all affects the design of national tax rules. With the exception of the free movement of capital, these articles cease to be applicable on movements between Sweden and the United Kingdom.

As part of Sweden's ambition to be loyal to its obligations towards the EU, many income tax provisions have been amended in order to conform to EU primary law. For many statutory provisions to apply, it the transaction at issue must involve a member state of the EEA. For instance, a deferral of capital gains tax after an exchange of shares is only permitted as long as the individual is a resident of an EEA state. In another example, in order to qualify under the group contribution rules (provided that other requisites are met) group companies must be resident in a member state of the EEA. As the statute specifically mentions residence in an EEA-member state, companies that reside in the United Kingdom do no longer qualify. Therefore, even if the statute itself has not changed, the fact that the statute refers to residence in an EEA-member state follows that Swedish subsidiaries of British parent companies can no longer benefit from the group contribution rules.

In those cases where Sweden has not (yet) adjusted its income tax rules to EU primary law, a taxpayer may nevertheless rely on the direct effect

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[4] EU, Council Directive 2009/133/EC on the common system of taxation applicable to mergers, divisions, partial divisions, transfer of assets, and exchange of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States, OJ L 310, 25 November 2009, pp. 34–46.

[5] EU, Council Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries in different Member States, OJ L 345, 29 December 2011, pp. 8–16.

on primary law. That is normally not available in case it involves a British resident or transaction relating to the United Kingdom.

To sum up, the United Kingdom becomes a third state and taxpayers cannot rely on the fundamental freedoms (except capital), state aid provisions, etc. It means that both the United Kingdom and Sweden can have domestic tax provisions that restricts the free movement, and even have discriminatory provisions. Of course, there is a tax treaty between Sweden and the United Kingdom containing an article on non-discrimination. However, that article, modelled after Art. 24 of the OECD Model Tax Convention, will not catch many of the situations covered by the EU primary law. I will later give a few examples.

As regards EU secondary law, Sweden has implemented the corporate tax directives, primarily in the Income Tax Act,[6] ITA, but also in the Withholding Tax Act.[7] The corporate tax directives typically provide for a solution to a specific tax problem, where approximation of national tax laws is needed for the establishment or functioning of the common market (Art. 115 TFEU). For instance, the Parent-Subsidiary Directive provides for non-taxation at source in the state where the distributing company is resident, and corresponding non-taxation in the state of the company receiving the dividends. A corporate tax directive typically lists the applicable taxes and companies in two annexes (list of type of corporations in Annex A and list of national tax laws in Annex B).

Normally, the directives provide for minimum solutions, so that a member state can go even further in its domestic tax rules implementing the directive. In the case of the Parent-Subsidiary Directive, a member state is required to apply the directive when a qualifying company in one member state has a holding of at least ten percent in a qualifying company in another member state (Art. 3). However, Sweden has gone further than that and normally apply the rules on non-taxation, both as a source state and as a residence state, even if the ownership is less than ten percent.

2. Examples on Swedish income tax provisions affected by Brexit

With respect to residency, a British company cannot be a resident for tax purposes in Sweden, as Sweden only applies incorporation as criteria for corporate residence. But the opposite is possible, as the United Kingdom

[6] SE, The Income Tax Act [*Inkomstskattelagen*] (1999: 1229).
[7] SE, The Coupon Tax Act [*Kupongskattelagen*] (1979: 624).

also has "central management and control" as criteria for tax residence in addition to incorporation.

A *foreign legal person* is defined in Ch. 6, Sec. 8 ITA, as a foreign association that 1) can acquire rights and assume obligations, 2) can be a party before courts and authorities, and 3) the owners may not freely dispose of the assets of the association. One must assess whether the law of the other country meets these three criteria, and if so, Sweden will in its tax laws treat the foreign association as a foreign legal person.

Importantly, some foreign legal persons will qualify as a *foreign company* in Swedish tax law, Ch. 2, Sec. 5a ITA. A foreign company is a foreign legal person resident in a country which subjects the company to an effective tax rate similar to that of a Swedish company. No statutory level is set, but 10–15 percent tax rate would likely qualify. If Sweden has concluded a full tax treaty with the other country that covers this type of legal person, then it will also be considered a foreign company in applying the domestic Swedish tax rules. British companies will therefore normally be considered as foreign companies.

