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Editorial

The European Cooperation Project, Tax & Sovereignty

Henk van Arendonk*

The European cooperation project is going through a difficult period. In itself, that is nothing new. There have been times in the past, such as in the 1970s, when the European Economic Community (EEC), as it was then, also came to a standstill. And it was not until the 1980s that a new willingness to cooperate started being seen. This was partly thanks to politicians demonstrating vision, but also to the appointment of a strong Commission President in the shape of Jacques Delors who, in his White Book, outlined the path to be taken to complete the internal market. And then there was also the 1986 signing of the Single European Act, which was the first of many treaty changes and ultimately led to the Lisbon Treaty of 2009.

So why is the situation different now? The focus in the first forty years of European cooperation was on economic cooperation and specifically on creating an internal market based on the free movement of goods, services, people (employees and businesses) and capital. Businesses had a direct interest in creating this internal market. As, too, did the citizens of the Member States, albeit indirectly. The problem was that those citizens were not aware of this as they were not directly involved in the various developments in any way.

A lot of things started changing in the 1990s, when European cooperation was extended by the Maastricht Treaty to include a second pillar comprising a common foreign and security policy, along with a third pillar covering police and judicial cooperation.

Although this cooperation was initially at a purely intergovernmental level, relationships changed over the years, with the result that, by now, only foreign and security policy is still of an intergovernmental nature.

The 1990s saw a great deal of work being done to ensure the final stage of the European Monetary Union (EMU) system could get underway in 1998, followed by the introduction of the euro on 1 January 2002. The players in this political game also signed up to the Growth and Stability Pact. Looking at the facts, however, we can certainly raise questions about some of the Member States that were allowed to join this system. When the economies of the various countries were going well, it was all too easy to overlook the shortcomings in the political decision-making. But things changed dramatically when Europe was hit by the financial crisis.

The Maastricht Treaty of 1992 introduced the concept of European citizenship. Since 1987, citizens of the Member States have been able to vote in elections for the European Parliament, which are held every five years. And a sense of European citizenship was all part of that. Although the European Parliament was initially only an advisory body, it is now an institution that has been assigned a role in legislation in almost all policy areas. In the case of taxes, however, the European Parliament continues to operate in a solely advisory capacity.

The European Parliament is there for the citizens of Europe. But European citizens do not see themselves as being represented by that Parliament at all. The turnout at European elections is dramatically low. And there are no indications that this will change any time soon. The gap between members of the European Parliament and the citizens of Europe is simply too great. And my firm impression is that Euro MP's are doing precious little to bridge this gap. Coming down from the ivory tower in Brussels once every five years will not create a strong relationship with the citizens of Europe.

As well as European citizenship's political dimension, it has also showed itself to have a specifically social dimension. European citizens can travel and reside freely in other European Union (EU) Member States, and this is a major benefit for students, among others. But European citizenship is not intended to facilitate people moving to another Member State simply to make use of the latter's more generous social provisions (not social security!). Member States are consequently allowed to impose conditions on access to social provisions, as the extensive Court of Justice of the European Union (CJEU) case law in this field demonstrates.

Since the 1990s we have also seen a development of a totally different nature, with European cooperation being extended to include a current total of twenty-

* Emeritus Professor of Tax Law at the Erasmus University Rotterdam and chairman of the editorial board of *EC Tax Review*. Email: vanarendonk@law.eur.nl

eight Member States. The year 2004 can be seen as a record year in this respect, with ten new members joining the EU, followed shortly afterwards by Bulgaria and Romania. The collapse of the Soviet Union in 1990 meant the old Eastern Bloc countries were forced to fend for themselves. And the European Community, as it was then, was only too keen to absorb these countries into the Community. For the European Community itself this was an opportunity to substantially increase its powers in return for setting up sizeable aid programmes to help these countries' outdated economies to modernize and adapt to a Western model.

The big question is whether all those countries were actually ready for EU membership at the time, or whether their becoming members so quickly was driven primarily by power politics and geopolitical considerations. We recently saw the same process operating with regard to the most extensive association agreement with Ukraine. Strictly speaking, this agreement does not provide for that country to become a candidate for EU membership. However, that is its ultimate aim and purpose. It is easy for politicians to confuse citizens by juggling with words. Meanwhile the discussions surrounding Turkey's possible membership present even more challenges. Many European citizens will oppose any move by the EU over the coming months to dirty its hands by, for instance, abolishing the visa requirements in exchange for a deal on migrants. And this will widen the gap between European citizens and the EU even more.

