

TAX CONFLICTS IN THE LIGHT OF THE EUROPEAN TAX HARMONIZATION

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I. INTRODUCTORY THOUGHTS

Studying the main points of the international tax law and the European tax law we can state that the international tax law gives rise to the conflicts in the differences national tax systems one hand, but the other hand the international and European tax law can solve the tax conflicts, which arise from the differences of (the member states') national tax system, legislation. The tax conflicts are originated from the narrower meaning of the international and European tax law, but an extensive sense the international and European tax law – which is the result of the European tax harmonization - is a legal-field, which gives solution for these conflicts and for the international tax problems.

Sovereign states have independent tax legislations, these tax systems are differences widely, but sometimes its have the same regulations. These differences and these sameness cause the conflicts between the nation's tax regulation.

In this study I examine what are the main points of the conflicts in the international and European taxation, what kind of conflicts are in the EU tax law, how can solve the tax conflicts the European tax harmonization, what is the method of it?

The principles often coincide with the methods of taxation that leads in the international relationships to injustice causing for example double taxation. Every state has own sovereignty in the right to levy taxes, it would be different, and that's why every state has a different taxation system:

Every state has own right to assessment the following in their tax system: The states are difference in the followings:

1. *The type of taxes.* How many and what kind of tax is in a state? (e.g: EVA (Simplified Entrepreneurial Tax) is introduced only in Hungary nowhere else in the EU)
2. Who will be the *taxpayer*, who will be the subject of the tax?
3. What is the order of *tax base* calculation amongst each tax? If the taxes are the same in two state, maybe the calculated of the tax is difference (for example since 2002 is a new topic in the EU, the corporate income tax is to be unified (the common consolidated company tax base), so there won't be high conflicts in calculation of tax base)
4. What is the *tax rate* in the difference taxes?

5. What *tax exemptions, allowances* are there?
6. What *tax preferences* are used? (After the economic regime has changed Hungary had a characteristic to give the foreign investors high tax preferences from corporate income tax, these regulations had to be abrogated in the year to year changing corporate tax rules since the mid 90's).

The items listed above, not only determine the states national tax system, also those elements within the tax system in which each state's tax norms may be different. They do differ, because the international taxation does not know in two or more states completely equally regulated taxes and tax rules. These differences lead to *conflicts in the area of international tax law*. Most common international tax law conflict is the problem of double taxation.

II. THE MAIN POINTS OF THE INTERNATIONAL TAX CONFLICTS

First of all we have to define the international tax law, why it is the law of the tax conflicts and the law which gives solution and answers to the tax conflicts?

- a.) *In a narrow sense* the international tax law means the conflicts of the different national tax systems (1)

In narrow sense the international tax-law is the aggregation of those national rules, which arise from the conflict of tax-law norms occurring from each states sovereignty, they trigger the tax-law conflicts.

It is the law of national tax-law conflicts arising from the diversity or tally (duplication) of each nations internal tax regulations and the different or even the same tax systems. These fall under each nation's internal tax legislation which conflicts with other nations internal fiscal rules, in the international tax-law relations. (double taxation).

In this sense the international tax law is the law of national tax-law conflicts and the law of conflict emerging.

- b.) *In a broader sense international tax law*: covers the rules of both, national and international tax law that tend to solve the problems of fiscal jurisdiction. This is the conflict of international and national tax law.

- c.) *Extensive meaning of the international tax law*:

It influences the fiscal jurisdiction with the instruments of international law, i.e. it is the law of conflict resolution that arises from the collision of national tax systems. *This is the conflict resolution of international tax law, also belongs here:*

- international bi- and multilateral treaties
- treaties about the avoidance of double taxation,
- EU treaties and secondary legislation, the primary and secondary legal sources of the European Tax Law
- the soft law of the EU (for example: the Code of Conduct for Business Taxation from the ECOFIN Council)
- the cases and decisions of the Court of Justice of the European Union.