A foreign company, as defined, is beneficially treated, and can in many instances be part of similar transactions as a Swedish company. For instance, a foreign company can transfer its assets/liabilities from its Swedish permanent establishment to a newly established subsidiary without immediate tax consequences, just as a Swedish company is able to incorporate assets, Ch. 23 ITA.

From the viewpoint of Brexit, it means that if the Swedish provision includes foreign companies, British companies will qualify. In those cases, Brexit will have no consequences.

When Swedish income tax laws have been adjusted to EU primary law a pattern is visible. The legislator has normally gone further than necessary. For instance, the developments on deductibility of foreign losses (starting with C-446/03, Marks & Spencer) led to the introduction of a Swedish *group relief system* applicable only on foreign losses. However, the right is restricted to losses in foreign companies similar to Swedish companies that are residents in an EEA member state, Ch. 35 a, Sec. 2 ITA. This is an example of where the concept of foreign company is applied, but in a narrower sense.

Domestically, the group contribution system applies to loss offsetting within a group. It has also been called "intra-group financial transfers" (C-484/19 Lexel AB). A profitable Swedish group member can give a deductible contribution to a Swedish loss-making company. The *Swedish* parent company must hold more than 90 percent of the subsidiary for the *entire tax year* during which the group contribution is made.

These criteria would normally mean that many group structures involving foreign companies resident in an EEA member state would result in a breach of EU law (primarily the right of establishment). For instance, group contributions between two sister companies having a common British parent company would not qualify. Thus, a provision was added, Ch. 35, Sec. 2 a ITA, stating that also foreign companies resident in the EEA area qualify as a Swedish company in applying the group contribution rules, provided that the recipient of the group contribution is taxed in Sweden on the payment.

This provision saved a number of group structures involving foreign companies in other EU member states. For instance, a British company could own two Swedish companies, and the subsidiaries could offset profits and losses between themselves. Or there could be a third subsidiary resident in the United Kingdom, having a permanent establishment in Sweden. Group contributions between the permanent establishment and the Swedish subsidiaries were allowed.

A consequence of Brexit is that British companies will not qualify as a Swedish company as of 31 January 2020. As one requirement for group contributions is that the holding of qualifying companies lasts the whole tax year; a group with British companies, may, depending on the structure, lose the possibility to offset losses for 2020 (provided that the tax year for the group is the calendar year).

I will later, in part 3, give some remarks on the impact from the Brexit agreement, which provided some perhaps unexpected relief for the year 2020. Another relief can be provided by the non-discrimination article in the tax treaty between Sweden and the United Kingdom (found in Art. 22). The non-discrimination will solve some but not all of the issues for a group involving British companies. For instance, Art. 22(4) will save the situation where two Swedish companies are directly held by a UK parent company, see for instance Swedish Supreme Administrative Court case RÅ 1987. ref. 158. In another case, RÅ 1993 ref. 91 I, a group contribution was allowed, based on the non-discrimination article in a tax treaty between Sweden and the United States, from a Swedish parent company to its Swedish second tier subsidiary, despite the fact that there was an intermediary US company. However, in RÅ 1993 ref. 91 II, the situation was different with companies involved from two countries, Germany and Switzerland. The Supreme Administrative Court decided that it was not possible to apply two tax treaties simultaneously, so none of the non-discrimination clauses was applicable. From this follows that group structures must be carefully reviewed in order to make sure that the non-discrimination article applies, for instance by making sure that Swedish subsidiaries are held directly by British parents or by inserting a Swedish holding company.

