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Editorial

EU Tax Dispute Resolution Directive: The Deathblow to Double Taxation in the European Union

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1 Double taxation and the internal market

Juridical double taxation 'is the most serious obstacle there can be to people and their capital crossing internal borders'.[1] However, outside the limited scope of the company tax directives,[2] EU law neither provides for explicit substantive mechanisms to avoid juridical double taxation of income or capital between Member States[3] nor do the fundamental freedoms offer relief.[4] It is nevertheless common ground that the abolition of double taxation is, still,[5] an objective of the Treaty on the Functioning of the European Union (TFEU) and even a 'priority objective of the Community',[6] as the overlap of taxing jurisdictions may result in distortions of the internal market.[7] In light of the un-harmonized international tax systems of the Member States and their competence to conclude bi- and multilateral tax treaties, the Commission's focus has always been on procedural mechanisms to avoid those distortions: As early as 1976, the Commission had tabled a proposal for a directive regarding an arbitration procedure for the elimination of double taxation resulting from transfer pricing adjustments,[8] but encountered Member States' resistance, largely on sovereignty concerns.[9] Hence, for many decades there was no EU instrument on mutual agreement proceedings or mandatory arbitration in direct tax matters. However, the Member States have, instead, concluded the multilateral Arbitration Convention,[10] which is based on former Art 220 of the EEC Treaty. This multilateral convention deals exclusively with the – narrow, but extremely important – issues of transfer pricing and profit attribution and has also been made workable in practice through the guidance developed by the EU's Joint Transfer Pricing Forum (JTPF).[11] Despite the OECD's work in that area, especially in the framework of Action 14 of the Base Erosion and Profit Shifting (BEPS) project and Part V of the Multilateral Instrument (MLI), there are still many situations where double taxation can persist, even within the European Union.

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1 Opinion of Advocate General Colomer, 26 Oct. 2004, C-376/03, *D*, EU:C:2004:663, para. 85.

2 Such as the avoidance of juridical double taxation of inter-company dividends under the Parent-Subsidiary Directive (Council Directive 2011/96/EU) and of inter-company interest and royalty payments under the Interest-Royalties-Directive (Council Directive 2003/49/EC). Also, the step-up provided in Art. 5(5) of the ATAD (Council Directive (EU) 2016/1164) is a measure to avoid – time delayed – double taxation of the same capital gain.

3 The only provision directly dealing with double taxation was former Art. 220 of the EEC Treaty (later Art. 293(2) of the EC Treaty), which urged the Member States, 'so far as is necessary, [to] enter into negotiations with each other with a view to securing for the benefit of their nationals … the abolition of double taxation within the Community'. That provision was not directly applicable to the benefit of taxpayers (ECJ, 12 May 1998, C-336/96, *Gilly*, EU:C:1998:221, para. 15) and was also subject to intense debate with regard to its interpretation. Art. 293 of the EC Treaty was, however, repealed by the Treaty of Lisbon (Point 280, [2007] OJ C 306/1) and speculation as to the reasons for its repeal and its effect are ongoing.

4 The Grand Chamber of the ECJ, in its 2006 decision in *Kerckhaert-Morres*, declined to hold juridical double taxation to be incompatible with the fundamental freedoms (ECJ, 14 Nov. 2006, C-513/04, *Kerckhaert-Morres*, EU:C:2006:713), and the Court has since confirmed that conclusion at a number of occasions (*see* e.g. ECJ, 12 Feb. 2009, C-67/08, *Block*, EU:C:2009:92, ECJ, 19 Sept. 2012, C-540/11, *Levy and Sebbag*, EU:C:2012:581, and also EFTA Court, 7 May 2008, E-7/07, *Seabrokers*, paras 49 et seq.).

