

# Editorial

## European Commission launches comprehensive strategy to promote tax coordination in the EU

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On 19 December 2006 the European Commission launched a comprehensive political strategy on coordination in the area of direct taxation. The communication on 'Coordinating Member States' direct tax systems in the Internal Market' sets out the general framework for this initiative. It was presented together with two further communications on exit taxation<sup>2</sup> and cross-border loss relief,<sup>3</sup> which provide the first examples of specific areas where EU Member States could benefit from a coordinated approach.

In the current state of Community law, EU Member States remain largely free to design their direct tax systems so as to meet their domestic policy objectives and requirements. Dealing with the interaction of 27 different national tax systems, however, poses a challenge for the Internal Market. National tax rules which have been designed solely or primarily with the domestic situation in mind do not necessarily result in coherent tax treatment when applied in a cross-border context. An individual or corporate taxpayer who is in a cross-border situation may be the subject of discrimination or may suffer taxation of the same income in more than one country. Conversely, there is also greater potential for inadvertent non-taxation or abuse and hence erosion of EU Member States' tax revenues. These problems have only been partly addressed through the OECD process and EU Member States' bilateral tax treaties, which fail to take account of the EU dimension.

The Commission believes that the problems posed by the interaction of multiple tax systems can often best be resolved through collective effort by EU Member States. It is difficult to achieve fully coherent tax treatment through isolated national measures. Fiscal barriers to cross-border activity and investment remain and have been the subject of extensive litigation over the last few years as taxpayers have sought to challenge Member State rules on the basis of the Treaty freedoms. On the other hand, EU Member States increasingly struggle to protect their tax bases unilaterally in a manner which is compatible with Community law. A number of Member States have highlighted the potential budgetary consequences of ECJ case law in this area.

At the same time, despite a series of proposals from

the Commission, discussions within the context of the recent intergovernmental conference and the treaty establishing a Constitution for Europe have not resulted in any substantive changes to the tax provisions of the EC Treaty. The current institutional framework which provides for decision making by unanimity in the area of taxation is unlikely to change in the short to medium term. It is therefore important to explore new and creative approaches, that is to say find pragmatic solutions to the main cross-border tax problems affecting Member States and market operators.

The Commission is convinced that proper coordination and cooperation between EU Member States can enable them to attain their tax policy goals and protect their tax bases while respecting the EU dimension by ensuring elimination of discrimination and double taxation. At the same time, coherent and coordinated tax treatment implies preventing inadvertent non-taxation and abuse, and reducing the compliance costs associated with being subject to more than one tax system.

The coordination initiative is aimed at improving the performance of unharmonized direct tax systems. Whereas harmonization results in the creation of a common body of Community legislation which supersedes national laws, coordination builds on domestic systems to render them compatible with the Treaty and with each other. The concept of coordination is sufficiently broad to also cover areas of taxation where harmonization would not be considered necessary or desirable, but there is nevertheless a need to ensure that existing national tax systems can be made to work seamlessly together.

The coordination initiative complements the Commission's ongoing legislative initiatives in the direct tax

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<sup>2</sup> COM(2006)825, 19 December 2006, Exit taxation and the need for coordination of Member States' tax policies.

<sup>3</sup> COM(2006)824, 19 December 2006, Tax treatment of losses in cross-border situations.

area. The Commission continues to believe that the only systematic way to address the underlying tax obstacles which exist for corporate taxpayers operating in more than one Member State is to provide multinational groups with a common consolidated corporate tax base (CCCTB) for their EU-wide activities. The Commission has announced its intention to present a comprehensive legislative proposal for a CCCTB in 2008. However there also continues to be a need for more targeted measures to address the most urgent problems in the short to medium term. The coordination initiative gives fresh impetus to the Commission's efforts in this area. Such fresh impetus is also called for in the light of recent developments, in particular the significant increase in litigation. There is a need for guidance on the principles flowing from ECJ case law and how they apply to the main areas of direct taxation. Such guidance will promote greater legal certainty for the benefit of taxpayers, tax authorities and national courts. In addition, there are issues which will remain even after a CCCTB has been introduced, e.g. because CCCTB does not cover individual taxpayers and may not necessarily apply to all corporate taxpayers and/or EU Member States and because there will be a need to address the interaction between the CCCTB and other elements of direct tax systems.

The two specific communications presented on 19 December 2006 illustrate what coordination means in practice. The communication on exit taxation explores the implications of recent judgments of the ECJ (the *de Lasteyrie*<sup>4</sup> case and the *N* case<sup>5</sup>), in respect of exit taxes levied on individuals and on companies. It examines how EU Member States' exit tax rules can be made compatible with the requirements of EC law and discusses the broad principles of possible coordinated solutions to the current mismatches between different national provisions. The communication on the tax treatment of losses in cross-border situations also

builds on recent case law of the ECJ, in particular the judgment in *Marks & Spencer*.<sup>6</sup> It promotes a minimum standard for cross-border loss relief involving relief for losses of subsidiaries at the level of the parent company. The Commission intends to present further coordinating initiatives on a range of issues including anti-abuse rules, cross-border compliance costs and generalized binding dispute resolution in order to eliminate double taxation for the benefit of all corporate and individual taxpayers.

In conclusion, the Commission believes that by coordinating their policies at EU level, Member States can, while rendering their direct tax systems compatible with Community law, find solutions for the mismatches between the different national provisions. When implemented properly, such solutions can help to eliminate double taxation and inadvertent non-taxation and reduce the scope for tax avoidance and evasion, thus protecting EU Member States' tax bases from further eroding. The success of this initiative will depend on EU Member States' willingness to co-operate and invest in such common solutions. A failure to act could only further impair Member States' ability to protect their tax revenues and lead to further litigation concerning individual provisions. The Commission for its part is willing to assist EU Member States in developing such coordinated solutions, as it is convinced that this could significantly improve the performance of tax systems which in turn can help to keep economic activity and 'mobile' assets in the EU.

<sup>4</sup> C-9/02, *Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie*, OJ, C 94, 17 April 2004, p. 5.

<sup>5</sup> C-470/04, *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo*, 7 September 2006, OJ, C 261, 28 October 2006, p. 2.

<sup>6</sup> C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)*, 13 December 2005, OJ, C 36, 11 February 2006, p. 5.