Traditional and Alternative Routes to European Tax Integration

Sample excerpt

Chapter 5

Soft tax law: steering legal pluralism towards international tax coordination

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5.1. Introduction

Legal pluralism stems from the presence of multiple legal systems within a given geographical area. Its existence in the European Union is the natural consequence of European law being set up as a separate legal system, which interacts with national systems and generally prevails over them by virtue of its higher rank in the hierarchy of legal sources. Specific issues within legal pluralism arise as to how legal systems and their respective founding principles interact, giving rise to flows of legal values within the more general phenomenon of constitutional pluralism[1]. The analysis of the latter problems in the European Union exceeds the scope of this paper, which aims instead at opening up the debate on legal pluralism within the European tax community. The goal is to pave the ground for future analysis at the 5th GREIT conference[2] and to support a possible solution based on a correct development and to use soft law with a view to enhancing international tax coordination within the European Union.

This article will focus on soft international tax law. The increasing use of soft law is gradually eroding the structural features of national tax sovereignty in the international scene, giving rise to a silent form of international tax coordination, which requires specific attention[3] in order to link up the general analysis of legal pluralism with the specific problems of European tax integration.

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[1] Komárek considers constitutional pluralism as existing in the presence of various constitutional authorities that compete over the same territory and the same legal relationships. See on this, Komárek, J., Institutional dimension of constitutional pluralism, in Eric Stein Working Paper No. 3/2010, at 2.

[2] The 5th GREIT conference (Taxation and Human Rights in Europe and the World) is to be held at the European University Institute in Florence on 16 and 17 September 2010.

[3] This paper therefore explores the output of analysis carried out by Franco Roccatagliata in the 3rd GREIT conference book (see Roccatagliata, F., The European Commission's Soft-Law Approach and its Possible Impact on EC Tax Law Interpretation, in Pistone, P. (ed.), Legal Remedies in European Tax Law, IBFD Publications, 2009, at 69 and ff.) and brings the analysis of soft tax law within a more general pattern, as a follow-up to the one already carried out by the author in Pistone, P., Soft Tax Coordination: A Suitable Path for the OECD and the European

Soft law is turning into a key element for understanding how states exercise their taxing powers in cross-border situations in an era of economic globalization. Sweeping past the absolute nature of taxing powers, soft law is gradually emptying the power to tax of substance, although it formally remains at the national level In other words, the appearance of national taxing powers is driven by the invisible engine of soft law, which approximates tax rules in cross-border situations[4].

In particular, this paper will ascertain whether specific issues of legal pluralism arise in a field like direct taxation as a consequence of taxing powers being kept at the national level, while their exercise is conditional upon an ever-growing number of limits, set in order to secure the supremacy of another legal system, such as European law, but also to ensure a consistent development of an internationally accepted tax practice. For the purpose of achieving a complete analysis of such issues, the paper will more precisely identify the boundaries and components of soft international tax law, but will also differentiate it from other sources of law and their relevance from the perspective of securing international tax coordination within the European Union and beyond.

The limits to the exercise of taxing powers within the European Union are the outcome of negative integration of direct taxes through the interpretation of EU law by the Court of Justice (CJ), but also of normative action, known as positive integration. Positive integration either (partially) shifts such powers to the EU level by creating secondary EU law in the framework of tax harmonization, or achieves a substantially equivalent goal by coordinating the exercise of national sovereignty. The latter phenomenon must be regarded as an expression of international tax coordination and can affect the relations between the EU legal system and the national ones of the EU Member States through binding or non-binding legal instruments. Binding coordination relies on the production of a common normative framework that creates an actual obligation for EU Member States to comply with rules that can be produced through multilateral tax treaties, whereas the norms of non-binding coordination leave the production of their effects up to voluntary compliance by their addressees.

The outcome of the binding coordination of direct taxes within European legal pluralism is difficult to spot, with the sole exception of the multilateral Arbitration Convention, hardly ever applied in practice. By contrast, non-binding coordination of direct taxes is becoming increasingly important and has possibly only partly exploited its enormous potential of catalyzing the legal framework for cross-border taxation within the European

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Union to Address the Challenges of International Double (Non-)Taxation in VAT/GST Systems, in Lang, M. et al. (eds.), Value Added Tax and Direct Taxation – Similarities and Differences, IBFD Publications, Amsterdam, 2009, at 1161 and ff.

[4] According to Chiodi, G.M., La menzogna del potere, Giuffrè, Milano, 1979, this power is not where it appears to be, but elsewhere, and when you see it formally, this often means that it has been shifted somewhere else.

Union and worldwide. Soft law is perhaps the most important legal instrument for non-binding coordination of cross-border direct taxation within the European Union, but most scholars ignore the issues it raises and find it difficult to define its boundaries and use.

This paper more closely addresses the problems of soft law on the international tax scene, and looks at its elements, issues, function, types and use in order to determine whether or not it is a desirable instrument of international tax coordination. In particular, after exploring the relations between legal pluralism and international taxation within the European Union, the paper will define soft law (including the elements required for its existence, the ones that indicate its formation and which differentiate it from customary international law, the peculiar features that it may have in the field of direct taxation) and will analyse its current use in European and international taxation. The goal of this analysis is to make some concrete proposals on whether and to what extent it can be used to reconcile legal pluralism within the European Union and as an alternative route for European tax integration, achieving effective levels of international tax coordination.

5.2. Legal pluralism and international taxation in the European Union

Legal pluralism is intrinsic to cross-border taxation. It is particularly evident within the European Union, but clear indicators of its existence can also be detected in other OECD Member countries.