5 *See* ECJ, 12 Sept. 2017, C-648/15, *Austria v. Germany*, EU:C:2017:664, para. 26, noting the 'the beneficial effect of the mitigation of double taxation on the functioning of the internal market that the European Union seeks to establish in accordance with Article 3(3) TEU and Article 26 TFEU'. In the past, the ECJ specifically referred to – now repealed – Art. 293(2) of the EC Treaty to establish that 'the abolition of double taxation is one of the objectives of the Community to be attained by the Member States' (*see* e.g. ECJ, 12 May 1998, C-336/96, *Gilly*, EU:C:1998:221, para. 16, and ECJ, 19 Jan. 2006, C-265/04, *Bouanich*, EU:C:2006:51, para. 49).

6 *See* e.g. 'Taxation in the Single Market', Periodical 6/1990, at 25.

7 Discussion paper for the Informal Meeting of Economic and Financial Affairs Council (ECOFIN) Ministers, Taxation in the European Union, SEC(96)487 final, 7 (20 Mar. 1996).

8 Proposal for a Council Directive on the elimination of double taxation in connection with the adjustment of transfers of profits between associated enterprises (arbitration procedure), COM(76) 611 final (25 Nov. 1976), [1976] OJ C 301/4 = Intertax 1977, at 7.

9 The proposal was eventually been withdrawn two decades later; *see* [1997] OJ C 2/6.

10 Convention 90/463/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, [1990] OJ L 225/10, as amended.

11 For a detailed overview on the Convention and the JTPF's work *see* e.g. G. Kofler, *Tax Disputes and the EU Arbitration Convention*', in *Resolving Tax Treaty Disputes: A Global Analysis* 205–36 (E. Baistrocchi ed., Cambridge University Press 2017).

2 The Dispute Resolution Directive

Accordingly, from an EU perspective, the Commission has long viewed the lack of an overall binding dispute resolution procedure for intra-EU situations as an issue to be addressed for both internal market reasons and global competitiveness. Having announced further work in this area in the early 2010s,[12] the Commission in 2016 made a proposal for a directive on dispute resolution,[13] which was swiftly adopted by Council.[14] This Dispute Resolution Directive provides a binding procedural mechanism with set timelines and taxpayer safeguards[15] for resolving disputes between Member States when those disputes arise from the interpretation and application of agreements and conventions (i.e. tax treaties between Member States and the EU Arbitration Convention) that provide for the elimination of double taxation of income and, where applicable, capital. It also contains rules regarding the interaction with national proceedings and dispute resolution under tax treaties and simplifications for individuals and small undertakings. The Directive had to be implemented by Member States by 30 June 2019 and it 'shall apply to any complaint submitted from 1 July 2019 onwards relating to questions of dispute relating to income or capital earned in a tax year commencing on or after 1 January 2018'.

3 Some interesting issues

This new Directive raises numerous fascinating issues, many of which have already been addressed elsewhere,[16] and I would like to arbitrarily pick out three of them: Which 'disputes' are covered? Which 'disputes' are not 'double taxation'? And which forms of arbitration are available?

3.1 What 'Disputes' Are Covered?

While one would have wished for a comprehensive mechanism to abolish all double taxation in the Union, the Directive limits its material scope by applying to 'disputes between Member States when those disputes arise from the interpretation and application of agreements and conventions that provide for the elimination of double taxation of income and, where applicable, capital'. This is broader and at the same time narrower than the Commission's proposal: The proposal would have applied 'to all taxpayers that are subject to one of the taxes on income from business listed in Annex I' – i.e. the Member States' income and corporate taxes – 'including permanent establishments situated in one or more Member State whose head office is either in a Member State or in a jurisdiction outside the Union', i.e. irrespective of the existence of a double taxation convention between the Member States (making, instead, 'international practice in matters of taxation such as the latest OECD Model Tax Convention' the yardstick for arbitration).[17] The actual Directive is narrower as it requires the existence of a tax treaty (or the Arbitration Convention) between the Member States. This is, however, not a high hurdle: Out of the 378 possible bilateral tax treaty relationships between the (current) twenty-eight Member States, only five are not covered by a tax treaty.[18] Conversely, the Commission's proposal with its limitation to 'income from business' raised criticism from the European Parliament which (quite correctly) pointed out that the impact of '[d]isputes on the taxation of income, such as pensions and salaries' on individuals 'can be significant'.[19] The final Directive applies to all kinds of income tax disputes, whether business or individual. Finally, it should be pointed out that the Commission's proposal as well as the final Directive only address income taxation (with the Directive potentially also covering capital taxation), but neither extends to inheritance and gift taxation or double taxation with other taxes (e.g. car registration taxes, consumption

