Dislocation refuted?

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1 Introduction

When professors Weber and Marres asked me to contribute to the Liber Amicorum of professor Wattel I of course was very happy and willing to prepare a contribution. There are a number of scholars whose academic work have been a source of inspiration for me and truly contributed to the development of my thinking, during the formative phase of my doctorate research for example and afterwards, and to this day. Wattel's work is one of the significant examples and I feel honoured to be allowed to now contribute to the Liber.

Wattel's intellectual creativity and academic independence have been an inspiration. I remember well studying his work at the time on the Court of Justice's (CJEU) *Bosal* judgment, where he observed that the Dutch interest deduction limitation in question actually is related to exempt income from foreign investments, and with the territoriality principle in hand perhaps indeed there is, or rather should be, something to be said about the merits of the Dutch tax measure as to its compatibility with EU law notions – from a conceptual standpoint that is as the Court ruled otherwise. I also remember well how I read about the analytical difficulties that he observed in the *Schumacker* doctrine, the threshold imposed by the CJEU that is, as a pre-condition for comparability in relation to any considering for individual income tax purposes of any personal related expenses, and that it perhaps might be more appropriate to adopt a more proportional approach here. More recently, I enjoyed reading how Wattel boldly calls the *Lexel* judgment a blooper, pointing out the implications of an EU law arm's-length-safe-harbour: the end of any cross-border-versus-domestic-differentiating unilateral anti-tax abuse instruments put in place by the individual Member States.

The same holds for Wattel's search for a system, for consistency, in Terra/Wattel's handbook 'European Tax Law' for example, and for years that is, not only in the current edition but in the earlier editions as well. A notable example of this, I think, is the line of thought in his book on the incomparability of domestic and cross-border scenarios, if and to the extent that the Member State concerned does not exercise tax jurisdiction in relation to the taxpayer's foreign activities involved. And that line, very interesting, is now reflected in the recent *Timac Agro*-inspired Opinion of Advocate General Collins in *W AG* (Case C-538/20). And that line, also interesting, seems at odds with what we saw earlier in, for example, *Bosal*, *Marks & Spencer*, *Lidl*, *Renneberg*, *Bevola* and all those other cases where the Court judged domestic and cross-border scenarios to be comparable in such cases. Wattel's underlying thinking here, I think, is that of the notion of 'dislocation', one of the concepts he developed and added to the discourse. It is this dislocation to which I would like to devote my contribution.

2 Obstacle

The spirit of the internal market essentially is about a desire for equal treatment and a legal guaranteeing of that. Within the scope of primary EU law, each Member State is obliged to treat taxpayers deriving income from cross-border (economic) activities in the same way as taxpayers deriving income from (economic) activities carried out only within the territories of the Member State concerned. The tax burden should not differ. Member States should not tax-treat taxpayers less favourably on the sole ground that they derive their income in a cross-border environment. Similarly, Member States are not allowed to tax-treat certain economic activities more favourably than other types of economic activities. Selectively favouring sectors or branches of industry, or individual market operators, is at odds with the prohibition of state aid. The CJEU is the designated EU-institution to ensure an equal treatment of economic operators by the Member States; the process of negative integration.

A difference in treatment imposed by a Member State by reference to nationality or (tax) residence is at odds with the principle of non-discrimination (discrimination). Such matters concern a different tax treatment of a taxpayer, typically imposed by the host Member State, by reference to a personal characteristic of that taxpayer. A taxpayer is treated differently, because of his nationality (direct discrimination), or because of his (tax) place of residence (indirect discrimination). Landmark CJEU cases in this area are *Avoir Fiscal*, *Saint Gobain*, *Denkavit Internationaal*, *Gerritse*, *Bouanich*, *Schumacker* and *Renneberg*. A difference in treatment based on the investment or work

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location/direction is at odds with the principle of neutrality (restriction). Such matters involve a different tax treatment of a taxpayer, typically imposed by the home Member State, by reference to a, say, locational characteristic of that taxpayer's source of income. A taxpayer is treated differently because of the geographical location of his source of income, or the direction in which he moves his economic activities. A taxable market operator (entrepreneur, investor, employee) is treated disadvantageously by a Member State for tax purposes vis-à-vis a comparable taxable market operator (entrepreneur, investor, employee) on the ground that the former taxpayer obtains his income (whether or not in part) abroad, or because he moves his economic activities abroad (outbound movement) or moves these activities in from abroad (inbound movement). Landmark CJEU cases here are *Lasteyrie*, *N.*, *National Grid*, *DMC*, *Commission v Portugal*, *Wächtler*, *Lenz*, *Manninen*, *Test Claimants in the FII Group Litigation*, *Haribo and Salinen*. It should be noted that the CJEU does not always strictly distinguish the terms discrimination and restriction and sometimes uses them interchangeably or as synonyms. I typically tend to refer to such differential treatments and their distortive effects for convenience purposes by reference to the term obstacle.