Over the coming years the EU will be expanded further to include Balkan countries such as Montenegro, Macedonia, Serbia and Albania, while Bosnia-Herzegovina and Kosovo are also potential candidates for membership. In the near future, therefore, there could be as many as thirty-five Member States. That will serve only to increase the cultural and other differences within the EU. And what will that mean for the effectiveness of the European cooperation project?

The financial crisis has certainly not boosted the credibility of this project. Of even more importance at present, however, is the refugee problem. This directly affects European citizens, as is immediately visible in national elections. We have seen that in both the Ukraine referendum in the Netherlands and the Brexit referendum in the United Kingdom, but it will also be an issue in the constitutional referendum scheduled for autumn this year in Italy, the referendum about the refugee crisis in Hungary and the forthcoming elections in Spain, Austria (president election), the Netherlands, France and Germany. In other words, it is going to be a challenging year for the future of Europe. The other twenty-seven Member States responded to the Brexit referendum by agreeing to meet on 16 September in Bratislava to discuss the way forward for the EU. By the time this issue of *EC Tax Review* is published we will know the outcome of this summit meeting. But given the very wide-ranging views on the future of European cooperation, I am not expecting any radically new ideas.

The other twenty-seven Member States responded to the outcome of the Brexit referendum in very different ways. While those in favour of a federal Europe immediately took it upon themselves to call for more Europe, others saw it as a sign that Europe first needed to put its existing house in order. As these responses show, the battle between federalists and non-federalists still has some way to go.

The rapid expansion, both in the number of Member States and also in EU powers, is creating problems that have increased existing tensions within the European cooperation project. And the refugee problem has made this all too evident. The deal with Turkey was, in effect, a deal between Merkel and Erdogan, and the other Member States are still far from willing to fall into line. As I see it, Merkel's '*Wir schaffen das*' was driven primarily by Germany's interests and took little account of the needs and wishes of other Member States. And Merkel also completely disregarded the Dublin agreements. 'Going it alone' in the EU by one Member State has a highly adverse impact on European cooperation.

The question we now have to ask ourselves is whether European cooperation is coming up against or has maybe even gone beyond its limits. Reaching consensus in today's EU, with its twenty-eight members, is far from easy in practice. That is why we regularly hear calls for closer cooperation. I doubt very much, however, whether this will prove to be the solution to the problems. Over time, we will see a patchwork of partial forms of cooperation and non-cooperation arising, and the result will be chaos. To me, therefore, it would seem sensible to give proper consideration over the next few years to deciding what should be handled supranationally and what should continue to be dealt with at a national level. In other words, a revival of the principle of subsidiarity. For the future of the European cooperation project, it would also be wise to seek to involve European citizens more in this process. Many citizens currently have no understanding whatsoever of the EU's institutional structure, as has become all too clear to me during presentations on the EU in the past few years. In effect we are now sailing on a European ship with several captains. There is Donald Tusk, the President of the European Council. And then there is Jean-Claude Juncker, who is the President of the European Commission and always keen to increase his political profile. And then we have Angela Merkel, as seen, for example, in the preparations leading up to the Bratislava summit on 16 September 2016. And none of this helps to make European politics any clearer.

Tensions in the European cooperation project are clearly running high. But what does this mean for the future of taxes in the EU?

The extent to which tax rules and regulations are decided on at a European level has so far remained very modest. A new Community Customs Code, for example, came into force on 1 May 2016, with customs having long been the most harmonized tax in the EU. In this special issue Jean-Marie Salva discusses the issues of customs valuations and transfer pricing. Indirect taxes such as value-added tax (VAT), duties and capital taxes have also been partly harmonized. In the field of corporation taxes, however, nothing has been achieved in terms of harmonization other than the Merger Directive, the Parent-Subsidiary Directive and the Interest and Royalty Directives. Indeed, Common Consolidated Corporate Tax Base (CCCTB) has been under discussion for years, as Carlo Garbarino's contribution to this special issue explains, while the closer cooperation planned for the financial transaction tax has still not materialized.