[12] *See* e.g. the Commission's Communication on 'Double Taxation in the Single Market', COM(2011) 712 final (11 Nov. 2011), at 11, where it is stated that the 'Commission sees a need to analyse the improvements that can be made to the procedures for the resolution of double taxation disputes within the EU. In particular, the possibility of a mechanism to effectively and swiftly resolve these disputes in all areas of direct taxation should be explored'.

[13] Proposal for a Council Directive on Double Taxation Dispute Resolution Mechanisms in the European Union, COM(2016)686 (25 Oct. 2016).

[14] Council Directive (EU) 2017/1852 of 10 Oct. 2017 on tax dispute resolution mechanisms in the European Union, [2017] OJ L 265/1.

[15] The Directive contains taxpayer safeguards throughout the procedure (e.g. where not all Member States involved accept a complaint), and the Commission has recently issued standard rules of functioning for the Advisory Commission and the Alternative Dispute Resolution Commission in case the competent authorities either have not agreed upon such rules or only done so incompletely. *See* Commission Implementing Regulation (EU) 2019/652 of 24 Apr. 2019 laying down standard Rules of Functioning for the Advisory Commission or Alternative Dispute Resolution Commission and a standard form for the communication of information concerning publicity of the final decision in accordance with Council Directive (EU) 2017/1852, [2019] OJ L 110/26. For an overview *see also* e.g. K. Perrou, *Taxpayer Rights and Taxpayer Participation in Procedures Under the Dispute Resolution Directive*, 47 Intertax 715–24 (2019).

[16] *See* e.g. the comprehensive analysis by H. M. Pit, *Dispute Resolution in the EU* (IBFD 2018), and the recent series of contributions on arbitration in this year's Issue 8/9 of Intertax. For a comparison between the OECD and the EU approaches *see* S. Govind, *The New Face of International Tax Dispute Resolution: Comparing the OECD Multilateral Instrument with the EU Dispute Resolution Directive*, 27 EC Tax Rev. 309–24 (2018).

[17] *See* Art. 13(2) of the Proposal COM(2016)686 (25 Oct. 2016).

[18] As of Sept. 2019, those are the relations between Cyprus and Croatia (the 1985 treaty was terminated), Cyprus and the Netherlands, Denmark and France (the 1957 treaty was terminated effective 1 Jan. 2009), Denmark and Spain (the 1972 treaty was terminated effective 1 Jan. 2009), and Finland and Portugal (the 1970 treaty was terminated effective 1 Jan. 2019, and the 2016 treaty is not yet in force).

[19] *See* Amendment 16 of the European Parliament legislative resolution of 6 July 2017 on the proposal for a Council directive on Double Taxation Dispute Resolution Mechanisms in the European Union (P8_TA(2017)0314), [2018] OJ C 334/266.

taxes etc.). There is hence ample room for expansion as to the taxes covered by the EU dispute resolution mechanism.[20] What is, however, a huge progress as compared with bilateral mechanisms is the fact that the Directive clearly covers disputes in tri- and multiangular situations involving three or more Member States, a typical 'risk area' for unrelieved double taxation.[21]

