The voice of banking & financial services

BBA Response to "The Government's review of the balance of competences between the United Kingdom and the European Union: call for evidence on taxation"

The British Bankers' Association (BBA) is the leading association for the United Kingdom banking and financial services sector, representing over 200 banks, which are headquartered in 50 countries and have operations in 180 countries worldwide.

The BBA welcomes the opportunity to contribute to HM Treasury's consultation "The Government's review of the balance of competences between the United Kingdom and the European Union: call for evidence on taxation".

We would, of course, be happy to clarify any points raised in these comments.

General Comments and Key Issues:

Before responding to the questions posed in the review, it is important to note that the BBA's membership place great importance on the UK's membership of the Single Market, in recognition of the linkage between the Single Market and the success of the financial services industry in the UK and London's place as a global financial centre. However, equally important is maintaining the attractiveness of the EU as a place to do business and the capacity of the EU to either enhance or diminish competitiveness.

The EU stance on taxation has at times been at variance with the views taken by other jurisdictions, which has competitive implications for the EU. This has potentially led to proposals or measures that do not fit with the globalised nature of modern financial services or business generally. In future, we would encourage a greater focus on ensuring that action taken at Union level is justified, proportionate and enhances the EU's competitive position vis- a-vis Third Countries.

In principle, and theoretically, the possibilities offered by facilitating a better co-ordination of tax systems across the EU are welcome. Initiatives such as a Common Consolidated Corporate Tax Base (CCCTB) or a Common EU Standard VAT Return could enhance the business environment of the EU and reduce the administrative burden on businesses. However, in practice the reality is that too often the theoretical benefits are lost in the execution. The reasons for this are manifold, including, inter alia: the approach taken to consultation; the different approaches of Member States (MSs) towards tax compliance; the differing stages of maturity of the economies and financial services sectors of the MSs; and the interaction with the political context.

There is an issue about the ability of EU institutions to appreciate the degree of complexity that can be involved in making tax changes sit appropriately with local regulatory and operational differences. Care would need to be exercised if EU bodies were to be given more power in the area of tax to force through changes. A move to qualified majority voting in relation to tax in particular may present difficulties; mechanisms to accelerate the process of getting unanimity and pragmatic implementation, however, should be further considered.

There is also a significant contrast in the approach of the European Commission and other MSs to that of the UK when it comes to the tax policy making process and the relationship between revenue bodies, taxpayers and tax intermediaries. The UK's consultative approach

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towards tax policy making, which has been consolidated over recent years, has led to more effective, proportionate legislation. The EU policy making process is less consultative, with the role for business less clearly defined. It is vital that, in future, the Commission carries out the widest possible consultations and impact assessments (especially country by country impact assessments) in advance of making proposals for legislation. The Commission ought to provide clear consultation documents, consult all relevant target groups, leave sufficient time for participation, publish the results and provide feedback. There may also be value in the Commission carrying out cost benefit analyses. We would also encourage greater transparency from the Council of Europe, as at present the policy making process seems to be reliant on judicious leaking of documents.

Specific Consultation Questions

Impact on the national interest

1) What evidence is there that EU-level action on taxation advantages the UK?

EU level action on taxation has mainly been advantageous in underpinning the fundamental principles of the Single Market. For example the Mergers Directive and the Parent-subsidiary Directive remove potential tax charges which could otherwise arise on restructuring or expanding businesses and on repatriating profits. This benefits UK groups wishing to trade, or to restructure businesses, in Europe.

Action taken to improve exchange of information between States, such as the EUSD, also benefits the UK by minimising opportunities for tax leakage resulting from concealed offshore savings.

2) What evidence is there that EU-level action on taxation disadvantages the UK?

In the VAT area, the Court of Justice has increasingly been refining and restricting the extent of MSs' ability to apply and operate the tax in a manner appropriate to their national jurisdictions. Due to a lack of clarity on the purpose behind sections of the VAT Directive the Court's decisions often end up unexpectedly overturning long-held national interpretations leading to significant Exchequer cost, and to long periods of uncertainty for business.

The lack of uniform implementation between MSs of what should be a common VAT framework also creates a financial and administrative burden on business (which in turn raises questions about the neutrality of VAT as an EU tax). Businesses are also negatively impacted by the need for significant investment of technology and processes to address the self assessment of VAT but without uniform application across the EU, there is less opportunity for businesses to create systemic synergies.

3) What do you think are the main considerations in determining the appropriate level for decisions to be made on tax policy?

The main considerations are:

- Need to ensure sufficient harmonisation at the strategic level to ensure that fundamental freedoms and principles of the Single Market can operate efficiently;
- Cost and complexity of achieving agreement to harmonised measures, which can paralyse progress and lead to long periods of uncertainty;
- Undesirability of complete harmonisation given MSs' needs to set their own domestic policy and tailor their tax systems to support that – there is a need to respect the principles of proportionality and subsidiarity; and
- Whether there will be a proper consultation with business and other stakeholders to understand the impact of measures proposed, with proposals then being refined accordingly

4) Are there any other impacts of EU action on taxation that should be noted, including as regards the process for taking action (for example unanimity versus qualified majority voting)?

The need for unanimity means that changes to tax law tend to proceed at a slow pace, consuming significant resource and creating prolonged uncertainty. We have seen that both in the area of VAT reform and in relation to proposed moves towards the CCCTB. Qualified majority voting might lead to a faster pace and ultimately to less differentiation between different tax systems. However the cost is obviously an important loss of sovereignty in the ability of individual MSs to control a fundamental tool of economic policy. The need for unanimity is therefore advantageous in terms of protecting the UK Exchequer and UK business from potentially damaging proposals, such as that in relation to the Financial Transaction Tax.

There is also an issue about the ability of EU bodies to appreciate the degree of complexity that can be involved in making tax changes sit appropriately with local regulatory and operational differences, and there may therefore be a concern about giving EU bodies more power to force through changes that would not be in the national interest. The BBA is therefore of the view that a move towards a greater use of qualified majority voting in relation to tax should be opposed, however mechanisms to accelerate the process of getting unanimity and pragmatic implementation should be further considered.

The current approach to the Financial Transaction Tax seems to be demonstrating that tax measures can be introduced by a mechanism which involves a qualified majority vote (in terms of allowing the enhanced cooperation to proceed). We think that this example is demonstrating the need for some additional protection to be included in the enhanced cooperation process. Where unanimity cannot be achieved, we suggest that the enhanced cooperation process should be modified, such that it does not allow the subset of MSs which are proceeding with the relevant measure to impose extraterritorial taxes or tax reporting obligations on citizens and businesses resident in MSs which are not participating in the enhanced cooperation. This would seem to be a reasonable protection for non-participating states, and obtaining that protection would appear to be a reasonable benefit of membership of the EU (which otherwise requires multiple bilateral tax treaties).

Future options

5) How might the UK benefit from the EU taking more action on taxation? Please provide specific examples, identifying where possible the pros and cons.

The question is difficult to answer as it depends very much on what action could be taken. Actions which would benefit the UK include:

- More action against harmful tax competition - could help the UK compete against say Ireland and Luxembourg as a location for funds.
- Common Consolidated Tax Base/rate harmonisation - pros would includes consistency of reporting for UK groups, but the con would be the loss of the UK's ability to determine its own tax base, the consequences of which are extremely difficult to predict.
- Faster action in removing cross-border withholding taxes which are a drag on the performance of UK (and other) funds investing outside Europe.
- Removal of all withholding taxes on payments within the EU.

6) How might the UK benefit from the EU taking less action on taxation? Please provide specific examples, identifying where possible the pros and cons.