The first Mutual Assistance Directive dates back to 1977. This was revised in 2011 and then, in 2014, replaced by a directive setting out rules for the automatic exchange of information. These provisions, which go far further than the provisions previously applying, entered into force on 1 January 2016. This latest directive primarily targets the exchange of information on private citizens' income. The Council adopted the Savings Directive on 3 June 2003, but this did not come into force until 1 July 2005. As a result of the far-reaching scope of the new 2014 Mutual Assistance Directive, the Savings Directive was able to be repealed by a European Council decision on 10 November 2015. Along with the Mutual Assistance Directive on the collection of taxes, a directive on assistance in the recovery of taxes was adopted in 2010.

The financial crisis has obviously put government budgets under pressure. And this has made it all the more attractive for them to seek to generate extra income by scaling up their efforts to combat fraud and abuse. This means exchanging information internationally, both on taxpayers liable for corporate taxes and on those liable for income tax. However, globalization has also enabled multinationals to make use of mismatches in Member States' tax legislation or arising from tax treaties. Tax competition between countries has consequently become ever more intense in recent years. In itself, competition in the internal market is a normal and also appropriate phenomenon within a cooperation project. We have seen that in respect of companies' right of establishment and the establishment of pension funds in the EU.

In the 1990s Europe set up the Code of Conduct Group in order to rein in harmful tax competition between Member States. This ultimately resulted in political agreement being reached as part of the Tax Package of 3 June 2003. This agreement has worked well and could potentially also be applied to rulings and unfair tax competition (see below).

The Organisation for Economic Co-operation and Development (OECD) and G20 subsequently launched their Base erosion and profit shifting (BEPS) initiative, which resulted in political agreement in 2015 on implementing a series of fifteen actions into national legislation (with regard to Action 7, see the contribution by António Carlos dos Santos and Cidália Mota Lopes on 'Tax Sovereignty, Tax Competition and the BEPS Concept of Permanent Establishment', as well as 'Tax Transparency in the EU regarding Country-By-Country Reporting (BEPS Action 13)' by Roman Seer and the contribution by Philip Baker and Pasquale Pistone on 'BEPS Action 16: The Taxpayers' Right to an Effective Legal Remedy under European Law in Cross-Border Situations').

Another issue arising during this period has been the problem of tax rulings and prohibited state aid (see my editorial in 2015-1: 'New Presidents, New Sound and New Confidence?'). This firstly resulted in the recasting of Directive 2011/16/EU to enable the automatic exchange of information on rulings (proposal submitted on 18 March 2015 and adopted on 8 December 2015 in Directive 2015/2376/EU and implemented by the Member States before 1 January 2017). With a view to combating tax fraud and evasion, the directive was subsequently re-amended to make provision for country-by-country reporting, as set out in the Council Decision of 25 May 2016, Directive 2016/881/EU (see Roman Seer's contribution to this special issue). This amendment has to be implemented by the Member States by 5 June 2017. Within a very short space of time, therefore, Europe has made substantial progress in exchanging information on corporate taxes.

In itself, it is not so strange that the Member States have been able to arrive at a consensus fairly quickly as each of them has an interest in combating fraud and abuse. Rather than reducing their sovereignty, the agreements reached in this respect actually strengthen it, as stated in the preamble to the Anti-Tax Avoidance Directive: 'It is thus imperative to restore trust in the fairness of tax systems and allow governments to effectively exercise their tax sovereignty.' The proposals for this directive were published by the Commission on 28 January and adopted by the Ecofin Council on 17 June 2016, just before the end of the Dutch Presidency of the Council. They reflect the recommendations set out in the BEPS Action Plan. Indeed, the EU is making quite some progress in implementing the BEPS Actions, whereas whether the United States will show the same willingness to act is very much open to question, not least because of the approach that the European Commission has adopted to rulings (see below).

The European Commission's appetite has now clearly been whetted because on 5 July 2016 it proposed a further series of measures to increase tax transparency and so help combat tax avoidance and evasion (IP/16/2354).

State aid has also become a very topical issue in the past few years in response to the Member States' ruling practices (on this, see Raymond Luja's contribution to this special: 'Do State Aid Rules Allow EU Member States to Claim Fiscal Sovereignty?'). I am not going to discuss cases here that are currently before the Court of Justice. The Commission has exclusive powers to act in cases involving possible prohibited state aid as that is an area where the Member States have transferred part of their sovereignty to the EU. In the case, however, of tax matters, they have not transferred any sovereignty. And this is where existing tensions give rise to conflicts. Transferring specific powers to a supranational body does not, however, equate to a transfer of sovereignty. In other words, a Member State remains sovereign in those areas in which there has been a partial transfer of sovereignty, with a good example of this being Brexit. The reverse, of course, is also true. Member States are sovereign in tax matters, but this sovereignty is not absolute as the way in which they exercise it has to comply with EU law. In all cases, therefore, they have to work together and take account of each other. Good tax governance is required of the Member States, but also of the EU institutions. It could consequently be questioned whether, from that perspective, the approach adopted by the Commission with regard to rulings is actually so sensible. Various cases have now been submitted to the European Court for judgment, and it will be a few years before the outcomes are known. These ad hoc decisions mean, however, that the situation remains unclear.