3.2 Which 'Disputes' Are not 'Double Taxation'?

It is also striking that the Directive speaks of 'disputes' between Member States that arise 'from the interpretation and application' of tax treaties or the Arbitration Convention. Those disputes certainly cover cases of double taxation, but are not limited to those. Rather, it extends to disputes beyond issues of double taxation, e.g. with regard to the application of non-discrimination provisions. However, the Directive deviates from Article 25 OECD MA in that its Article 2(1)(c) specifically defines 'double taxation' as 'the imposition by two or more Member States of taxes covered by an agreement or convention referred to in Article 1 in respect of the same taxable income or capital when it gives rise to either: (i) an additional tax charge; (ii) an increase in tax liabilities; or (iii) the cancellation or reduction of losses that could be used to offset taxable profits'. What seems hence not to be included in the Directive's notion of 'double taxation' are situations of so-called 'virtual double taxation', where a tax treaty would, in principle, require exemption even if the other State does not tax the income (e.g. because of an exemption under domestic law or an unresolved negative conflict of qualification).[22] Conversely, situations of conflicts of qualification, where, e.g. 'one Member State interprets a source of income as salary while the other Member State interprets the same source of income as profit', would be covered by that definition,[23] and relevant 'double taxation' arguably also exists where Member States tax the same income but in different taxable years. Likewise, classical economic double taxation in transfer pricing and profit attribution cases (i.e. the object also of the EU Arbitration Convention) seems to fall squarely within the Directive's notion of 'double taxation', as it does not require that double taxation occurs in the hands of the same taxpayer. That said, the distinction of whether a 'dispute' involves 'double taxation' is neither trivial nor inconsequential: This is because, under Article 16(7), a Member State may 'deny access to the dispute resolution procedure under Article 6 on a case-by-case basis where a question in dispute does not involve double taxation'.[24] However, that case-by-case exclusion is limited to the arbitration procedure, whereas access to the Directive's mutual agreement procedure remains available for all relevant 'disputes'.

3.3 Which Forms of Arbitration Are Available?

In line with the concept of the Arbitration Convention, the primary tool for dispute resolution after a failed Mutual Agreement Proceeding is arbitration by a so-called 'Advisory Commission'. The Directive provides a detailed set of rules on procedure, timing, appointments, information, evidence, hearings, costs, etc. (and the Commission has further drafted standard rules of functioning[25]), and – in Article 15 – also determines that the Advisory Commission has to issue a – reasoned – independent 'opinion' in writing (which may or may not be accepted by the competent authorities[26]). This opinion is to be based on the 'on the provisions of the applicable agreement or convention […] as well as on any applicable national rules'. While an independent opinion might certainly have its benefits, a recent international trend is to agree on so-called 'final offer', 'last best offer' or 'baseball' arbitration,[27] where the arbitration panel (only) has to decide between competing proposals made by the competent authorities (e.g. a specific monetary amount of income or expense). This implicitly forces the competent authorities to take reasonable and well-considered positions in their submissions, while also barring the arbitration panel from simply 'splitting the difference'.[28] That said, the Directive gives Member

[20] *See* e.g. the Commission's Communication on 'Tackling cross-border inheritance tax obstacles within the EU', COM(2011) 864 final (15 Dec. 2011), and the Report of Commission's expert group on 'Ways to tackle inheritance cross-border tax obstacles facing individuals within the EU' (Dec. 2015).

[21] *See* e.g. Art. 2(1)(c), speaking of the imposition of taxes 'by two or more Member States', and similar language throughout the Directive.

[22] For a detailed analysis of this definition of double taxation and further nuances *see* R. Ismer, *Was ist internationale Doppelbesteuerung?*, in *Territorialität und Personalität, Festschrift für Moris Lehner* 27–46 (R. Ismer, E. Reimer, A. Rust & Ch. Waldhoff eds, Otto Schmidt 2019).

[23] The European Parliament refers to that situation as 'economic double taxation'. *See* Amendment 16 of the European Parliament legislative resolution of 6 July 2017 on the proposal for a Council directive on Double Taxation Dispute Resolution Mechanisms in the European Union (P8_TA(2017)0314), [2018] OJ C 334/266.