Group contributions to and from a permanent establishment in Sweden will normally fall outside the non-discrimination article. The National Tax Agency refers, with respect to Art. 22(2) in the tax treaty between Sweden and the United Kingdom on non-discrimination of permanent establishments, to Para. 41 of the commentary on Art. 24 of the OECD Model Tax Treaty. Here it is stated that the equal treatment principle does not "extend to rules that take account of the relationship between an enterprise and other enterprises (e.g., rules that allow consolidation, transfer of losses or tax-free transfers of property between companies under common ownership)" since such rules does not focus on the enterprise's own business activities. Only in a special case under the citizen article would the National Tax Agency allow group contribution from a Swedish company to a foreign company's permanent establishment in Sweden.[8]

In conclusion, the non-discrimination clause will only in limited cases be applicable, and as regards permanent establishments, it would normally not be helpful at all. Taxpayers will have to reorganise their legal structure in order for them to come under the non-discrimination article.

So far I have described a few examples on provisions adopted in Sweden to accommodate EU primary law, where British companies can no longer avail themselves of beneficial tax treatment awarded to EU companies. What happens with tax provisions that are implemented following different corporate tax directives?

In many cases, Sweden has implemented the directive making the provisions applicable to all foreign companies, without restriction. For instance, the domestic provisions adopted because of the merger tax directive are applicable to all foreign companies, whether they are resident in the European Union or not. Such a broad implementation means that in many cases it does not matter that the United Kingdom is no longer a member of the European Union. For instance, a merger between two British companies involving assets linked to a permanent establishment in Sweden can normally be done without immediate tax consequences, under the same conditions as for example a merger between two Swedish companies, Ch. 37 ITA.

An interesting effect occurs concerning foreign tax credit, as Sweden has followed Art. 10(2) of the Merger Tax Directive. Assume that a Swedish company merges into a German parent company, and the Swedish company has a permanent establishment in the United Kingdom. Prior to Brexit, Sweden would have to give a credit for the tax that would have been paid in the United Kingdom on the transfer of the permanent establishment if the United Kingdom had taxed the transfer (which it could not because of

[8] *Skatteverket Ställningstagande Dnr* 131 461482-12/111.

the Merger Tax Directive). Sweden has correctly implemented Art. 10(2) and would give a credit for the fictitious British tax conditioned on the United Kingdom being an EEA member state. Now it is not a member of the EEA anymore. In case the United Kingdom does not tax such a transfer (which I have not researched) then no credit is given.

Unclear, at least to me, is the situation where there is a cross-border merger between for instance a British and a German company involving a permanent establishment in Sweden. The Swedish tax rules apply, but is it even possible to merge cross-border? Do the corporate rules allow for that? Looking at Swedish corporate rules, a cross-border merger requires that the Swedish company merge with a company resident in another state within the EEA (Ch. 23, Sec. 36 Swedish Companies Act). A merger is therefore no longer possible between a Swedish and a British company. In other words, tax rules cover a situation that cannot take place anymore, which is nothing new (since its adoption in 1990, the Merger Tax Directive has since its adoption in 1990 covered reorganisations that were not possible to conduct under the corporate directives). I assume the same applies between Germany and the United Kingdom.

With respect to dividend distributions, the Swedish provisions for intra-corporate dividends already includes distributions to and from foreign companies, Ch. 24 ITA and the Withholding Tax Act. For non-listed shares, inbound dividends are normally exempt, and outbound dividends are exempt from the withholding tax on dividend distributions. For listed shares, there is a holding requirement of 10 percent of the voting rights. There may in a few cases be problems after Brexit, e.g., if the holding is less than ten percent of the voting rights but more than ten percent of the capital. But in the overwhelming number of cases the existing domestic provisions or the tax treaty will lead to no changes on taxation of intra-group dividends.

Turning to taxation of individuals, there are some interesting effects also here. I will give a couple of examples. Sweden allows an individual that sells a private home to reinvest without immediate tax consequences on the profit (up to 3 million Swedish crowns) in a new home, provided that the acquired home is located within the EEA, Ch. 47, Sec. 5 ITA. It means that there are individuals who have sold private homes in Sweden and acquired a new home in the United Kingdom. After Brexit, that is not possible anymore. But what happens to those individuals that moved before Brexit? As I read the statute, there will be no immediate tax effects of Brexit, but when they sell the home they have acquired in the United Kingdom, then the deferred gain will be taxed in Sweden. From this follows that the individual must keep his or her home in the United Kingdom and not move if one wants to avoid taxation of the deferred gain.