The international tax law is the law of international and national tax law conflicts, and of rules established by national law related to international finances (for example foreign tax payers, the activities of foreigners or the conflict of "local" taxpayers.) This is the international and national conflict law and the national substantive law, for example; unilateral rules in cases where the tax responsibility of foreigners is questioned. In cases falling under the first interpretation (a.) international tax law creates the collision, however in the second and third cases (b., c.) it finds solutions to the conflicts, resolves the international tax-law conflicts.

The international tax law includes:

- a) *International treaties concluded in subject to avoid double taxation:* they resolve to overwrite the states internal tax-law (for example Hungary has one with each EU states, and Hungary has more than 60 double taxes treaties) ,
- b) *The results of the European tax harmonization:* its aim is to close the member states tax rules. This means that there is a supra national law - the tax law of the EU - that has priority against the member states' national law. The goal of the European Tax Law is giving solution to the international tax conflicts in the EU.

The European tax-law has three instruments to resolve the tax law's conflict:

- 1.) *with primary source of law:* founding treaties and their amendments, it is important to mention that these rules enforce without any specific national legislative act,
- 2.) *with secondary source of law:* In the directives of the European Council (Acting by unanimity or qualified majority with the proposal of the Committee, in the subject of taxation), or for example the Code of Conduct for Business Taxation -that is implemented individually in the member states-(soft law). The tax preferences of foreigners had to be repealed in Hungary as a result of this regulation.
- 3.) *Case decisions of the Court of Justice of the EU: (shortened.ECJ):* In connection with Hungary a lot of cases entering the Court were connected with taxation. (e.g. case of the registration tax, HIPA case C- 283/06 and C-312/06. about the local business tax, Cartesio case C- 210/06.- home transfer taxation decisions, Parat case C-74/08.- decisions concerning the reimbursement of the VAT on state aid., CIBA case C-96/08.)

International tax-law as the law of conflict and collisions: Collisions arise from the overlapping of tax systems, tax-law jurisdiction, and these overlapping lead back to the lack of limitation in internal and external (meaning national and international law) sovereign taxation.

III. TAX LAW CONFLICTS IN THE EUROPEAN TAX LAW

The most common conflicts of the international and European tax law are the following:

1. conflict of double taxation (for example: an income is taxed in two states at once)
2. tax avoidance, tax evasions' conflict

3. conflicts concerning tax havens, off-shore firms
4. conflict because of the discrimination between foreign and domestic taxpayers
5. conflicts of the harmful tax competition
6. conflicts arising out of abusing the international tax law principles

1. *Conflict of double taxation* (for example: an income is taxed in two states at once):

- The same tax is levied by two or more states
- to the same taxpayer,
- in connection with the same tax subject, and
- for the same period.

The main problem is the *collision of the principle of residence and the principle of source*. The definition of *the principle of residence*: in general, a state levies a tax by the *domestic residence*, the domestic residence is determined by the connecting criteria, who is concerned as domestic in the tax law (for example Hungarian PIT - who is a Hungarian citizen and has a permanent residence in Hungary - or habitual residence is in Hungary - if he stays in one place for 183 days in a year, or where the centre of existence is, e.g.. the place of most important family and economic ties). This is considered as *personal connecting criteria*.

Source principle: where the income is generated, there must also the tax be paid. This is the economic, territorial connecting criteria. The principle of general and proportionate sharing of taxation: everyone has to contribute the general and proportionate sharing of taxation in proportions to property and financial conditions in the state of residence. Everyone shall contribute to public services where it is actually availed. By the general and proportionate sharing of taxation the citizens obtain a part of the paid taxes in form of public services. The solution is: limitation or exemption, in the treaties between the member states avoiding the double taxation.

2. *Conflict of tax evasion/tax avoidance*

First of all we need to make differences between the definition of tax planning, tax avoidance, tax evasion and tax fraud.

Tax planning: tax minimization, tax optimization – accepted activity in international law, that is carried out by the tax experts, the question is to find the limit, where the stages of this violate the law.

Tax avoidance: it is at the border of criminal grade, it can be allowed, there is no illegality.

Tax evasion: it always has a purpose that violates the law.

Tax fraud: the highest rate of tax evasion, it falls under criminal law provisions, and it can lead to tax evasion, and there is always violation of law.