[24] *See* for that compromise of keeping a (broader) scope of the Directive and permitting Member States to deny access to the dispute resolution procedure on a case-by-case bases paras 8–10 in Doc. 9011/17 FISC 99 ECOFIN 345 (12 May 2017).

[25] *See* Commission Implementing Regulation (EU) 2019/652, [2019] OJ L 110/26.

[26] Under Art. 15, it is for the competent authorities to agree on how to resolve the question in dispute within six months after the opinion. The competent authorities may take a decision which deviates from the opinion of the Advisory Commission or Alternative Dispute Resolution Commission. However, if they fail to reach an agreement as to how to resolve the question in dispute, they shall be bound by that opinion.

[27] It should be noted, e.g. that under Part V of the OECD's Multilateral Instrument (MLI) twenty-one out of the currently twenty-nine states opting for mandatory binding arbitration have chosen 'baseball arbitration' (these are Australia, Austria, Barbados, Belgium, Canada, Curacao, Fiji, Finland, France, Germany, Ireland, Italy, Liechtenstein, Luxembourg, Mauritius, Netherlands, New Zealand, Singapore, Spain, Switzerland and the UK, whereas Andorra, Greece, Japan, Malta, Papa New Guinea, Portugal, Slovenia, and Sweden have opted out of baseball arbitration).

[28] For a brief analysis *see* e.g. N. Bravo, *Mandatory Binding Arbitration in the BEPS Multilateral Instrument', Nathalie Bravo*, 47 Intertax 693 (698–99) (2019).

States a tool to opt for 'baseball arbitration' in that it foresees, in Article 10, the setting up of an 'Alternative Dispute Resolution Commission' (ADRC) to resolve the dispute instead of an Advisory Commission. Indeed, the ADRC may apply 'any dispute resolution process or technique', 'including the "final offer" arbitration process (otherwise known as "last best offer" arbitration)', hence enabling the choice of a streamlined process. Also, 'baseball arbitration' does not necessarily mean that the arbitration panel must be prevented from giving reasons for the decision, although Article 23(1)(c) of the OECD's MLI takes the clear position that the arbitration panel's decision 'shall not include a rationale or any other explanation of the decision'; in contrast, the Directive would certainly allow for 'baseball arbitration with reasons'.[29] Moreover, the ADRC is not limited to ad hoc arbitration, but can also have a permanent nature (a so-called 'Standing Committee'), which could be a real chance for a permanent arbitration structure[30] or even serve as a first step towards the establishment of a European tax court.[31]

4 A HUGE STEP FOR THE INTERNAL MARKET

The EU Tax Dispute Resolution Directive is a welcome (huge) step to prevent persisting double taxation in the European Union and might even open further avenues for the establishment of a permanent arbitration structure. Moreover, and even if some technicalities might need to be worked out in practice, the mere existence of a legally enforceable, tightly timed arbitration mechanism will certainly have a positive impact on the Member States' willingness to speedily resolve double taxation issues in mutual agreement proceedings before cases are taken out of their hands and into independent arbitration.

[29] *See* however, J. F. Avery Jones, *Types of Arbitration Procedure*, 47 Intertax 674 (675) (2019), who considers 'baseball arbitration with reasons' as 'the best of both worlds'.

[30] *See* e.g. the discussion in paras 14–17 in Doc. 9011/17 FISC 99 ECOFIN 345 (12 May 2017), and the ideas on a permanent structure developed by S. Piotrowski, R. Ismer, P. Baker, J. Monsenego, K. Perrou, R. Petruzzi, E. Reimer, F. Serrano Antón, L. Stankiewicz, E. Traversa & J. Voje, *Towards a Standing Committee Pursuant to Article 10 of the EU Tax Dispute Resolution Directive: A Proposal for Implementation*, 47 Intertax 678–92 (2019).

[31] *See* J. Voje, *EU Tax Dispute Resolution Directive (2017/1852): Paving the Path Toward a European Tax Court?*, 58 Eur. Tax'n 309–17 (2018).