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EU legal Person Double Taxation Laws and Structures

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Abstract

The United Nations Conference and Trade Development (2000) explains that double taxation has caused the occurrence of jurisdictional vacuums as well as conflicts. This is because most nations lack the necessary definitions of income classification. Thus leads to a person being considered as a resident by two or more states by virtue of the divergent perspectives held by the states involved. Such situations are common among people who maintain habitual abodes and conduct professional activities in 2 or more nations. It is also the case for entities operating in 2 or more nations (United Nations Conference on Trade and Development, 2000). Take, for example, a firm may be incorporated under the laws of Germany, which will determine residence by exploring the place of incorporation. In the same manner, the firm might be effectively managed and controlled from France, which determines the residence by exploring the place of management. The company would be required to meet the residence test in both France and Germany. This will ergo lead to it being taxed as a resident.

Likewise, the existence of a jurisdictional vacuum allows two states to tax the same item of income by their own definition if they think that the item arises from sources within their territories. The United Nations Conference and Trade Development (2000) indicate that such definitions cause mismatches in the timing of income recognition and accounting standards. The occurrences are mostly classified as either economic or judicial.

The topic on how to avoid double taxation is explored by Radu (2012), who notes that unilateral or international schemes can be put in place. The unilateral measures are often determined by the choices of economic policy. For instance, a nation which exports capital will exempt the foreign source income from their trade agreements so as to avoid being in a competitive disadvantage in third-country markets. The capital importing nations will exclude interest remunerating bank deposits for the non-residents in order to attract capital and improve on foreign direct investment (Radu, 2012; Barbuta-Misu & Tudor, 2009). The unilateral restraint measures are thus dictated by the restrictions which are imposed by a nation outside its own territory.

Keywords: European Union, Legal Person, Double Taxation Laws, Structures.

1. Introduction

Organization for Economic Co-operation and Development (2001) opines that members of the European Union have put up infrastructures that are aimed towards undoing double taxation. Even though the arrangements are imperfect, they have helped in minimizing the conflict and filling the jurisdictional void. Some EU nations grant the resident individuals a set level of relief from the taxes imposed on corporate levels (Micossi & Parascandolo, 2010). This is attained by granting them a tax credit, which is in line with the amount of taxes paid on corporate profits (Organisation for Economic Co-operation and Development, 2014).

Comparisons drawn between the EU's and Japan's modus operandi shows that the former is much friendly to its denizens and non-residents when it comes to double taxation. Also, resident investors are offered relief, which causes a decline in the tax wedge on profits that are bound to be distributed (Organisation for Economic Co-operation and Development, 2001). However, in the case that the typical investor is a resident household, then the taxation system used in the nations will give a strong incentive against equity or retained earnings funding. This is brought about by the fact that countries in the OECD area tax corporate interest payments at the personal interest income and the corporate tax base at a lower rate compared to that applied to dividends (Organisation for Economic Co-operation and Development, 2001). This might result in undercapitalization, which will lead to corporations being more susceptible to insolvency. Furthermore, the business cycles are bound to be affected at the macro levels (Organisation for Economic Co-operation and Development, 2014).

The EU has implemented divergent international measures with the first being the development of comprehensive double tax treaties (DDT) (United Nations Conference on Trade and Development, 2000). The tax treaty is vital for capital-exporting nations in that it allows them to own enterprises and gain a competitive advantage in the foreign market compared to the capital importing nations. Also, bilateral tax treaties help in the creation of possibilities for information exchange between capital importing and exporting nations (United Nations Conference on Trade and Development, 2000; Worldwide Tax Summaries, 2020).

A good majority of the comprehensive tax treaties deal exclusively with matters of taxation in regard to capital and income. There are a few of the multilateral instruments which deal with taxation matters. United Nations Conference and Trade Development (2000) denote that avoiding double taxation does not entirely mean that the taxpayer will be provided with the benefit of paying the lowest tax. Actually, its only objective is to avoid the accretion of concurrent taxes, which is attained by eliminating mismatches in definition and providing relief for the tax borne in the different states (United Nations Conference on Trade and Development, 2000).

The European Commission (2020) show that the tax provisions chapter of the treaty on the Functioning of the European Union was formulated to handle the increased concerns about double taxation. Articles 110 to 113 of the provisions chapter argue that

nations have to develop harmonized legislation to guide the union on how to handle jurisdictional conflicts focusing on indirect taxation, excise duties, and turnover taxes. Articles 114 to 118 of the treaty indicate that double taxation directly affects the formulation of an internal market, especially because the financial dictums are not subject to the ordinary procedure of legislature formulation (European Commission, 2015; European Commission, 2019).

Deductions by European Commission (2020) explain that the recurring effects of double taxation should be addressed pursuant to Articles 326 to 334 of the treaty. The main feature of the tax provisions is that the European Council will decide on whether a commission proposal is viable for implementation. The provisions implemented in the field will be inclusive of directives that approximate national provisions (European Commission, 2019). A two-tier system of corporate taxation was recently introduced in Austria and Italy, which would allow for companies to be relieved from the impact of double taxation on their corporate structure (European Commission, 2020). The system applies a combination of a dual income tax system and imputation credit with non-neutrality being offered in some instances.

The two-tier system gave birth to newer packages and policies, with the first being the tax transparency package doled out on March 18, 2013 (European Commission, 2020). The package aimed to improve the levels of cooperation and transparency between members of the European Union regarding tax rulings over the border. It also repealed the savings tax direction aimed towards streamlining legislation on how information can be exchanged automatically. This would be attained by assessing transparency initiatives in tandem with cross-country reporting for multinationals. The European Commission (2020) indicates that nations must learn how to review the code of conduct on business taxation to make it more effective and functional. The review process will help quantify the tax gap, which is rarely attributed to evasion and tax avoidance (European Commission, 2020).