3 Disparity

The spirit of the internal market is also about the removal of internal borders, the establishment of an internal market without internal frontiers. Member States are called upon to make efforts to eliminate any market distortions resulting from differences between the operation of their tax systems. Such disparities influence the tax burden imposed and thus the decision whether or not to move across the national borders of a Member State in order to (or continue to) engage in economic activities in a cross-border environment. A lower effective tax rate abroad encourages investment there, as the after-tax income then is higher, ceteris paribus. A higher effective rate discourages this, ceteris paribus. The same applies to juridical double taxation or juridical double non-taxation, which arises when Member States use mutually different taxation principles (residence, nationality, source) to establish tax jurisdiction. Double taxation discourages the decision to set up economic activities abroad, whereas double non-taxation invites to do this. Both effects distort a neutral distribution of factors of production and supplies of goods and services within the internal market and are therefore essentially undesirable. The appropriate route to ensure an equal treatment of economic operators here is that of positive integration; harmonisation through EU legislation, secondary EU law. Primary EU law does not offer solutions here.

Disparities are market distortions caused by a difference between the tax systems of two or more Member States, producing economic double taxation or economic double non-taxation, for example, due to differences between country tax systems in the determination of the tax subject ('who to tax'), the object of taxation ('what to tax'), the geographical division of the tax base ('where to tax'), or the tax rate ('how much to tax'). A straightforward example is that of a rate disparity (*Eschenbrenner*). A relatively lower tax rate in Member State X (e.g. 20%) compared to Member State Y (e.g. 30%) encourages market participants to invest in Member State X, ceteris paribus. After all, every €1.00 return before tax yields €0.10 extra for an investment in member state X after tax (return after tax Member State X: €0.80; Member State Y: €0.70). Somewhat more complex are those examples of disparities and associated double taxation or double non-taxation due to classification, qualification and allocation differences (hybrid entity mismatches, hybrid income mismatches and transfer pricing mismatches). Disparities also arise where Member States rely on mutually different tax principles to base tax jurisdiction upon. One Member State links to the residence of the taxpayer, the other to the geographic source of the income, with juridical double taxation as a result. The same applies to juridical double non-taxation, which is also a disparity. Examples of a disparity due to a concurrent or parallel exercise of taxing rights can be found in the landmark cases *Kerckhaert-Morres* and *Damseaux*.

4 Demarcation

Any drawing of an analytical demarcation between the EU law notions of discrimination/restriction on the one hand and that of disparity on the other, is a complex and sometimes even controversial affair. The CJEU also seems not always that clear on this point, unfortunately.

I think the analytical dividing line here is, or should be, a binary one. Pivot point is whether the issue at hand lies *within* the operation of a tax system of a single Member State – then we are dealing with discrimination or restriction – or whether the issue at hand is the result of a difference *between* the operation of tax systems of two or more Member States, in their conjunct interplay that is – then we are dealing with a disparity. A convenient way to detect a discrimination or restriction – again inspired by Wattel's thinking – is to hypothesize that the tax system

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subject to assessment equivalently applies on the other side of the tax border as well. Via this approach one may be able to keep the mutual differences, the disparities that is, and the implications of these out of the analysis, out of the EU-equation. If in such a thought experiment the market distortion were to disappear, the tax system of the Member State concerned operates internally consistent. In such a case there appears to be no discrimination or restriction. This makes sense as the problem then does not lie within that system but is caused by a difference between the systems at hand, a disparity that is. If the market distortion does not disappear in the thought experiment, the tax system of the Member State at hand does not operate internally consistent. In such a case one is likely to be dealing with a discrimination/restriction.[1]

5 Dislocation

Then the dislocation, what about that? Matters here tend to emerge when it comes to establishing or assessing EU law positions in loss import cases, the question of cross-border loss offset eligibility for tax purposes under EU law; perhaps is the unruliest part of EU treaty freedom law in direct tax matters.