A more drastic effect of Brexit concerns capital gains on exchange of shares. Sweden has generous provisions allowing an individual to defer gains on exchange of shares. However, the individual must be resident in an EEA state. According to Ch. 48 a, Sec. 11 ITA, as soon as the individual is no longer a resident in an EEA member state, the deferred gain is taxed. That became the situation after 31 January 2020. It should be said that Art. 13(6) of the tax treaty between Sweden and the UK complicates the legal situation, depending on whether the exchange of shares took place before or after emigration to the United Kingdom. I will not deal with these issues here.

3. The Brexit agreement and the year 2020

It is clear that the United Kingdom left the European Union on 31 January 2020. The tax effects resulting from income tax provisions that specifically refers to a company or an individual being a resident in EU or EEA will therefore be triggered as of that date. The Brexit agreement dealt with the conditions for the withdrawal but also regulated the transitional period until 31 December 2020.

Article 127(1) of the Brexit agreement states that "Unless otherwise provided in this Agreement, Union law shall be applicable to and in the United Kingdom during the transition period". Furthermore, under Art. 127(3), during the transition period, union law "shall produce in respect of and in the United Kingdom the same legal effects as those which it produces within the Union and its Member States and shall be interpreted and applied in accordance with the same methods and general principles as those applicable within the Union."

Union law is in Art. 2 defined to include, inter alia, the Treaty on the European Union, the Treaty on the Functioning of the European Union, the Charter of Fundamental Rights of the European Union, general principles of union law, and the acts adopted by the institutions, etc, of the Union.

Furthermore, in Art. 4 it is made clear that union law produces the same legal effects in respect of and in the United Kingdom as within the union, and that legal and natural persons can rely directly on provision providing direct effect under union law.

Thus, generally speaking, during 2020 EU primary and secondary law applied as usual. This means that in those cases where Sweden has made residence in an EU member state or in an EEA state a condition for specific beneficial tax treatment, such as deferral of capital gain in an exchange of shares or allowing a group contribution within a qualifying group of companies, then the statutory requirement is no longer fulfilled. But as the Brexit agreement provides for union law to be applicable during all of 2020, taxpayers in Sweden (and the United Kingdom) could rely on the direct effect of union law. This is the good news. However, in those cases where the statutory provisions went further than required by union law, then a taxpayer will lose some. The loss can vary, and a test of the statutory provision towards union law must be made.

4. Concluding remarks

The United Kingdom is the first country to leave the European Union. It would not be surprising if it happens again, that a member state for various political reasons leaves or must leave the union. The experiences from Brexit on income tax may therefore be valuable in dealing with future exits.

It is also likely that there will be new members of the European Union. As shown above, it may be problematic when a change of membership status occurs during the tax year. For many reasons, foreseeability not least, it is desirable to have new tax rules implemented at the start of a new tax year. Sweden has recognized that when it comes to new member states. In Ch. 2, Sec. 2 a ITA, it is stated that if a state becomes a member of the European Economic Area at another time than at the start of a new tax year, then that state, in applying the provisions of the Income Tax Act, will be considered a member for the full tax year. This is an important rule. It means, for instance, that Ch. 35, Sec. 2 a ITA will be applicable as of the first day of the tax year, and loss offset among members of the group can be achieved already in this first year.

Unfortunately, there is not a similar provision when a state leaves the European Union or the EEA. If there had been, the uncertainties of 2020 would not have existed and the reliance on the transitional rules in the Brexit agreement would not have been necessary.

A related conclusion is that any agreement on entering and exiting the European Union should provide for long transitional rules specifically aimed at the income tax effects.

It is also interesting to see that the often-broad implementation of EU law in Sweden has made some of the tax issues on Brexit less burdensome or even nonexistent. There is the reliance in many Swedish statutory provisions on the concept of a foreign company, which cover companies both within and outside the European Union. It makes the effects of Brexit when it comes to, for instance, cross-border dividends, many reorganizations, and other corporate situations much less negative for business.