3. *Conflicts concerning tax heavens, off shore companies*

These are the so called off-shore companies: it does not violate the criminal law but does violate the tax law principles - source principle, principle of general and proportionate sharing of taxation - there activities are in any case illegal.

4. *Conflicts because discrimination between foreign and domestic taxpayers*

Discrimination can be

- positive: it can occur in the form of tax relief, for example when in Hungary the foreign off-shore companies had to pay only 3% instead of 18% (until 2004.)
- negative: a foreign taxpayer does not receive the same tax benefits as a domestic (for example. Bachman-case: A German dentist is settled in Belgium, he starts its work there, and he is not subject to those tax relief as a German enterpriser; In Hungary until '96 foreign individuals could not be self-employed
This is linked to two other important international tax law principles:
- *national treatment principle* = principle of equity: the foreign tax payer has to be the subject to the same reliefs and exceptions as the residents, this is violated for example when the state grants the foreign investors investment tax credits, so the foreign capital can be lured to the.
- *the principle of competitive neutrality*: to each taxpayer, whether foreign or domestic has to be granted the neutral economic environment.

5. *Conflict of the harmful tax competition*: a tax competition is harmful when it bends the economic competition (for example investment tax credits granted for foreign investors) it can occur in a single state or even in the EU, i.e. also between states. We can talk about it, if someone does not contribute to public services at the place of usage.

ECOFIN Council rules 1998. Code of Conduct for Business Taxation(2): it is not a source of law, it is not executable, and it is not enforceable, but prevails by voluntary law abiding.

The Code of Conduct requires Member States to refrain from introducing any new harmful tax measures (“standstill”) and amend any laws or practices that are deemed to be harmful in respect of the principles of the Code (“rollback”). The Code covers tax measures (legislative, regulatory and administrative) which have, or may have, a significant impact on the location of business in the UNION. The criteria for identifying potentially harmful tax measure include: (3)

- an effective level of taxation which is significantly lower than the general level of taxation in the country concerned ;
- tax benefits reserved for non- residents ;
- tax incentives for activities which are isolated from the domestic economy and therefore have no impact on the national tax base;
- granting of tax advantages even in the absence of any real economic activity (off shore rules);
- the basis of profit determination for companies in a multinational group departs from international accepted rules, in particular those approved by the OECD;
- lack of transparency.(4)

6. *Conflicts arising out of breach of international tax law principles*:

The main conflicts are the cases of tax discrimination, when the countries ignore the rules of equity and neutrality, and make anti discrimination with foreign and inland taxpayers. The other example of this collision, if two states use the same connecting

criteria (residence or source principle), or violate the discrimination or sustain regulations that lead to harmful tax competition.

Summary the tax-law harmonisation what definition can we give to the *European tax-law*: The aim is not the establishment of a „Federal tax system, but the full implementation of the *requirement of national treatment* on the fiscal judgement field of movement of goods and services”, ultimately granting the enforcement of the uniform internal market, and in the 2. Art. of the Treaty of Rome enshrined four basic freedoms -goods, services, people (labour) and capital movements. Accordingly the main obstacles are those rules of the Member States that restrain the enforcement of the four basic freedoms, which result in *discriminative perception* of domestic and foreign goods and services, the problems *arising from the differences of the Member State's tax systems*, and the *double taxation*.(5)

IV. CONCLUSION – SOLUTION OF THE TAX LAW CONFLICTS IN THE EUROPEAN TAX LAW

The most significant solutions are in the decisions of the Court of Justice of the EU., and the results of the EU tax legislation. The secondary law sources are the directives connected with the taxes.

The soft law also gives a very important solution to the tax collisions of the Member States, so the Code of Conduct for Business Taxation with the” roll back” and “standstill” regulations resolve the discrimination between the domestic and foreign taxpayers., and gives solution to the conflict of the harmful tax competition.