The BBA considers that there is a need for more effective decision making and that where national interests are holding back EU progress, effective decision making is required. As noted elsewhere, the difficulty is the need to balance that with appropriate protections. Businesses are hurt by the limbo created by the slow progress of the legislative process, and the uncertainty and expense that ensues.

7) How could action on taxation be undertaken differently? For example:
7a) Could more action be taken at the national level? If so, what domestic legislation would be needed on taxation in the absence of EU legislation, for example to take account of issues around international trade and cross-border transactions?

The BBA considers that there is a need for some overriding principle to ensure no tax blockages to freedom of establishment / trade within the Single Market. It is hard to see how that could be enforced without some EU legislation. Perhaps, though, EU action should be confined to setting broad principles, and leaving domestic legislatures more flexibility to decide how to apply them.

7b) What action could best be taken at other international levels (by a different body or institution)?

Securing agreement to broad consistent principles at OECD / G20 level would seem a sensible approach.

8) What future challenges and opportunities might the UK face on the balance of competence on taxation? What impact might different scenarios for the future development of the EU have on the national interest?

The challenge appears to be how to balance the need for sufficient cohesion in the tax area to underpin the single market with the difficulty of trying to achieve a workable process for workable legislation which takes sufficient account of individual national interests and sovereignty. It seems likely that, as unanimity becomes an increasing barrier to effective action, there will be more pressure from other MSs for qualified majority voting. A scenario where there was significantly more EU legislation which could not be vetoed could significantly damage the UK national interest (as with the FTT, where if the original Commission proposals had been pushed through without the need for unanimity there would have been a disproportionate impact on the City of London, and where there is still the likelihood of adverse impact on the UK as a result of the enhanced cooperation).

General

9) Are there any general points on competence you wish to make that are not captured above?

No.

1 March 2013
British Bankers' Association

1 March 2013

BY EMAIL

[redacted]

Re. Review of the balance of competences between the United Kingdom and the European Union: call for evidence on taxation

Thank you for the opportunity to input into HM Treasury's Balance of Competences review on taxation. The purpose of this short response is to register our interest in the review and ask that the impact of EU-level action on the UK charity sector is considered as part of the process. We appreciate that the deadline for submissions was 22 February – we apologise for the delay and hope that you can still take the points made below into consideration.

Our organisations, Charity Finance Group (CFG) and the National Council for Voluntary Organisations (NCVO) are charities and membership bodies representing charity finance professionals and the wider voluntary sector respectively. For further information please see www.cfg.org.uk and www.ncvo-vol.org.uk.

Below is a brief summary of some of the key issues relating to charity taxation, and its interplay with the EU.

Charities and taxation

The charity tax regime is complex. Charities commit a significant amount of time and resource understanding and applying regulations, managing the burden of compliance, and seeking to ensure they can make use of the valuable tax reliefs available to them. However, it is the VAT system more specifically that poses one of the biggest challenges for the UK charity sector.

VAT is underpinned by the premise that the cost of a service or product is ultimately borne by the final consumer, yet charities operate outside this underlying principle as they rarely charge for the goods and services they provide. The result is that charities face an un-level playing field when it comes to VAT, with this irrecoverable VAT estimated as costing the sector £500 million per year. The costs of any VAT rises are also borne by charities themselves (as opposed to the final consumer), further exacerbating the problem.

The VAT reliefs available to charities are therefore extremely important in going some way, in certain areas, to correcting this unjust structural inconsistency. Zero and reduced rates are extremely valuable to charities, allowing them to undertake activities which might otherwise be unaffordable.

The impact of EU decision-making

In light of these points and VAT's status as a European tax, many decisions taken at an EU level regarding VAT have a significant impact on the sector. The EU has been open in its desire to harmonise the VAT regime across Member States and moves in this direction have been made since the early 1990s.

While a simpler, more uniform VAT system may be desirable, the form and activities undertaken by civil society organisations will vary considerably between EU Member States. Therefore legislation which may be appropriate in one country will not be appropriate in another. The differences in the role played by civil society between countries is a result of long-standing cultural and historical factors and are unlikely to converge at any point, particularly in the near future.

It is also worth noting that the rationale for providing tax reliefs and exemptions for charities (and the shape these take) will vary between Member States, again due to historical and cultural reasons. In the UK charity tax reliefs exist to support the sector in recognition of charities' public benefit function, and to encourage giving, but other countries will be different. It is important that the UK is able to continue to recognise the contribution charities make to society in this way.

While we acknowledge the benefits of a harmonised VAT system for the efficient functioning of the internal market, it is essential that Member States are able to respond to national needs and circumstances. Moves to simplify and harmonise the VAT regime across the EU have in some cases proved detrimental to the UK charity sector and we would urge caution on any efforts to harmonise direct taxation.

The impact of EU-decision making: examples

Outlined below are a few recent examples of changes to tax policy, influenced or driven by the EU, which have impacted on the UK charity sector. For each we have briefly described a few of the issues arising and associated tensions between decision making at a European and national level.

- **The VAT cost sharing exemption**

  The VAT cost sharing exemption – Article 132(1)(f) of the Principal VAT Directive – has recently been introduced into UK law. Before implementation, it was hoped that the exemption would allow charities to adopt shared service arrangements, by removing the most significant barrier to this type of collaboration: the VAT charge which in most cases offsets potential cost savings and/or the expected value from working together.

  This was an exemption originating from the EU and the Government introduced the exemption only after strong pressure was placed on it by the European Commission (although this is not to ignore the contribution lobbying efforts from charities and other sectors hoping to avail of the exemption made) – clearly a positive. However, interpretation and use of the exemption varied

considerably between Member States, prompting the European Commission to enforce a more uniform application across the EU.

The result is that while the UK has applied the exemption, the lack of flexibility to deviate from the EU's interpretation has meant there has been little take up from charities. While it is understood that legislation simply can't be tailored to suit the needs of individual groups, this case nonetheless demonstrates that *in seeking to ensure there is uniform application of a measure across Member States, the policy objectives cannot be met in all countries. It also leads to a degree of frustration about the lack of flexibility* – in this case the Government was extremely receptive to charity concerns and recognised that the irrecoverable VAT on shared services was problematic, yet was not able to go as far in addressing this as it would otherwise be willing to due to European restrictions.

- **Removal of the VAT zero rating for approved alterations to listed buildings**

In Budget 2012 it was announced that a number of VAT 'anomalies' would be corrected, one of which was the treatment of alterations to listed buildings. Under the new proposals alterations would be charged at the standard (rather than zero) rating to bring the VAT treatment in line with repairs. While in principle harmonising the treatment of alternations and repairs appears a sensible step, the reality is that withdrawing of the relief will impact significantly on the upkeep of UK heritage assets. For charities (and others) owning or using listed buildings it will significantly reduce what is financially viable in terms of the upkeep and preservation of these assets.

This move was taken by the UK Government rather than coming directly from the EU, however what is concerning regarding the policy making process is that *removing a zero rating today leaves no scope for a re-think tomorrow. The number of valued zero ratings which charities make use of can only decrease.* If future governments find that long-term, the move has a detrimental effect on the preservation of heritage assets in the UK they will have to explore other means to addressing the problem rather than reinstating the zero rating.

- **Removal of the zero rate for supplies of business research**

The Government has recently announced plans to withdraw the zero rating for qualifying supplies of business research, following pressure from the EU. A number of charities, including hospices and other research bodies, have indicated that they will lose out as a result of the change – some saying it will lead to a reduction in the amount of research commissioned.