As one of the main objectives of EU primary and secondary law is to provide for a smooth common market, and to facilitate cross-border activities, I think it is fair to argue that many of these provisions can be extended to third states. Not that I argue that EU law should be changed, that would require further deliberations, but rather that EU member states (as well as non-member states should try to facilitate company and individual cross-border activities.

Two examples. First, the above-mentioned rules for transfer of assets in Sweden between companies allows also foreign companies, as defined, to participate without immediate tax consequences as long as the assets continue to be taxable in Sweden. Second, a merger of two US companies involving a permanent establishment in Sweden will normally not trigger tax, and the cost basis of the assets are simply carried over to the surviving company.

The risks are limited using Sweden's definition of a foreign company. Either the foreign company is a resident in a country with a tax level similar to that in Sweden or there is a full tax treaty with the other country. Such a tax treaty will normally contain an exchange of information clause. If legislators are hesitant, they could consider including a requirement that there exists a provision on exchange of information.

It is also important to note that domestic tax laws in the United Kingdom and in Sweden have not been changed after Brexit. As noted above, there are criteria in the tax provisions that may no longer be fulfilled. But in order to change the laws, legislative action is needed. It remains to be seen if, for instance, the United Kingdom will change those tax laws that are implementing EU corporate tax directives. There is anyhow no immediate need for such changes as the directives normally make sense.

Abstract

The article deals with some income tax in particular corporate income tax aspects of the United Kingdom leaving the European Union, from a Swedish perspective.

Keywords: corporate income tax, BREXIT

CRIDO

Działające od 2005 r. CRIDO to wiodąca polska firma doradcza. Strategicznie wspiera polskich i międzynarodowych przedsiębiorców w prowadzeniu i rozwoju biznesu. Kompleksowy zakres doradztwa obejmuje obszary: prawny, podatkowy, biznesowy, digitalowy i transakcyjny (M&A). CRIDO pozyskuje także finansowanie na innowacyjny rozwój firm – zarówno ze środków publicznych, jak i z innych dostępnych źródeł.

Prawie czterystuosobowy zespół CRIDO tworzą ludzie zaangażowani społecznie. W 2022 r. CRIDO powołało Fundację, która w sposób systemowy wspiera organizacje trzeciego sektora w rozwiązywaniu ważnych problemów społecznych. W ramach wolontariatu pracowniczego i kompetencyjnego CRIDO pomaga także szczególnie uzdolnionym dzieciom i młodzieży.

Stuczterdziestoosobowy zespół podatkowy CRIDO specjalizuje się w różnych obszarach związanych z krajowymi i międzynarodowymi podatkami. Doradztwo podatkowe obejmuje: międzynarodowe rozliczenia podatkowe, ceny transferowe, CIT, VAT, podatek od nieruchomości, postępowania podatkowe i sądowo-administracyjne, podatkowe i prawne aspekty dotyczące zatrudniania pracowników i menedżerów, a także doradztwo w obszarze *tax governance*. Zespół Digital dostarcza narzędzia informatyczne wspierające funkcję podatkową oraz automatyzujące procesy w organizacjach.

Mariański Group Kancelaria Prawno-Podatkowa

Mariański Group Kancelaria Prawno-Podatkowa Sp. K. jest niezależną polską firmą doradczą działającą na rynku od 2013 r. Nasz zespół tworzą eksperci w zakresie VAT, podatków dochodowych, cen transferowych, podatków międzynarodowych, podatków lokalnych, postępowań podatkowych i sądowych czy fundacji rodzinnych. Stanowimy grupę nowoczesnych podmiotów prawnych wspierających biznes.

Naszym celem jest, by prawo nie ograniczało kreatywności naszych partnerów, lecz zabezpieczało ich interesy. W związku z tym zawsze poszukujemy najlepszych rozwiązań. Dzięki rodzimym korzeniom doskonale rozumiemy specyfikę polskiego biznesu, co pozwala na podpowiadanie praktycznych rozwiązań oraz umożliwia definiowanie potrzeb danej firmy w szerszej perspektywie. Dla naszych Klientów jesteśmy partnerem biznesowym przewidującym potencjalne ryzyka oraz prawne konsekwencje działań gospodarczych.