The issue at hand in matters involving loss import (in)eligibility under EU law is whether Member States are obliged – and if so, to what extent – to allow taxpayers to deduct foreign costs or losses or to offset them against domestic benefits or profits. This is the case where these Member States also allow a deduction or netting for tax purposes if the income components in question were derived from sources within the territories of the Member State concerned. Should a Member State allow for any offsetting of foreign 'minuses' with domestic 'pluses', if it would also do so if these 'minuses' and 'pluses' had been derived from domestic sources? Should Member States take a cross-border, international approach here? Or is that not necessary and is a strictly territorial approach sufficient? The latter has as a consequence that the foreign 'pluses' and 'minuses' remain entirely abroad for taxation purposes and only the domestic 'pluses' and 'minuses' are tax-taken into account in this regard.

The point is that where, on the one hand, a Member State does not allow its taxpayers to offset any foreign results (e.g. losses) against any domestic results (e.g. profits), that Member State hinders a proper functioning of the internal market. Strictly territorial tax systems render outbound investment less attractive compared to equivalent domestic investment. A territorial tax system that does not allow for cross-border loss offset encourages economic operators to invest in those Member States in which they are already present and derive taxable profits. After all, they can offset their (start-up) losses with their local profits for tax purposes in such cases. A territorial tax system discourages any outgoing cross-border investments, because any (start-up) losses incurred abroad cannot be offset against any domestic profits. Under territorial systems, it is more expensive from a tax perspective to cross the border than to stay at home. This distorts the functioning of the internal market which calls for neutrality. Although import-neutral territorial systems are production factor import-neutral, they are not production factor export-neutral.

[1] Notably, the CJEU regularly points out in its case law that the comparability of the domestic and cross-border situation requires the consideration of 'the aim pursued by the national provisions at issue' (e.g., CJEU, 12 June 2018, Case C-650/16 (*Bevola*), observation 32). At the same time, according to the Court, it cannot be the case that 'where national tax legislation treats two situations differently, they cannot be regarded as comparable' (observation 35). Otherwise, the right to freedom of movement 'would be deprived of its substance' (observation 35). 'Consequently, the comparability of the situations must be assessed with regard to the purpose of the national provisions at issue' (observation 35); according to the CJEU, that is. The Court's reasoning here, and rather unfortunate, is problematic, because of its analytical circularity. To the extent that the objective pursued by the national legislation is required to be taken into account in examining the comparability of cross-border environments vis-à-vis domestic environments under a meta-level EU law analysis, any examinator of the matter at hand will irrevocably get stuck analytically. Viz, any analytically sound reasoning under such a parameter necessarily steers the examinator to the observation that the circumstances differ as the regulation at hand treats these circumstances differently – as such is the purpose since otherwise the regulation at hand would have obviously done something else – and thereby and with that the finding that any differential treatment cannot be held discriminatory considering the differences in circumstances as observed by reference to the objective pursued by the national provisions at issue. One ends up in analytical circularity: "You are not being discriminated against but treated differently because the rules say – in line with their objective – that you find yourself in a different circumstance vis-à-vis the other, i.e., the person you are comparing yourself with." In this way, indeed, and in the words of the Court itself, one deprives the principle of equality of its substance, and which then gives the Member States the freedom to freely restrict and discriminate against any market operators seeking to make use of their freedom of movement. Things analytically go wrong in the Court's assessments where the Court seeks to deduce from its initial observation that "[c]onsequently, the comparability of the situations must be assessed with regard to the purpose of the national provisions at issue." There the Court ends up in a self-created analytical quagmire. What it perhaps should done is to observe that 'consequently the comparability of the situations must *not* be assessed with regard to the purpose of the national provisions at issue', for the fairly straightforward reason that the national measure involved actually is the object of the meta-assessment under supranational EU law. One can compare this to a mathematical calculation. There, the amounts put into the equation (national legislation) also do not affect the mathematical rules (principle of equality/comparability) and with also do not affect the outcome of the calculation (comparability analysis; conclusion whether or not there is an restriction/discrimination. In math whichever number combinations you choose, the mathematical rules remain the same. This should also be the case with the principle of equality. What the CJEU actually allows is that the aim pursued by the national measures involved (amounts) influences the principle of equality (calculation rule) and thus the outcome of the comparability analysis (calculation). And that simply cannot hold water. And I think that it is exactly this what explains the sometimes somewhat puzzling features and enigmatic naure of EU jurisprudence.