As stated previously, zero and reduced rates are extremely valuable to charities and are factored into long-term income and expenditure plans. *We strongly oppose the further withdrawal of any zero or reduced rates and this view was put forward in CFG's response to the recent European Commission review of existing legislation on VAT reduced rates. We hope HM Treasury can support our position.*

- **Extension of UK charity tax reliefs to EU and EEA equivalent organisations**

In 2010 UK charity tax reliefs were extended to certain organisations which are equivalent to charities and Community Amateur Sports Clubs (CASCs) in the EU and in the European Economic Area (EEA) countries of Norway and Iceland. At the time concerns were raised that extending

reliefs to other Members States would dilute the impact expenditure from the UK government would have within this country. While this has not proven to be the case, it highlights concerns around the potential cost impact of further harmonisation. It would be extremely concerning if the obligation to harmonise across the EU makes a relief financially unviable – particularly pertinent given the challenging economic climate.

Lack of knowledge at an EU level

One issue at the heart of this is that to make effective tax policy decisions, a solid grasp of the economic and social implications a measure will have is essential. Accurately calculating the impact of a measure is no easy task and despite taking decisions in good faith the UK Government, on occasion, overlooks or miscalculates how a policy will affect the UK charity sector. It is therefore difficult to see how tax policy can be effectively set and targeted to meet specific national needs at a supranational level.

We hope the points raised in this response prove helpful. We would like to take this opportunity to offer CFG and NCVO's support to HM Treasury in undertaking the review. With a combined membership of in excess of 12,000 we are well positioned to draw on the experiences of a wide range of charities should you want to further explore any of these issues. [redacted]

Yours sincerely,

[redacted]

Jane Tully
Head of policy and public affairs
Charity Finance Group

[redacted]

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Chartered Institute of Taxation
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22 February 2013

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Balance of Competences Review – call for evidence on taxation

The Chartered Institute of Taxation (CIOT) refers to the call for evidence on taxation published by HM Treasury in November 2012.

Overview

The key word in the consultation document is 'balance'. Balance is recognised in European Law as part of the principle of 'subsidiarity'. According to that principle, the European Union (EU) only has competence in areas where the action of individual countries is insufficient.

It is *prima facie* desirable that national rules should be harmonised or modified when this helps to facilitate cross-border trade or the exercise of the fundamental treaty freedoms. However, while harmonisation may in theory be desirable, obviously its desirability in practice may depend on the precise form of the proposals and their impact on national interests. The development of proposals raises questions about the decision making process in the EU.

Although the European Commission has recently taken steps to increase the transparency of the legislative process, one of the main problems with the EU has been a lack of transparency, particularly when decisions are taken in the Council. This often makes it difficult for businesses and other interested parties to make constructive contributions to the debate and to point out short comings with proposals.

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Problems are also frequently caused by the requirement of unanimity; achieving this, or failing to, results in reforms either being blocked or based on compromises. The potential problems that can arise can be illustrated by the proposals for a standard VAT return.

In principle businesses might welcome the idea of having standardised returns, since this might make it easier to conduct cross-border trade. However, this is subject to the important caveat that whatever is proposed should not place too onerous a burden on business. The UK's VAT return is very simple; the returns used by some other Member States are much more complicated. The requirement for unanimity in agreeing the standardised return means that there are dangers that the proposals are either not implemented or will be implemented in a manner that imposes disproportionate burdens on business, as each country seeks to ensure that all the information they currently obtain is retained in the standardised return. We can see that national vetoes can act as a protection against disproportionate burdens being imposed on business and actions being taken contrary to a particular national interest. However, they can also act as a block on reforms.

Achieving balance

The tension between creating a level playing field within the internal market and a reduction in burdens for cross-border business activities on one hand, and the ability of member states to respond to specific national circumstances and make national choices on the other hand, is recognised in the consultation document.

In the context of cross border trade and free movement of goods and services, administration simplification should remain a priority if growth in trade and goods and services is not to be inhibited by the tax system. This should be an aim irrespective of whether tax measures are implemented at EU or at Member State level.

Even in areas such as VAT, which is based on a European Directive, problems are caused by the considerable latitude given to Member States. Problems are not only caused by the different ways that measures are implemented into national law but also by the manner in which measures are interpreted and by the fact that Member States are frequently given power to derogate. There are two types of derogations – specific derogations applied for by Member States, such as those under article 395 of the Principal VAT Directive, and those generally permitted by the wording of the EU legislation, for example provisions that leave it to Member States to define eligibility for exemptions. In principle, derogations from generally applicable legislation should be kept to a minimum and should not interfere with cross-border trade. As cases such as *The Commissioners for Her Majesty's Revenue and Customs v RBS Deutschland Holdings GmbH* (Case C-277/09) illustrate, lack of harmonisation can result in double non-taxation. However, from a business perspective, it also gives rise to dangers of double taxation and protracted disputes with tax authorities. Steps need to be taken to avoid or minimise these problems.

The CIOT conducted a survey of our members when formulating its response to the Commission's consultation on the future of VAT. Many of our members pleaded for EU law harmonising not only in relation to the structure of VAT but also in relation to how it is administered: see www.tax.org.uk/tax-policy/public-submissions/2011/Green_Paper_VAT. Some work has been done in this area but more needs to be done. Indeed the complexities of doing business in the Union are such that we are aware that some businesses prefer to do business with third countries rather than with other EU Member States. Some purported simplification measures, such as triangulation, can be so complex that businesses prefer not to use them.

As the call for evidence notes, the measures relating to tax in the Treaty on the Functioning of the European Union (TFEU) are unusual in that they require unanimity rather than qualified voting. This is the case even in relation to subsidiary legislation, for example Council Regulation 282/2011 on the implementation of the Principal VAT Directive. As is also noted, this has permitted the UK Government (and governments of other member states) to retain a large degree of control over UK tax affairs but it also means that there can be difficulties in relation to cross-border matters since there is no way to quickly fix a problem that impedes cross-border trade.

On direct taxes, there have been a number of Directives agreed. Implementation by member states has varied and infringement proceedings have been taken against some states in this respect. The Parent-Subsidiary Directive and Mergers Directive have been technically desirable and could, in that sense, be seen as largely positive moves. However, the Interest & Royalties Directive and the Savings Directive have been constrained by difficulties in obtaining wide agreement to detailed terms and are consequently seen as political compromises which give rise to problems of practical application.

Although not specific to tax, the overarching requirements of the TFEU - the free movement of people, goods, services and capital (the freedoms), State aid and anti-discrimination provisions – have also affected member states' tax regimes to a significant extent, and probably much more than many people anticipated. The provisions in the TFEU on State aid have resulted in effective challenges to an increasingly large number of domestic tax arrangements of member states, eg aggregates levy in Northern Ireland and plans to devolve that levy and air passenger duty in Scotland. Also, general anti-discrimination rules regarding the freedoms in the TFEU have given rise to infringement proceedings on tax issues.

Certainty

For the taxpayer, a key issue arising from the application of EU law in the UK is one of uncertainty. The main institution tasked with ruling on EU law is the Court of Justice of the European Union (CJEU). Unfortunately the judgments of the CJEU are not always very clear. This can frequently result in protracted litigation in the national courts and also multiple references on the same issue. It is possible that reforming the procedures of the CJEU could result in improvements. For example, requiring the Court to adopt a 'precedent' system would help individuals, businesses and advisers predict with greater certainty how the court might rule. As it is, there are a number of decisions where the Court appears to have developed its reasoning without ever over-ruling a prior case. It might be worth considering giving the parties an opportunity to comment on judgments and opinions before they are finalised in case they consider that the questions put have not been answered in a manner capable of application nationally. This would slightly lengthen the decision making process but it may have the benefit of reducing the need for further references to clarify points and reduce the room for arguments about the consequences of a reference.