Angażujemy się w sprawy, które uważamy za kluczowe. Prawo jest naszą pasją – za jego pomocą mamy wpływ na kreowanie rzeczywistości. Poszukując nowych rozwiązań, jesteśmy zawsze o krok do przodu, aktywnie uczestnicząc w różnorodnych, wieloaspektowych konsultacjach projektowanych aktów prawnych, a nasi eksperci są autorami wielu publikacji książkowych i artykułów w wydawnictwach fachowych.

MARIAŃSKI
GROUP

MDDP Michalik, Dłuska, Dziedzic i Partnerzy

MDDP jest niezależną polską firmą doradczą działającą na rynku od 2004 r.

Nasz zespół tworzy niemal 200 ekspertów w zakresie VAT, podatków dochodowych, cen transferowych, podatków międzynarodowych, podatków lokalnych, postępowań podatkowych i sądowych oraz cła i akcyzy. Prowadzimy innowacyjne, pionierskie sprawy i projekty podatkowe w Polsce.

Angażujemy się w sprawy, które uważamy za ważne – aktywnie uczestniczymy w konsultacjach projektowanych aktów prawnych; jesteśmy ekspertami Komisji Europejskiej, organizacji przedsiębiorców oraz stowarzyszeń branżowych. Nasi eksperci są autorami wielu publikacji książkowych i artykułów w wydawnictwach fachowych. Jako wykładowcy, partnerzy stowarzyszeń studenckich, a także organizatorzy konkursów akademickich angażujemy się w kształcenie młodych prawników i ekonomistów.

TPA Poland

TPA to wiodąca międzynarodowa grupa konsultingowa oferująca kompleksowe usługi doradztwa biznesowego w 12 państwach Europy Środkowej i Południowo-Wschodniej.

W Polsce TPA należy do największych firm doradczych. Nasz zespół ponad 300 ekspertów w biurach w Warszawie, Poznaniu i Katowicach oferuje efektywne rozwiązania z zakresu doradztwa podatkowego, outsourcingu księgowości i płac, doradztwa dla sektora nieruchomości, a także audytu i doradztwa biznesowego pod marką Baker Tilly TPA oraz doradztwa prawnego pod marką Baker Tilly Legal Poland.

TPA Poland, Baker Tilly TPA oraz Baker Tilly Legal Poland są jedynymi reprezentantami Baker Tilly International w Polsce – jednej z największych globalnych sieci niezależnych firm doradczych.

Jako członek Baker Tilly International łączymy zalety zintegrowanej, interdyscyplinarnej obsługi *one-stop-shop* z lokalną ekspertyzą i zasięgiem międzynarodowej grupy doradczej.

Wardyński i Wspólnicy

Kancelaria Wardyński i Wspólnicy od 1988 r. jest trwale zakorzeniona w życiu prawniczym w Polsce. Skupiamy się na biznesowych potrzebach naszych klientów, pomagając im znaleźć skuteczne i praktyczne rozwiązanie najtrudniejszych problemów prawnych.

Dbamy o zachowanie najwyższych standardów prawniczych i biznesowych. Angażujemy się w budowę obywatelskiego państwa prawa. Bierzemy udział w projektach non profit i działaniach pro bono.

Nasi prawnicy są aktywnymi członkami polskich i międzynarodowych organizacji prawniczych, dzięki czemu mają dostęp do światowego know-how i rozwijają sieć kontaktów z najlepszymi prawnikami i kancelariami na świecie, z czego korzystają później nasi klienci.

Dzielimy się wiedzą i doświadczeniem za pośrednictwem firmowego Rocznika, portalu Co do zasady, blogów newtech.law i HRlaw.pl, żywego komentarza do nowego Prawa zamówień publicznych oraz licznych publikacji, seminariów, webinariów i opracowań.

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wydawnictwo.uni.lodz.pl
ksiegarnia@uni.lodz.pl
(42) 665 58 63

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