Corporate Income Tax Subjects and EU Harmonization

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I. Introduction

The EU Directives existing in the field of direct taxation define the scope of corporate income tax subjects by way of annexes which, besides an explicit list of entities, leave considerable leeway to each Member State in order to define which entities fall within the scope of the Directives. Taking the Parent-Subsidiary Directive (90/435/EEC) as an example, there are four different methods of assigning the right to determine the Directive's personal scope to national legislators. The Directive is applicable to non-listed entities if they can be classified as

- other companies constituted under the respective national law which are subject to corporate income tax,[1]
- other companies subject to corporate income tax, in so far as their taxable income is calculated and taxed in accordance with the general tax legislation rules applicable to business corporations,[2]
- companies incorporated under the respective national law[3], or
- private or public entities whose activity is wholly or principally commercial[4].

This current method of classifying different entities for purposes of the Directives does not seem to be satisfactory. The variety of tax law, private law and substantive criteria[5] together with the inconsistencies between EU law terms and their national understanding[6] leads to a considerable uncertainty. In addition, the fixed catalogues of the Directives are not adequately able to react to changes of national law.[7] This especially holds true considering the fact that, in most cases, not only the Member State which the entity originates from has to deal with its classification. Rather, all other Member States have to potentially evaluate foreign national law and its underlying concepts in order to decide about the personal entitlement to the Directives.

The problem of diverse national concepts, however, is not specifically assigned to the Directives in the field of direct taxes. Their personal scope merely tries to cover all entities treated as opaque for purposes of national tax law. Therefore, the significant incoherence of the Directives' personal scope can be considered as a mere symptom of a more profound

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[1] This is the case for Austria, Belgium, France, Germany, Greece, Spain, Luxemburg, the Netherlands,

[2] This concept is applicable to Denmark. As similar wording is used for Portuguese companies.

[3] Such a connection to private law is used by Ireland, Lithuania, and the UK.

[4] This broad concept is applicable to Italian entities.

[5] See for this triad to methods to determine corporate income tax subjects *R. Martini*, Numerical Methodology in Comparative Tax Law, Cambridge Journal of International and Comparative Law (forthcoming 2013).

[6] E.g., the different understandings of the term „company“ as mentioned by *J. Heinrich* & *C. Slawitsch*, National Report Austria, p. 9. Even seen from the perspective of only one country there are differences between the Directives, see *H. Arts*, Dutch National Report, p. 9.

[7] This effect is especially obvious in France, see *P. Kouraleva-Cazals*, National Report France, p. 11.

diversity. The obvious problems of the Directives dealing with this legal environment raise the general questions if, how and to which extent the personal scope of corporate income tax should be harmonized among the Member States.

This complex contains two main aspects. First, and most fundamental, the interrelation of the fundamental freedoms on the one hand and the personal scope of corporate income tax on the other has to be analyzed (below II.). On a second step, against this background of – partly existing, partly lacking – negative integration, the need for and the conditions of a positive harmonization can be identified (below III.).

II. Negative Integration: Corporate Income Tax Subjects and Fundamental Freedoms

Difficulties in the application of the fundamental freedoms arise where entities which are resident, and liable to corporate income tax, in country A move their seat or place of effective management to country B. Assuming that country B used to acknowledges the tax status of the entity in full accordance to the status assigned to this entity by state A as long as the entity is a resident of state A,[8] but undertakes its own test (e.g. a resemblance test[9]) as soon as the entity moves to state B, this could constitute a violation of the freedom of establishment.

In more detail, we have to admit that there is no discrimination. The entity is not placed on unequal footing, compared to entities which have always been residents of, and established under the law of, state B. The comparison has not to be made between resident and non-resident companies. Their overall situation does not seem comparable.[10] Rather, it seems appropriate to compare resident companies (incorporated under the laws of state B as well as under foreign law) on the one hand and non-resident companies on the other hand.

The system of state B might, however, constitute a restriction. The moving entity might be held away from immigrating, given that its status under the law of state B might change. Is this eventually a restriction? If so, is this restriction justified under the Marks and Spencer rule of a disparity of national tax systems?

Second, the mere fact that an entity which used to be treated as a corporation under the law of state A might now become a transparent entity according to the resemblance test of its new state of residence, state B, (or vice versa) might also constitute a restriction. This restriction follows from the fact that, e.g., the corporation has no longer any tax benefit if it refrains from distributing its annual profits. At the same time, profits distributed to the shareholders/partners will no longer trigger a second taxable event. However, the fundamental freedoms do not guarantee a full stability over the entire life of the entity, thus do not contain a principle of mutual recognition under which state B is obliged to continue to treat this entity in exactly the same way, and under the same status, as was assigned by state A.

III. Positive Harmonization?

The interrelation of fundamental freedoms and the national provisions to determine corporate income tax subjects raises several issues. First, the existing disparity of national tax (corporate

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8 See for example the Dutch administrative guidelines applicable until 2004: DG097/00417, BNB 1998, 15 para. II.6.

9 As applied by, e.g., Austria, Denmark, France, Germany, Luxembourg, the Netherlands, and – outside the EU – Norway.

10 Cf. for individuals ECJ, Case C-279/93, *Schumacker*, no. 31.

income) systems seems to require a diversity of personal scopes. Is a harmonization of direct taxes a prerequisite for a harmonization of the personal scopes of corporate income tax? Or, on the contrary, could the positive integration of the personal tax liability constitute a promoter for a spontaneous coordination of the tax systems in general?

A second point relates to the existing differences in company law. A different treatment of domestic and foreign companies could even be required by the fundamental freedoms in order to avoid treating unequal situations as equal. Is a harmonization of corporate income tax, especially its personal scope, possible without harmonizing national company law? And going beyond the mere tax perspective: Is there a negative competition of company law systems within the EU (race to the bottom) and does this require a (tax) harmonization?

The last issue is the different tax treatment of corporate tax subjects and transparent partnerships. It is true that the fundamental freedoms do not contain any neutrality of different legal forms under one and the same company law of one member state.[11] However, time might come that the ECJ interprets the Charta of fundamental rights and/or the ECHR in a way that guarantees such neutrality. If so, tax legislators in one and the same member state might be obliged to treat, in all cross border cases, corporations and partnerships alike. Assuming that jurisprudence and case law might go into this direction, this would have tremendous impact on the design of both the three directives and the national corporate and personal income tax acts. Such a scenario might be an *agent provocateur* for a harmonization of both company law and taxation.

[11] ECJ, Case C-307/97, *Saint Gobain*, no. #.