I also wonder whether the European Court is the appropriate body to assess the principle of 'European arm's length pricing' or, in other words, to decide on a compulsory transfer pricing method for Europe. This is not a subject for a court – not even a European court – to decide on. On the contrary, it would be far more appropriate for it to be dealt with by the Code of Conduct Group so that agreement could be reached on what constitutes harmful tax competition in this field. The approach adopted by the Commission is also strange in view of the work of the EU Joint Transfer Pricing Forum. The latter commented in its Program of Work for 2015–2019, which was published in September 2015, that the Forum 'should also continue its efforts to provide all stakeholders with practical tools and solutions relating to the arm's length principle'. This means Member States and the business sector need to work together far more closely to devise solutions. In my view, therefore, it is remarkable that the Commission has chosen this particular route for such a politically sensitive subject. Or maybe it was because the current President of the Commission, Jean-Claude Juncker, was previously Minister of Finance in Luxembourg and so must have been aware of the rulings – in any event those in Luxembourg – for years. An investigation of national ruling practices by the Code of Conduct Group could cause him more damage than a judgment by the European Court some years down the line. And here we move on to the interesting subject of EU tax policy, see the article in this special 'Tax policy: Trends in the allocation of powers between the Union and its Member State' of Hanno Kube, Ekkehart Reimer and Christoph Spengel.

In the case of income tax, it has not proved possible to achieve positive integration through directives. However, Regulation 1612/68 (now 492/2011) makes provision for employees working in a Member State other than their own to claim the same social security and tax benefits as citizens of that State. Meanwhile Regulation 883/2004 and Regulation 987/2009 provide for coordination of social security. In this issue, Bruno Peeters and Herwig Verschueren examine the impact of EU law on the interaction of Member States' sovereign powers in the policy fields of social protection and personal income tax benefits.

In *After the Storm: How to Save Democracy in Europe* (edited by Luuk van Middelaar and Philippe Van Parijs), Herman van Rompuy claims in his reflections after five years in office that 'The EU will always be a very distinct structure.' He goes on to state that 'As long as the European budget amounts to only 1 per cent of European GDP and national public sectors as much as 50 per cent of their respective GDPs, political leaders will know where their power base lies.' In these circumstances, the idea of the EU being able to levy taxes of its own, which is so cherished by federalists, is an illusion. And it is also perfectly understandable that, for national tax and budgetary policy reasons, Member States will not be willing to abandon their tax sovereignty, which is already curtailed by the provisions of EU law. Furthermore, the problems currently affecting Europe hardly serve to encourage greater cooperation in the fiscal sphere, except where more extensive cooperation is directly in the interests of the Member States and their efforts to combat tax fraud and avoidance.

Editorial board

It is now more than twenty-five years ago that Leo Stevens and I, both associated with the Erasmus University Rotterdam, were closely involved in launching this journal. This cooperation project with our Belgian colleagues, Frans Vanistendael and Luc Hinnekens, proved very successful. Major changes in the editorial team were made some ten years ago, when I took over Frans Vanistendael's role as chairman and the board's composition became an example of broader-based European cooperation. Michel Aujean, who at the time was working for the European Commission, was also a member of the editorial board for ten years. In his final editorial in the 2016/2 issue, he looked back on his career in the world of European taxes. His contributions to *ECTR* over the years focused on subjects such as VAT and corporate taxes, but above all on the issue of European tax policy.

Over the years Michel has done much to promote the role of taxes in the European cooperation project and we are very grateful to him for the expertise he contributed during his time on our board.

Rita de la Feria will join the editorial board on 1 January 2017.

Even though the immediate future for European cooperation does not look particularly bright, the project itself remains exciting. Developments in the field of taxes over the past twenty-five years have enabled our journal to evolve and I have every confidence that we will be able to maintain this growth over the coming years.