Yours sincerely

Bill Dodwell
Chairman, Technical Committee

The Chartered Institute of Taxation

The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 16,500 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

H.M. GOVERNMENT OF GIBRALTAR

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THE GOVERNMENT'S REVIEW OF THE BALANCE OF COMPETENCES BETWEEN THE UNITED KINGDOM AND THE EUROPEAN UNION : CALL FOR EVIDENCE ON TAXATION.

Evidence submitted by Her Majesty's Government of Gibraltar ("HMGoG")

Main submission and evidence provided by HMGoG.

The Government is invited to identify core elements of taxation policy which must, at all times, remain outside EU competence. This need arises from the fact that it would be dangerous for the Government to consider that those core elements are safeguarded by the unanimity requirement in Article 115 TFEU. Whilst that unanimity requirement should never be abandoned, it is not a sufficient safeguard against EU-level action on taxation. It is of equal importance for the Government to be prepared to prevent the EU (including its courts) from acquiring "surreptitious competence" in such core elements of taxation policy through the backdoor of other EU competences such as EU rules on free movement and, in particular, state aid.

The principal evidence submitted by HMGoG will demonstrate how, under the guise of the application of EU state aid rules, the European Commission embarked on a course that would have put an end to the viability of the Gibraltar economy by requiring Gibraltar to operate the same tax system as the UK notwithstanding the fact that the UK and Gibraltar constitute, and have always constituted, two entirely separate and distinct fiscal territories. The fiscal, political and constitutional consequences of that application of EU state aid rules cannot be overstated. It would have far-reaching effects on fiscal sovereignty, on the UK-Gibraltar relationship and on the devolution process within the UK itself. It must be a matter of the utmost concern if EU state aid rules, which have been designed to regulate commercial transactions and to ensure a level competitive playing field, are allowed to interfere with devolution processes and the internal constitutional architecture of Member States in this way.

INTRODUCTORY COMMENTS.

1. Her Majesty's Government of Gibraltar ("HMGoG") is grateful for the opportunity to submit evidence on the *"Government's review of the balance of competences between the United Kingdom and the European Union : call for evidence on taxation"* published by HM Treasury in November 2012.

2. HMGoG is conscious of the fact that the call for evidence seeks to analyse what the UK's membership of the EU means for the UK national interest. The Government is hereby invited to also take into account Gibraltar's interest in this exercise since the TFEU applies to Gibraltar by virtue of the fact that Gibraltar is a European territory for whose external relations a Member State (the United Kingdom) is responsible.

3. By virtue of Article 28 of the UK's Act of Accession 1972, EU acts on the harmonisation of legislation of Member States concerning turnover taxes do not apply to Gibraltar. These submissions are therefore limited to competence in the area of direct taxation.

IMPACT ON THE NATIONAL INTEREST

1. What evidence is there that EU-level action on taxation advantages the UK?

4. The three principal EU measures on direct taxation currently in force, the Parent/Subsidiary Directive (2011/96/EU), the Interest/Royalties Directive (2003/49/EC) and the Mergers Directive (2009/133/EC), are good examples of EU-level action on taxation that advantages the UK. Such measures are good for business, avoid double taxation and facilitate cross-border trade, without unduly interfering with Member States' fiscal sovereignty.

5. EU measures that facilitate exchange of information on tax matters also advantage the UK since their objectives can only be achieved at EU-level. The Savings Directive (2003/48/EC) and the Administrative Cooperation Directive (2011/16/EU) are clear examples of this.

6. Gibraltar's own experience with the measures listed at para. 4 above is, however, extremely disappointing and gives rise to issues of enforcement. This is discussed in the reply to Question 4 below.

2. What evidence is there that EU-level action on taxation disadvantages the UK?

7. The evidence to this question can be provided by way of reply to the following question : "Is unanimity a sufficient safeguard against EU-level action on taxation ?"

8. Much comfort is derived from the fact that Article 114 (2) TFEU does not allow the EU to adopt harmonisation measures in matters concerning fiscal provisions on the basis of a qualified majority vote. As a result, the EU can only act on the basis of Article 115 TFEU pursuant to which harmonisation measures on direct taxation can only be adopted on the basis of unanimity.

9. However, that overlooks two important issues.

10. **Firstly,** Article 115 TFEU is a catch-all provision. It is not a specific provision on direct taxation. There is no express enabling power on direct taxation in the entire TFEU. There has never been one in any of the EU Treaties going back to the Treaty of Rome in 1957. The contrast with indirect taxation (Article 113 TFEU, formerly Article 99 Treaty of Rome) is clear. There must be a reason why indirect taxation has always been expressly referred to in the EU Treaties as an area of EU competence and direct taxation has never been. It raises the question as to whether the EU was ever meant to have competence in direct taxation matters at all.

11. In HMGoG's opinion, it is important to bear that mind. If the EU is to take action on direct taxation, Article 115 TFEU must be used sparingly and only in areas, such as those described in the reply to Question 1, which are absolutely essential to ensure the functioning of the internal market and which do not unduly interfere with Member States' fiscal sovereignty.

12. **Secondly,** in the Executive Summary of HMT's Paper it is stated that "*the Government opposes any extension of EU competence in the area of taxation*". At para. 3.5 it repeats that statement and goes on to state that the "*Government believes that tax matters should remain subject to unanimity and upholding the veto on tax is a key priority*".

13. HMGoG agrees entirely with those statements. However, they raise a number of questions : How does the Government ensure that the EU does not extend its competence in the area of taxation indirectly via other EU policies such as state aid or the single market ? Is the Government in a position to stop the EU (and its courts) from "surreptitiously" extending its competence on taxation irrespective of the veto ? Can the Government actually deliver that commitment as matters currently stand ? Gibraltar's experience with the application of state aid rules to corporate taxation may serve as evidence to illustrate these tensions[1].

14. On 30 March 2004 the European Commission adopted Decision 2005/261/EC in which it found that a new system of corporate taxation to be introduced in Gibraltar constituted a scheme of State aid that was incompatible with the common market (OJ 2005 L 85, p. 1). The Commission found that the proposed tax system was both materially selective and regionally selective. With regard to regional selectivity, which is the issue that is relevant for present purposes, the Commission found that the proposed system of corporate taxation was selective because companies in Gibraltar would be taxed at a lower rate than companies in the United Kingdom.

15. The effect of the Commission's finding was that any taxation system implemented in Gibraltar, other than the United Kingdom system, would be incompatible with EU law. Such a finding would put an end to the long-established status of Gibraltar as an entirely distinct fiscal and economic territory to the United Kingdom. It would put an end to Gibraltar's right to exercise its legislative powers to adopt its own taxes. It would subject Gibraltar to taxation legislation enacted by a parliament (Westminster) in which it has no representation. It would put an end to the viability of Gibraltar's economy which is entirely dependent on Gibraltar's ability to operate the tax system which it considers most appropriate to the specific circumstances and characteristics of its territory without reference to the tax system in the United Kingdom or elsewhere. It had the potential for dismantling the constitutional relationship between Gibraltar and the United Kingdom which is based on the fact that both territories constitute entirely separate jurisdictions in every sense.

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[1] On state aid rules and taxation generally see "*Commission Notice on the application of State Aid rules to measures relating to direct business taxation*", [1998] OJ C 384, 10.12.1998, p.3.