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On the other hand, if Member States do allow cross-border results to be offset a risk of a double loss relief arises, i.e., loss-relief in both countries involved and some potential double non-taxation as a corollary. In the presence of loss imports eligibility, there is a risk that a loss in Member State A in year 1, which is set off in Member State B that year against the profit in Member State B of that year, will then be set off again in Year 2, but then in Member State A against the profit in Member State A of that year. Double loss relief in the cross-border situation also is not neutral, as it is more advantageous compared to the domestic situation where such a loss is deductible once. Then it is cheaper from a tax perspective to cross the border than to stay at home. This also distorts a proper functioning of the internal market.

The question then is where the balance should lie, in the spectrum that is between loss import ineligibility on the one outer end and double loss relief on the other outer end. The CJEU's case law on this matter is rather erratic. In some judgments, the Court finds that the import of a foreign 'minus' is necessary (*Bosal*, *Marks & Spencer*, *Bevola*, *Renneberg*). In some other judgments, however, the Court seems to find this of some less relevance (*Lidl*, *X Holding*). In some other cases the Court has also found it acceptable that losses may be not deductible anywhere (*K.*). The Court has even ruled that losses could prove or at least potentially end-up being deductible twice (*Nordea Bank*), although it now seems to have returned from this position to some extent (*Timac Agro*). The latest development is the move towards a confirmation of *Timac Agro* by Advocate General Collins in his opinion in *W AG*.

This is where Wattel's dislocation comes in. If I am not mistaken, Wattel believes that whenever there is a tax-induced distortion in the functioning of the internal market due to a 'fragmentation of the tax base', a phenomenon that he coined as a dislocation, such a matter, or such an effect, cannot be resolved by the freedoms or via an interpretation of these. The pluses and minuses at hand are not geographically located within the same tax jurisdiction and however unfortunate there is nothing in primary EU law that can be resorted to, that is, to do anything about that about. In European Tax Law (2018 edition, Sec. 3.2.2.) I read that under certain circumstances it may be observed that there would not even be a comparability of cross-border scenarios at hand with any domestic equivalent scenarios. This is the case if the Member State concerned does not extend its tax jurisdiction to the foreign income involved, thereby making a reference to the considerations of the CJEU, inter alia, in *Timac Agro*. After all, as the handbook says: 'from a corporate income tax point of view, subject-to-tax is not comparable to not-subject-to-tax'. And this line of thought runs throughout the book, quite interestingly of course – and consistent too. Weber, incidentally, considers this type of market distortion, if I see it correctly, in his inaugural lecture in 2006 as a disparity (In search of a (new) equilibrium between tax sovereignty and the freedom of movement within the EC), thereby pointing to the considerations of the CJEU in *Futura*. Both Wattel and Weber accordingly position themselves on the one outer end of the spectrum of loss import ineligibility.

6 Dislocation Refuted?

Is there nothing in primary EU law doctrine that can be resorted to, to address any tax-induced distortions in cases where tax bases are fragmented across tax borders? Should we just accept the distortive implications of such a dislocation? I think we should not. And I also think that a dislocation does not exist in EU law, or at least not as an analytically distinctive concept or phenomenon. And I also think I couldn't have devised the train of thought set out below in substantiation without Wattel's thinking, and Weber's for that matter, and their academic shoulders to stand on as a steppingstone.

With Wattel I also think that jurisdiction-exercise implies comparability: '(No) jurisdiction? (No) comparability!'. Unlike Wattel, I however do not think that the scope or extent of such an exercise of jurisdiction should be available for Member States to be freely used to subsequently base upon a differential tax treatment, for example by reference to the place of residence (for example, by establishing an unlimited tax liability for resident taxpayers and a limited tax liability for non-resident taxpayers) or the investment location/direction (for example, by subjecting taxpayers to tax only on domestic sources of income and thereby fragmenting the internal market). Although perhaps far-reaching, I honestly see such a differential tax treatment on this basis as an obstacle eligible to (actually) be solved under the freedoms. This is because the distinction here lies within the operation of a single tax system of a single Member State, and, hence, can also be resolved by that single Member State. The problem of the differential tax treatment here also does not disappear in the thought experiment. And moreover, I just cannot accept and agree to an adhering and accepting of a notion of dislocation – and by extension the line of thought derived from *Timac Agro* – and thereby a de-facto-embracing of a territorial tax system, and market fragmentation

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as a corollary, in a market environment that is envisaged as a single market without internal frontiers. Noteworthy, the European Commission has described the limited possibility of cross-border loss relief as one of the main obstacles to cross-border business activities and an effectively functioning internal market (COM(2006) 824).