The second policy formulated by the European Union is the action plan on corporate taxation, which was rolled out on June 17, 2015 (European Commission, 2020). The plan sets out a series of initiatives to improve the business milieu in the single market by tackling double taxation, avoidance, and evasion. The action plan offers a description of 4 guiding objectives, namely reestablishment of the link between the geographical location of economic activity and taxation; making certain that the member states value corporate activities in their areas; creation of a growth-friendly and competitive tax environment for the European Union; protecting the single milieu and setting up a collective approach to settle the corporate tax issues; implement the base erosion and profit shifting actions of the OECD; deal with tax jurisdictions that are not cooperative and increase transparency between non-cooperative and cooperative tax jurisdictions.

Dumiter and Turcas (2019) cite that there are at least two methods used in managing double taxation in Germany. The first method is the foreign tax relief, which is covered by double tax treaties mentioned later on (German Federal Ministry of Finance, 2020). The relief exempts firms from paying double taxes, thus allowing them to accrue

their income with progression. In addition, foreign income taxes are only credited against German-based or international entities if a tax provided in the applicable treaty is existent (German Federal Ministry of Finance, 2020). The tax credit should also be possible up to the amount of German income taxes imposed on the specific foreign income (German Federal Ministry of Finance, 2020).

The second method is tax treaties, wherein the national income tax laws have been revamped to ensure that income is not taxed by more than one nation. As it stands, Germany has double tax treaties with over 90 nations, with most of them being industrialized (German Federal Ministry of Finance, 2020). On the contrary, the nation is yet to conclude a double tax treaty with Hong Kong and Brazil. Deloitte (2019) introduces the Income Tax Act and the Fiscal Code as viable laws that are used by German to address any double taxation issues. The overarching aim of the case law is to prevent double non-taxation and double taxation, with every individual and entity being required to pay their fair share of tax. The nation has developed double taxation agreements which distribute the rights among its partners.

The law does not, however, create new claims of revenue, but it allocates the taxation right to the import or export country if competing revenue claims exist. The German Federal Ministry of Finance (2020) opines that special double taxations are also existent for gift taxes, motor vehicle taxes, and inheritances. The income tax act has allowed for the exchange of information among tax authorities, which comes in handy in detecting and mitigating the occurrence of tax evasion (German Federal Ministry of Finance, 2020; Deloitte, 2019). The figure below offers a color-coded world map that shows the nations with which Germany has double taxation agreements with.

German Federal Ministry of Finance (2020) highlights that advance pricing arrangements and advance cross border rulings reached in 2017 by the nations working in tandem with Germany were amended and renewed. The amendments allowed Germany to introduce a new provision that would limit the royalty payments and license fees doled out to preferential tax regimes. The provision also ensured that the nation's structures are in tandem with the OECD nexus approach of the BEPS 1 implementation act.

German Federal Ministry of Finance (2020) notes that the BEPS 1 implementation Act put in place a new regulation that would reduce the double deduction for partnerships as from January 1, 2017. The OECD multilateral instrument signed in June 2017 also helped Germany amend over 100 double tax treaties in compliance with the recommendation offered in the BEPS act (Organisation for Economic Co-operation and Development, 2014).

The issue of double taxation is evaluated in case number C-64/15 which lodged the Republic of Austria against the Federal Republic of Germany. The contents of the case highlight that Germany was guilty of imposing double taxation to companies operating in both the nations which contravened article 273 of the TFEU, the Vienna Convention and the Austro-German convention. Between the years of 1996 and 1998, the Bank Austria AG which has headquarters in Austra was allowed to work in tandem with Landesbank NRW found in Germany (Republic of Austria v Federal

Republic of Germany, 2017). The bank claims that the terms of operation were that they would be exempt from paying any extra taxes since they had unlimited tax liability back in their home state.

Bank of Austria through the government lawyers claimed that the courts should hold the German government guilty of imposing taxes when a clear agreement had been put in place. Moreover, the government had to refrain from taxing the interest accrued by the firm as it operated in Germany (Republic of Austria v Federal Republic of Germany, 2017). The German government, on the other hand, argued that the taxes were imposed using the situs or source

principle. This meant that they had an exclusive right to tax their interests.

The ruling from the court noted that the certificates issued to the Bank Austria AG to operate in Germany without paying taxes were not valid or included in the Convention between the Republic of Austria and the Federal Republic of Germany for the avoidance of double taxation with respect to taxes on income and capital. Therefore, Germany had every right to pay taxes based on the situs principle, although they had to find an amicable agreement to avoid future issues or debt claims.

2. Conclusion

Avoiding double taxation has thus far proven to be effective for individuals and organizations. This is because it helps in minimizing tax deductions and controlling the timing of income. Moreover, entities can forecast income and expenses as they get to plan and develop solid estimates about their business/ personal income in the coming years. Kerr (2017) cites that tax dodging has its benefits as it limits the inchoate ability of firms to impose even higher taxes. Termed as the Laffer effect/ curve, this concept highlights that high taxes can be lowered to increase growth that will provide the government with more revenue. Conversely, if people decide to evade or avoid high taxation, then this will reduce the revenue to be accrued by the government. The authorities will then be forced to review their tax rates to collect enough finances from each and every citizen.

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