16. The Decision was annulled by the Court of First Instance[2]. However, the mere fact that the European Commission made that finding in a formal decision, with the political, constitutional and fiscal implications described above, is disconcerting. Not even the most ardent fiscal federalist would dare propose legislation under Article 115 TFEU to that effect. Yet, that is what the European Commission did under the guise of the application of EU state aid rules.

17. HMGoG fully agrees with the Government when it states that it "*opposes any extension of EU competence in the area of taxation".* The question is how can the Government oppose such an extension when it occurs in the alleged pursuit of EU policies which are at the hands of the European Commission and where the veto under Article 115 TFEU is powerless. A possible solution is proposed in the reply to Question 3 below.

18. The CJEU has now developed a test to assess the application of the state aid principle of regional selectivity. It did so in a case concerning the tax regime in the Azores[3]. The test contains three limbs as follows :

(i) the decision on the tax measure must have been taken by a regional or local authority which has from a constitutional point of view, a political and administrative status separate from that of central government (institutional autonomy);

(ii) the decision must have been adopted without central government being able to directly intervene as regards its content (procedural autonomy) ; and

(iii) the financial consequences of a reduction in the national tax rate for undertakings in the region must not be offset by aid from other regions or central government (economic autonomy).

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2 Joined Cases T-211/04 & T-215/04, *Gibraltar and the United Kingdom v European Commission* [2008] ECR II-3745 (later on appeal Joined Cases C-106/09 P & C-107/09 P where the question of regional selectivity was not, however, considered).

3 Case C-88/03, *Portuguese Republic v Commission* [2006] ECR I-7115.

19. For those regions which seek greater decentralisation and greater political powers at regional level, not least in the United Kingdom itself and be it at the level of Scotland, Wales, Northern Ireland, county level or even local government level, the Azores criteria will assumedly now form a central aspect of the powers that would have to be bestowed upon them if the decentralisation process and devolution of powers will be acceptable to Brussels. They will also have to be prepared to assume the responsibilities, in particular, the financial responsibilities, that flow from the application of those criteria. It is questionable whether EU state aid rules should play such a central role in the determination of issues of such great constitutional importance within the United Kingdom (or, indeed, any other EU Member State).

20. In addition, questions remain in respect to the micro-economy of regions. Many matters that sub-national authorities may wish to regulate (social services, municipal services, health) are matters for which locally-elected representatives may wish to have a considerable level of direct control. They may give rise to budgetary considerations. They may need to be accompanied by revenue raising measures. Whereas cases such as Gibraltar concerned general corporate fiscal measures, it cannot be excluded that the principle of regional selectivity comes to be applied to local authorities who "only" wish to have tax raising powers in relation to more local matters such as those described above. It is unlikely that they will meet the three conditions of institutional, procedural and economic autonomy, thereby calling into question their capacity to regulate such local matters in the manner they consider most appropriate at their level of sub-national division. It is a matter of grave concern if EU state aid rules, which have been developed to regulate commercial transactions between companies and to ensure a level competitive playing field, could interfere with the internal constitutional architecture of Member States in this way.

21. Of similar concern is the interpretation of EU rules on free movement and the establishment of the internal market. Although Article 115 TFEU is, by default, the enabling power for the adoption of EU direct tax directives which are deemed necessary for the functioning of the internal market, barriers, including fiscal barriers, to the functioning of the internal market can also be removed by the European Courts when applying and interpreting the TFEU's internal market rules. In this case too, the unanimity requirement under Article 115 TFEU is powerless.

3. What do you think are the main considerations in determining the appropriate level for decisions to be made on tax policy?

22. In HMGoG's view, the main consideration in determining the appropriate level for decisions to be made on direct tax policy is to identify a set of core elements of taxation policy which will, at all times, remain outside EU competence as a whole. The Government is invited to consider a safeguard that would prevent the EU (including its courts) from acquiring "surreptitious competence" in such core direct taxation matters through the backdoor of other EU competences such as the rules on free movement and, in particular, state aid.

23. Such core elements must be all those matters that go to the heart of fiscal sovereignty and must include, as a minimum, the level at which tax rates are set and the general tax system that fiscal jurisdictions within the EU may choose to implement. No EU policy, and no interpretation of EU rules by the European Courts, should be allowed into that preserved area.

24. There must be a limit beyond which the desire to ensure the proper functioning of the internal market and the avoidance of distortions of competition cannot go. That limit should be established by those core elements.

4. Are there any other impacts of EU action on taxation that should be noted, including as regards the process for taking action (for example unanimity versus qualified majority voting)?

Unanimity v QMV

25. As already stated in this paper, although unanimity under Article 115 TFEU is a must, it would be dangerous for the Government to take the view that by securing unanimity fiscal sovereignty is safeguarded.

Code of Conduct on Business Taxation

26. One area of EU action on taxation that should be noted is the Code of Conduct on Business Taxation. At para. 3.47 of HMT's Paper it is stated that the "*Code of Conduct has no effect on the balance of competence on direct tax, because it is a voluntary mechanism between Member States to cooperate for their mutual interest*".

27. Whilst strictly speaking that statement is correct, it is submitted that the existence of initiatives such as the Code of Conduct sends the wrong signals to those who seek greater fiscal harmonisation between the Member States. As far as HMGoG is concerned, the Code of Conduct exists precisely because there is no EU competence to adopt an equivalent EU measure and the Code is aimed at circumventing that lack of competence. It is precisely with initiatives such as the Code, and by the creation of bodies such as the Code Group with considerable involvement of the European Commission itself, that impetus is given and momentum is gathered for greater EU competence on direct taxation matters.

28. It is perhaps no coincidence that the adoption of the Code of Conduct on Business Taxation on 1 December 1997 coincided with a particularly active consideration of taxation issues by the EU[4].

[4] See, for instance, "Discussion Paper for the Informal Meeting of ECOFIN Ministers, "*Taxation in the European Union*", SEC (96) 487 final, 20.03.1996 ; "*Taxation in the European Union: Report on the Development of Tax Systems*", COM (96) 546 final, 22.10.1996 ; "*A Package to tackle harmful tax competition in the European Union*", COM (97) 564 final of 5.11.1997 ; "*Conclusion of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy – Resolution of the Council and the Representatives of the Government of the Member States, meeting within the Council of 1 December 1997 on a Code of Conduct for Business Taxation – Taxation of Savings*", [1998] OJ C 2, p.1.

Enforcement

29. The vast majority of Member States take the view that the Parent/Subsidiary Directive, the Interest/Royalties Directive and the Mergers Directive do not apply to Gibraltar. They hold that view on the spurious ground that Gibraltar, and Gibraltar taxes, are not expressly listed in the directives. It is an argument with no sound foundation.

30. The UK and Gibraltar Governments have been lobbying the European Commission to rectify this injustice since the early 2000s, to no avail.

31. Ensuring a level playing field in the sensitive area of direct taxation is of vital importance. In those areas of direct taxation over which the EU has acquired competence, as with the three directives cited above, it is of critical importance that the European Commission ensures that those EU rules are respected in full by all. The lack of proper enforcement of EU direct taxation measures is a matter of the greatest concern.

FUTURE OPTIONS

5. How might the UK benefit from the EU taking more action on taxation? Please provide specific examples, identifying where possible the pros and cons.

32. We do not consider that that the UK (or Gibraltar) would benefit from the EU taking more action on taxation. The disadvantages of further EU action are likely to outweigh any advantages that may be gained. In any event, consideration should not be given to this matter until the core elements of taxation policy which will, at all times, remain outside EU competence and all EU policies have been identified.