The tax treaties connected with avoiding the double taxation also give solution to the conflicts of double taxation. The limitation or exemption is a good method to avoid the double taxation. In these treaties the limitations are differences, can be: overall limitation, per country limitation, income basket limitation and per-country basket limitation.(6)

The cases of the Court of Justice of the European Union, in which there were solutions of the international tax law's conflicts. *The case numbered C-210/06. of the ECJ is the Cartesio case*: The European Court was not allowed the freedom of the firm's establishment (EC Treaty Article 43-38.), if the aim of it a tax avoidance, tax evasion. In this case the European Court resolved the conflicts of harmful tax competition and the conflicts of tax evasion. The judgement in the Cartesio case suggests the nationality and residence of a firm must not be separated, and the freedom of the movement of firms does not cause tax evasion in the domestic state.

The CIBA case: C- 96/08 This case was connected with the double taxation. The Hungarian national law about training contribution is contrary to EU law, because of the double taxation of its employees located in Czeh Republic.(international treaties on avoidance of double taxation do not mention the training contribution) One of the judgement of the Court of Justice of the European Union is related to a Hungarian registered company's reclaiming of training contribution. The court examined in its preliminary ruling that the Hungarian national law about training contribution is contrary to EU law or not. The company was registered in Hungary but it had premises

in the Czech Republic as well and it had to pay this training contribution to Hungary after its employees located there also, despite the fact that the company paid all the contributions payable in the Czech Republic to the Czech state so the problem of double taxation arose. Since the international treaties on avoidance of double taxation do not mention the training contribution the Court should decide in the case. According to the Court's judgement these kind of double taxations are contrary to the EU law despite the fact that the Court of the European Union generally does not want to intervene into double taxation and interstate taxation issues leaving the regulation of it to the Member States.

Principle of tackle against the harmful tax competition: The repealed Hungarian off-shore rules:

The application of the so-called „tax paradise” “tax haven”(off-shore) rules had been a legal way for tax evasion and tax optimisation until Hungary joined the European Union in 2004.

The Act on Corporation Tax (7) regulated the preferential taxation of 'taxable persons operating abroad' (off-shore firm) until 1 January 2004. Such a foreign (non-resident) company is incorporated and established in Hungary according to the Hungarian Act on Business Associations, a limited liability company or share company with its headquarters in Hungary, that is owned in 100% by a foreign private person or legal entity (8) the incomes from sales may originate only from abroad, proceeds commerce abroad, it has a license granting concessions to companies that operate in free zones (9), it employs only Hungarian auditors, head senior executives, members of the board of supervisors, attorneys and employees, and the company and its members (shareholders) have only issued registered shares and do not have any direct or indirect business shares in other domestic business associations. Off-shore companies in Hungary had to pay only 3% corporation tax instead of 18%.

The elimination and abrogation of this rule, that is the complete eradication of it from the body of law on corporation taxation, can be evaluated as a special provision. (10) Off-shore firms, in case of existence of all the conditions detailed above, could be created in Hungary until 31 December 2002 and could claim for paying 3% corporation tax until 31 December 2005 so the off-shore firms and their tax reliefs were completely gone from the Hungarian legal material after January of 2006, since then these firms pay taxes like any other domestic firm does and no special provisions or denominations or other related preferences can be used by them. So the rule of tax haven ceased to exist in Hungary from 2006.

In these cases we can see the results of the EU tax harmonization, so the cases of the European Court of Justice can solve the conflicts and gives solution to the problems of the international tax law's conflicts, and relief from the collisions. The European tax law with its primary and secondary legal sources also resolve the collisions which came from the member states' different tax law system, so the European tax law gives answers to the international tax law's conflicts.

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- (8) 1996. évi LXXXI. Tv. 4.§. 28.f.) says: „the company has no members (shareholders) who are domestic persons; nor is there any domestic person among the members of the company's members (shareholders), or if one of the company's members (shareholders) is a public joint-stock company, no more than three per cent of the member's (shareholder's) subscribed capital is held by domestic person(s);”
- (9) It has a license issued by the Minister of Finance after 31 December 1992 registered by the Minister of Finance prior to 31 December 1996 and thereafter by the state tax authority.
- (10) The Act on XLVII. 2002. 303.§.(10) abrogated the favourable corporation tax regulations on „taxable person operating abroad (off -shore firms). Valid establishment until 31 December 2002, taxation validity (3%) until 31 December 2005.