Much more than for the purpose of securing compliance with the supremacy of European law, the exercise of national sovereignty in cross-border situations by EU Member States is limited by (mainly bilateral) tax treaties, which they voluntarily conclude in order to prevent, limit or relieve international double taxation. Most tax treaties of the EU Member States are patterned along the lines of the OECD Model Tax Convention (hereinafter: OECD Model), which not only affects the drafting of tax treaty clauses, but also their concrete application, especially due to the Commentaries. Unlike other international treaties, tax treaties face legal pluralism as a natural condition for their application, since Article 3.2 OECD Model allows characterization based on the domestic law of either contracting state for terms not defined by the treaty, unless the context otherwise requires. This is possibly a necessary consequence of the absence of an international tax court and the need to secure effective application of limits on the exercise of taxing powers in the national jurisdiction of each contracting state.

Critical issues of legal pluralism in international taxation have so far been addressed in two different ways in the European Union. First, over the past fifty years the OECD has carried out enormous activity in the field of tax treaties, supporting their technically correct understanding and interpretation, but ending up in approximating tax treaty practice through a soft-law approach that in fact achieves a significant level of international tax coordination. Despite being free to decide whether, when and with what

states tax treaties should be concluded, OECD Member countries have in fact outsourced the substance of their tax treaty clauses, as well as most policy goals, to the OECD. Implicitly, they have also given the OECD their consent to set up the OECD tax treaty standards. In principle, OECD Member countries are free to include non-OECD standard clauses in their tax treaties, but in fact they are not keen to do so, because this would in fact harm the consistency of their network with the OECD standard and deprive them of the possibility of invoking the technically correct interpretation provided by the OECD Commentaries. The impact of OECD rules and principles is decisive within the EU internal market, considering that the settled case law of the CJ acknowledges them as expressions of generally accepted treaty practice. Furthermore, the consistent behaviour of OECD Member countries in tax treaties with non-OECD countries as well, which often use the OECD standard clauses, has turned the OECD into a worldwide standard for coordinating the exercise of taxing powers in cross-border situations through tax treaties. In other words, OECD Member countries have significantly removed their taxing powers of substance, while preserving them formally under their own jurisdiction. For all these reasons this paper will pay particular attention to soft international tax law rooted in the practice of the OECD Model and its Commentaries in order to build an alternative route to European tax integration.

Second, EU law regards tax treaties as part of national law[5]. Therefore, Member States must comply with the supremacy of EU law even when the exercise of their taxing powers is regulated by tax treaties[6]. CJ case law, however, supports the view that juridical double taxation is the outcome of a disparity resulting from the parallel exercise of national tax sovereignty, based on different connecting factors, whereas tax treaties merely allocate taxing powers[7]. Although this is indeed the function of tax treaties, on the interpretation of which the CJ lacks jurisdiction just as much as in respect of any other national law provision, some cases of juridical double taxation may arise from the different views that two EU contracting states have on the interpretation of defined or undefined tax treaty clauses. In such cases the correct functioning of legal pluralism within the European Union requires a different approach by means of negative integration to problems of juridical double taxation in order to secure the effective supremacy of European law over national law.

The two approaches to legal pluralism in international taxation will be defined for our purposes as the soft and hard approach to international tax coordination and currently correspond to the prevailing ones from the perspectives of the OECD and the European Union. Hard obligations stem, however, from tax treaties and negative integration of

[5] See CJ, 19 January 2006, Case C-265/04,*Margareta Bouanich v Skatteverket*, para. 51.

[6] CJ, 21 September 1999, Case C-307/97*, Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt*, para. 57.

[7] CJ; 14 November 2006, Case C-513/04 *Marc Kerckhaert, Bernadette Morres v Belgische Staat*, paras. 20-23.

European law; soft ones mainly come from the OECD Model and its Commentaries, but often also include frequent statements by the European Commission. This framework indeed shows a fairly complex and random interaction between soft and hard obligations for EU (and OECD) Member States arising from both tax treaties and European law. International tax coordination requires instead an appropriate combination of both approaches, in order to properly address the critical issues of legal pluralism, giving soft law its appropriate role to enhance the approximation of hard law to the extent required by the EU internal market and to achieve a correct functioning of legal pluralism.

5.3. Soft international tax law

5.3.1. Soft international tax law and the role of the OECD

The role of soft law in cross-border taxation has grown considerably over the past decade, turning it into the main conveyor of international tax coordination around the world. Various factors may have contributed to its success. Economic globalization was enhanced by the removal of economic and tax barriers in several geographical areas and has certainly increased the links between national economies. States seem to pay growing attention to best international tax practices worldwide, often voluntarily implementing them in their national tax systems. In the author's view, this indicates that they in fact perceive a much stronger impact of taxation on cross-border investment than the one traditionally acknowledged by economists[8]. Furthermore, insofar as soft law succeeds in spreading the acceptance of a given tax measure so that it becomes an internationally accepted tax standard, it is likely to lead more states to comply with it, thus securing a smoother path for achieving more far-reaching results of international tax coordination than the one that binding measures of hard law can have.

[8] Elsewhere (see Pistone, P., Tax treaties and developing countries, in Lang, M. et al. (eds.), Tax treaties from a legal and economic perspective, Linde Verlag, 2010 forthcoming) the author suggests that the position held by economists is based on a too general understanding of tax treaties, which are instead much more complex as to their rules, function and features, than a single homogeneous block as the economists seem to indicate.