6. How might the UK benefit from the EU taking less action on taxation? Please provide specific examples, identifying where possible the pros and cons.

33. Less action by the EU on taxation means more competence retained by the UK on taxation. It seems to HMGoG that as a matter of policy, and consistently with the fact that no EU Treaty has ever contained an explicit provision granting the EU competence on direct taxation, the UK should retain competence over the vast majority of direct taxation issues. Only a limited degree of competence should be conceded to the EU in clearly defined areas, such as avoidance of double taxation or exchange of information.

34. The draft directive on the Financial Transaction Tax may be cited as one recent example of how might the UK benefit from the EU taking less action on taxation. Even though this proposal is now proceeding without the UK on the basis of the enhanced cooperation procedure, it is still likely to have an impact on the financial services industry in the United Kingdom and in Gibraltar. Financial services constitute one of the pillars of the Gibraltar economy and any attempts to tax financial transactions are likely to be damaging to this vital sector of our economy.

7. How could action on taxation be undertaken differently? For example:

a. Could more action be taken at the national level? If so, what domestic legislation would be needed on taxation in the absence of EU legislation, for example to take account of issues around international trade and cross-border transactions?

b. What action could best be taken at other international levels (by a different body or institution)?

35. It is clear that domestic legislation on its own could not replicate the effects of EU legislation in matters of cross-border transactions. In the absence of EU legislation, that could only be achieved through double taxation treaties or other international initiatives. As already stated, HMGoG considers that there is no problem in supporting EU measures, in properly circumscribed areas, that are good for business, such as those that avoid double taxation and facilitate trade without unduly interfering with Member States' fiscal sovereignty.

8. What future challenges and opportunities might the UK face on the balance of competence on taxation? What impact might different scenarios for the future development of the EU have on the national interest?

36. It could be said that any difference in the tax laws of the Member States may directly affect the establishment or functioning of the internal market. There will therefore always be those in the EU who will always seek to achieve more and more harmonisation and approximation of laws, regulations or administrative provisions of the Member States in the area of direct taxation. That appears to us to be the main challenge that the UK (and Gibraltar) face.

37. That challenge can be met if the areas of EU competence are clearly defined, and circumscribed, and if the set of core elements of taxation policy which will, at all times, remain outside EU competence are identified. This would go a long way in protecting the UK's (and Gibraltar's) fiscal sovereignty from future developments of the EU.

GENERAL

9. Are there any general points on competence you wish to make that are not captured above?

38. The principal points have been covered above.

Her Majesty's Government of Gibraltar

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Balance of Competences Review : Taxation
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

19 February 2013

Dear Sir / Madam

Government Review of the balance of competences between the United Kingdom and the European Union. Call for evidence on taxation. HM Treasury November 2012

Imperial Tobacco is a FTSE 30 Company with its International Head Office in Bristol. Imperial Tobacco sales account for approximately 46% of the UK Tobacco market and has sales operations in all EU Member States and factories in several including Nottingham in UK. We welcome the UK Government's initiative to review the balance of European Union competences in order to secure the best advantage for UK citizens and businesses within the EU. We will be looking to respond to a range of reports with relevance to our business and trust our responses will help the Government to act in the UK's national interest and to advance the wider interests of the EU.

The following note relates to question 5, on how the UK might benefit from the EU taking more action on taxation, and question 7, on how action at the national level could be undertaken differently.

The current EU competence allowing the European Commission to produce and adopt a Directive on the general arrangements for products subject to excise duty has set a minimum excise level for tobacco and tobacco products. Member States did not consider it necessary for full harmonisation and therefore Member States retain competence to set the excise rate at the level, above the minimum, that they consider is appropriate to their national circumstances. While we support the UK's policy of maintaining a right to set domestic tax rates which suit the UK's particular circumstances, we do believe that there are areas in which the UK's tax policy is having unintended consequences for the Exchequer.

As the UK has one of the highest excise rates in the EU for tobacco and cigarettes it is a preferred destination for smugglers who are able to set a higher margin on non-duty paid tobacco in the UK than they would be able in other Member States. The enclosed map shows the current selling price of 20 premium cigarettes across Europe. Any EU measure that reduces the profit to smugglers is an advantage to the UK Treasury and industry alike however in this case there is a strong argument for an EU

measure to close the price differential across Europe – and particularly with neighbouring countries – to make smuggling tobacco in to the UK less lucrative.

At a national level, we have suggested to HM Treasury that it change the excise tax from the UK's current system to a Minimum Excise Tax (MET), as is used by most other Member States (23 out of 27). We believe this would result in an increased level of revenue for HM Treasury and provide additional harmonisation across all Member States.

The UK has by far the widest retail price gap between premium priced cigarettes and the cheapest competitive cigarette products on the market and is therefore highly susceptible to consumer down trading. Imperial Tobacco estimates that consumer down trading since 2005 cost the Treasury approximately £350 million in lost fiscal revenues in 2009. We recognise the Government's desire to reduce the affordability of tobacco products, especially for young people and poorer smokers, and also understand the Government's need to generate additional fiscal revenues where it can.

Implementing a MET is the optimal solution for narrowing the wide cigarette retail price gap in the UK and generating additional fiscal revenues while reducing the risk of exacerbating illicit trade when increasing revenues. Irrespective of the prevailing tax incidence level, or the price level used as the basis for tax calculation purposes, levying a minimum excise is always more effective in increasing excise tax yields than increasing the specific proportion of total tax. We recommend that the Government introduces a MET equal to the excise tax payable on the market volume weighted average retail price. Presentations have been made by Imperial Tobacco to the current Economic Secretary, Sajid Javid, and his predecessor, Chloe Smith on this subject.

Yours faithfully,

[redacted]

Richard Ross
Head of Political Affairs UK
[redacted]

TAXREP 23/13

(ICAEW REP 36/13)

ICAEW TAX REPRESENTATION

The Government's review of the balance of competencies between the United Kingdom and the European Union: call for evidence on taxation

Comments submitted on 22 February 2013 by ICAEW Tax Faculty in response to HM Treasury call for evidence, as above, published in November 2012

Contents

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on *The Government's review of the balance of competencies between the United Kingdom and the European Union: call for evidence on taxation* published by HM Treasury in November 2012.

2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

3. On 31 January 2013 we attended a meeting with HM Treasury jointly with other professional bodies and other commentators at which we were able to put forward some key comments and concerns and discuss aspects of the call for evidence paper.

4. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

5. ICAEW is a professional membership organisation, supporting over 140,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.

6. Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.

7. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

MAIN POINTS

8. The design of the UK's tax system remains the responsibility of the UK government and parliament, because the EU has no specific competence in the area of direct taxation. This remains primarily within the competence of each member state, subject to our remarks about the influence of the Court of Justice of the European Union (CJEU).

9. Apart from the adoption of the VAT system when the UK joined the EU, there have been very few pan-EU tax measures because of the unanimity principle. The Common Consolidated Corporate Tax Base (CCCTB) project has been under active consideration for nearly ten years and is now with ECOFIN, but it is not clear when, if ever, this is going to be introduced. It will almost certainly require enhanced co-operation as a number of countries are opposed to it, including the UK. There is also currently a proposal, again using the enhanced cooperation procedure, for an FTT to be introduced in 11 countries, but again the UK is not going to participate and is concerned about the potential impact on the UK economy and the Financial Services sector in particular.

10. The UK benefits from EU-level action on taxation through solutions on cross-border tax issues; more consistent tax rules for British businesses operating across the continent; and the existence of a level playing-field on EU tax issues adjudicated by CJEU.