There is no necessity to throw in the towel and by inference there is no necessity to accept as a given the market distortion dubbed as dislocation. On the contrary, there actually is a unilateral tax model conceivable in which such a dislocation does not arise in the first place, namely a model in which unlimited tax liability of all economic operators – either corporate or individual – with a domestic source, regardless of their place of residence, is combined with a double tax relief mechanism to prevent double taxation in a way akin to the operation of the double tax relief mechanism in the Dutch individual income tax system (and the Dutch company tax system until 2012), the 'belastingvrijstelling': i.e., a proportional reduction in the tax due on the worldwide income earned by an amount equal to the domestic tax that is attributable to the foreign income of the taxpayer concerned (basically a tax credit at an amount equal to the second limitation under a typical ordinary credit mechanism however then operated as a default mechanism, that is without a first limitation). A calculation of the effects of this model – respectfully paraphrasing Van Raad by coining such as 'taxing the fraction' – leads to the observation that any cross-border movements of taxpayers and their income-generating activities will have no effect on the tax burden whatsoever, from the unilateral perspective of a taxing Member State concerned; this, in comparison with the tax burden in a purely domestic/national context. Neither the nationality of the taxable person nor his place of residence would have any effect on the tax burden imposed. There would no longer be any unilaterally imposed differences in tax treatment between domestically and internationally operative taxpayers. The model functions completely non-discriminatory. Nor would there no longer be any unilaterally imposed differences in tax treatment between the domestic and international economic activities of those taxpayers. The investment location/direction or work location/direction (inbound/outbound) would have no effect on the tax burden. It would not matter whether a taxpayer earns the income in a purely domestic environment or in an international environment. The model functions completely non-restrictive. A calculation – see for some references to further reading the footnote below – illustrates that the tax burden in the domestic and cross-border environment is identical, in terms of rate progressivity, in exit tax matters as well as in cases involving cross-border losses.[2]

7 Closing comments

I am expressing my gratitude once again to the Liber editors for the provided opportunity. Market distortions caused by dislocations are unilaterally solvable, that is with a tax model that combines unlimited tax liability with a made in the Netherlands 'belastingvrijstelling' for double tax relief purposes for every taxable economic operator with a locally taxable source of income, regardless of his residence and regardless of the geographic locations of his source(s) of income. The EU principles of equality and neutrality would be fully respected and in an internally consistent manner. The model would operate in full harmony with the fundamental freedoms, as there would in fact no longer be any unilaterally imposed obstacles in existence. All would be gone. The 'justified discrimination/restriction', steps 2 and 3 in the CJEU's decision schedule in treaty freedom cases, would no longer exist as these steps would coincide in a final interpretation of the treaty freedoms in direct taxation matters. Is such a system as outlined practically feasible? There will be practical objections, of course, such are always there. However, for practical objections we have practical solutions. And such are always there too, if one only wants to.

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[2] See M.F. de Wilde, 'European Union - What if Member States Subjected Non-Resident Taxpayers to Unlimited Income Taxation whilst Granting Double Tax Relief under a Netherlands-Style Tax Exemption?', *Bulletin for International Taxation* 2011, no. 6, M.F. de Wilde, 'European Union - Currency Exchange Results - What If Member States Subjected Taxpayers to Unlimited Income Taxation Whilst Granting Double Tax Relief under a Netherlands-Style Tax Exemption?', *Bulletin for International Taxation* 2011, no. 9 and M.F. de Wilde, 'European Union - Intra-Firm Transactions – What if Member States Subjected Taxpayers to Unlimited Income Taxation whilst Granting Double Tax Relief under a Netherlands-Style Tax Exemption?', *Bulletin for International Taxation* 2011, no. 12.

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