11. The UK sometimes does not benefit from EU-level action on taxation where the need for compromise has negative unintended consequences – for example, where lack of progress on charging VAT cross border has led to a higher level of fraud.

12. In deciding whether to pass more or fewer powers on tax to EU level, the UK must consider that while it may be necessary to occasionally compromise in the national interest, there is an increased need for cross-border tax collaboration in a globalising economy – for example on tax avoidance and evasion.

RESPONSES TO CONSULTATION QUESTIONS

Q1. What evidence is there that EU-level action on taxation advantages the UK?

13. In a globalising economy where the UK wishes to increase its exports, increasing collaboration on tax issues is necessary. The Prime Minister recognised this recently in seeking G8 agreement to tackle tax avoidance and evasion issues which, due to the global nature of modern business, cannot be tackled unilaterally at national level. This debate is also taking place at EU level, and EU initiatives, as well as work undertaken in other international forums such as the OECD, could play a major role in advancing this agenda.

14. The European Commission has used its "powers of persuasion" to encourage member states to collaborate and create fairer competition on tax issues in the EU. In 1997, member states agreed to set up the Code of Conduct Group (Business Taxation) which reported in 1999 and identified 66 harmful tax practices which were eliminated over the ensuing years. More recently in April 2009 the Commission issued a Communication on Good Governance in Tax Matters which recommended more transparency, exchange of information and, again, fair tax competition. The work of the code of conduct group helps to ensure a level playing field within the internal market for EU companies.

Q2. What evidence is there that EU-level action on taxation disadvantages the UK?

15. EU-level decisions on taxation will often require accommodation of the different views of the member states, including the UK, and seeking agreement can sometimes create less than optimum results. An example here is the failure to agree to charge VAT across borders. There have been very serious levels of 'missing trader' or 'carousel' VAT fraud, which has taken many years to bring down to more acceptable levels.

16. The lack of practical instructions from the CJEU on tax-related rulings has also caused uncertainty for UK courts and businesses. The CJEU upholds the principles of EU law, but it is then up to the UK courts to determine what the court's decision means in practice.

Some further comments on indirect taxation in the EU

17. The EU has had a profound and direct impact on the UK indirect taxation system. This is because, in order to join the Common Market in 1973, the UK had to introduce a VAT system (though significant derogations were secured, notably over zero rates on items like children's clothing). VAT has remained a fundamental part of the UK tax system. The current rate is 20%, and receipts from VAT represent nearly a fifth of total tax receipts. ICAEW has made a number of recommendations on how EU VAT should be reformed, including:

- Adopt the origin principle for all supplies within the EU.
- There should be only two VAT systems – domestic and international.
- Allow full input tax recovery relating to business or charitable activities.
- Abolish the concept of exemption - all supplies either positive rated or outside the scope with recovery.
- Substantially reduce the range of supplies not subject to VAT.
- Eliminate all reporting requirements other than VAT returns.

- Abolish the concept of input tax for public authorities – use alternative government funding to substantially reduce administration and compliance costs.
- All public transport to be outside the scope with recovery.

Some further comments on the CJEU

18. It is impossible to describe the influence of the EU in shaping UK tax policy without noting the impact of the CJEU's decisions. For instance, the UK has had to amend its cross-border loss relief provisions to reflect the CJEU decision on Marks & Spencer. (C-446/03). The UK domestic tax system must allow the possibility of relief for losses made by overseas subsidiaries in order to mirror the relief that is available if domestic subsidiaries make losses. The recent recasting of the Controlled Foreign Companies (CFC) regime owes something to the CJEU decision on Cadbury Schweppes. (C-196/04). The tax treatment of dividends was changed in 1999 and again in 2009, but the Hoechst/Metallgesellschaft cases (C-397 & 410/98) would have required a fundamental change in any event. The credit system spawned a considerable number of Group Litigation Order Classes (GLOs) as to the compliance with the EC treaty of the old ACT/imputation/tax credit system that was abolished in 1999.

19. At the start of the 2000s, there were a considerable number of CJEU cases which significantly affected what the UK Government could or could not do in relation to its domestic tax system.

20. In our annual publication TAXline Tax Planning 2005-06, in the edition published in autumn 2005, we wrote:

> "Ever since the Treaty of Rome in 1957, various freedoms have been enshrined within the framework of the EC Treaties. What was not apparent for a very long time was that these freedoms were going to have a profound impact on what was going to be acceptable direct tax policy in any one of the EU Member States. The fact that any changes to direct tax at an EU level required the unanimous approval of all the Member States, and any one Member State had an effective power of veto, lead the Member States to assume that domestic tax policy remained within their powers.
>
> However, the European Court of Justice, in applying the freedoms enshrined in the EC Treaty has increasingly shown that this domestic tax sovereignty may have less and less practical effect."

21. However, it should also be noted that at about that time, late 2005, the CJEU began to change its approach. Since then it has been more prepared to accept that domestic tax systems are generally compliant with the EU Treaty, but may then require some modification for the particular measures to be proportionate. This can be seen very clearly in the Marks & Spencer case. The Advocate General's opinion, delivered in April 2005, held that the UK system did not comply with the EU Treaty. The CJEU's final decision in December 2005 found that the UK system was compliant in general, but in order to be totally compliant needed some amendment to the UK law to allow the possibility of foreign subsidiary losses being used in the UK if there was no possibility they could be used abroad.

22. This rather more nuanced approach of the CJEU has actually led to quite considerable confusion about how the UK domestic tax system needs to be modified to comply with the EU Treaty. For instance, the FII GLO case has recently been referred to the CJEU for the third time, in addition to a very considerable number of hearings in the UK domestic courts. This case is about the different treatment of dividends from foreign subsidiaries, which were at that time taxable in the UK with relief for foreign tax suffered, compared with dividends from UK subsidiaries which were exempt. The CJEU ruled that the treatment of these two types of dividends needs to be equivalent, but more than six years later we are still not clear what this means in practice in relation to the UK tax system. This uncertainty is not good for taxpayers, and does not help the government which requires a stable source for its public finances.

23. Most recently in the 2013 UK Finance Bill draft clauses, the changes to the exit tax regime and the recognition of losses of UK permanent establishments are both being introduced to try to ensure that the UK domestic law reflects the terms of the EU Treaty.

Q3. What do you think are the main considerations in determining the appropriate level for decisions to be made on tax policy?
Q4. Are there any other impacts of EU action on taxation that should be noted, including as regards the process for taking action (for example unanimity versus qualified majority voting)?

24. We are not responding on these points.

Q5. How might the UK benefit from the EU taking more action on taxation? Please provide specific examples, identifying where possible the pros and cons.

25. More EU action on tax would be beneficial if it facilitated pro-growth cross-border cooperation, and further developed our capacity to agree international tax issues.

26. But this may open the UK up to the risk of more action on taxation by the EU that may not be in the UK's national interest, for example more requirements similar to the proposed financial transaction tax.

Q6. How might the UK benefit from the EU taking less action on taxation? Please provide specific examples, identifying where possible the pros and cons.

27. We are highlighting the Financial Transaction Tax draft directive proposals as an example of where the UK would benefit from the EU taking less action on taxation. We are very concerned by this development, which is not in the best interests of the EU or UK economies, will hit a financial services sector employing hundreds of thousands of British citizens right across the country, and damage a major sector of the UK economy.

28. The proposal could put the UK in a difficult position which could threaten the UK's ability to maintain mutual tax collecting agreements. As currently drafted, the directive would require the UK government to collect FTT on behalf of member states participating in the tax. It is not clear how these member states will secure UK agreement on this, and if the UK does not collect this levy or refuse to transfer the revenues, other member states may feel unable to engage in existing mutual tax collecting agreements in the same way.

Q7. How could action on taxation be undertaken differently? For example:
a) Could more action be taken at the national level? If so, what domestic legislation would be needed on taxation in the absence of EU legislation, for example to take account of issues around international trade and cross-border transactions?

29. The design of the UK's tax system remains the responsibility of the UK's government and parliament, because the EU has no specific competence in the area of direct taxation. This remains primarily within the competence of each member state subject to our remarks about the influence of the CJEU.

30. The vast majority of taxes in the UK are controlled domestically and not subject to EU legislation – such as national insurance and employment tax.

31. The UK government is also required to implement EU legislation (for instance, directives) agreed at EU level into national law. This means the domestic legislation is already in place.

32. VAT is UK law based on the provisions in the EU directives. If the UK's relationship with the EU on VAT changed, the UK would not need to pass a new VAT law, and the government would be able to freely adjust VAT law as it wished – this is not currently possible under EU rules.

33. The UK's double taxation agreements are mostly agreed bilaterally, based on the OECD Model Tax Convention, so we do not anticipate problems around double taxation if the UK's relationship with the EU changed.

Some caveats on the UK's tax autonomy

34. The EU can bring forward proposals in relation to direct taxation under Article 115 of TFEU "if such measures are necessary for the establishment and functioning of the internal market" – but such measures must be agreed by all the 27 member states. In the early 1990s, a number of directives were adopted including, for instance, the Parent Subsidiary and the Mergers Directive.

35. If all the member states cannot agree on a tax proposal, then as a result of the Nice Protocol of 2000, nine or more member states can take forward the proposal under the Enhanced Cooperation procedure. This is the decision-making process around the FTT proposals.

36. The other caveat is the requirement for the member states to "exercise their competence in areas of taxation consistently with the fundamental freedoms, avoid any discrimination on the grounds of nationality and comply with the rules on State aid." (Paragraph 3.21 of HM Treasury "Call for evidence" paper). We have discussed above some of the changes to the UK law as a result of decisions in the CJEU.

b) What action could best be taken at other international levels (by a different body or institution)?

37. A lot of the rules of international taxation are already promulgated by the OECD as a result of agreement by the OECD member countries which includes the UK. So the UK's treaty network is largely based on the OECD Model Double Tax Convention, and the UK has incorporated the OECD Transfer pricing guidelines into its domestic law.

Q8 What future challenges and opportunities might the UK face on the balance of competence on taxation? What impact might different scenarios for the future development of the EU have on the national interest?

38. We are not responding to this question.

[redacted]

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)

Review of EU Competences, First Semester

Taxation

Response by the Institute of Directors

21 February 2013

Introduction

1. We have prepared this note in response to the Treasury's *Call for Evidence on Taxation*, published in November 2012. References are to that document.

2. We appreciate that the immediate purpose of the Review of Competences is to gather evidence, rather than to come up with a list of demands for repatriation. However, in the field of taxation, we have had plenty of negotiation, legislation and litigation over the years, making clear the ways in which the EU's institutions can help British business, and the ways in which they can hinder it by constraining the power of the UK government to bring in, or to maintain, tax measures that would benefit British business. (If, for example, the benefit of a relief would have to be extended to businesses in all EU member states, that may make the relief unaffordable. If the decision in *C446/03 Marks & Spencer v Halsey* had been different, group relief might have become unaffordable.) We have therefore moved straight to what needs to be done, in order to improve the position for the UK.

The importance of unanimity

3. Tax matters should be decided at the national level, with any EU action strictly subject to unanimity. There are two reasons for this. The first is that taxing and public spending are central to people's voting decisions, and decisions on taxing and spending therefore need to be made by the primary entities that people directly elect: their own national legislatures and executives. The second is that each country's taxpayers have to fund their own country's public spending. So long as there is no fiscal union on the spending side, there should be no fiscal union on the tax-raising side, not even a union of policies that then allows for different tax rates in different countries.

4. In relation to paragraphs 3.50 to 3.54, it is absolutely wrong to slide from unanimity to qualified majority, when a tax measure is incidental to a non-tax measure. Unanimity on tax must be universal.

5. Unanimity is particularly important because there is a choice between harmonisation and competition. If a majority of member states see benefits in harmonisation, but a few see an opportunity to compete effectively by offering more business-friendly tax regimes, the few must be allowed to do so. That keeps the pressure on the majority, not to over-tax business. Any form of majority voting would allow the majority to block this competitive pressure, rather than face up to it by improving their own tax regimes.

Action by bodies other than the Court

6. On paragraph 3.14, Article 115's final words, "as directly affect the establishment of functioning of the internal market", are potentially very broad. While the article requires unanimity, it is also a standing invitation to the Council to interfere in all aspects of member states' tax policies, when it would often be better for the Council to stay out of that area. Relatedly, the Commission's right of initiative should perhaps be curtailed. The simple facts that the Commission has that right, and that it wants to be seen to be doing things, are likely to lead to unnecessary interference.

7. On box 3.A, the enhanced cooperation requirement to "respect the competences, rights and obligations of those Member States which do not participate in it" needs to be strengthened to give any non-participating state a right to block an enhanced cooperation measure if it would have any but the most trivial effect on its interests. All member states are entitled to preserve for themselves the benefits of being in the single market, and of having a level playing field. Their interests may be harmed by a cartel of member states, under the banner of enhanced cooperation, just as they may be harmed by state aid. The proposal to apply a financial transactions tax to transactions in securities that originate in the participating member states, even when the parties to the transaction are all outside those states, is a clear example of this danger.

8. The directives listed in paragraph 3.41 do indeed require a close look. In particular, while the parent-subsidiary directive has been very useful in reducing tax burdens, it can significantly handicap a country that wants to introduce a tax on distributions by the companies within its tax base (perhaps instead of a tax on all profits made), in order to ensure that profits made within its territory are taxed in its territory.

The Court

9. Paragraph 3.22 touches on Court of Justice decisions. These decisions, and fear of possible litigation in relation to current or prospective tax policies, have been a massive constraint on UK tax policy-making in recent years. In particular, the Court has not been interested in the UK's concern to ensure that UK profits get taxed in the UK. It has at best been interested in ensuring that they get taxed somewhere or other. If our right to set our own tax policies is to mean anything, we need something in place to ensure that the Court does not interfere, where the unanimity requirement would prevent the Council from legislating without the UK's consent.

10. One particularly troubling aspect of the Court's decisions has been their long retrospection, sometimes for six years, sometimes back to when the member state joined (1973 for the UK). The UK would no doubt find life a good deal easier if retrospection were more limited, perhaps to the time when action was commenced in a UK court or tribunal.

22 February 2013

[redacted]
Balance of Competences Review: Taxation
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[redacted]

The Government's review of the balance of competences between the United Kingdom and the European Union: call for evidence on taxation

IMA represents the investment management industry operating in the UK. Our members include independent investment managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of around £4.2 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our members represent 99% of funds under management in UK authorised funds (i.e. unit trusts and open-ended investment companies).

Moreover, one-third of the £4.2 trillion of assets are managed on behalf of non-UK clients, the majority of whom are EU citizens or institutions. Also, UCITS (open-ended regulated funds for retail investors) are the only retail financial products that themselves have a pan-European passport, and from July of this year, there will be a further passport (under the AIFMD) for non-UCITS funds marketed to professional investors. Therefore, the UK-based investment and fund management industry derives many trade benefits from the EU.

The EU regulation of UCITS, together with measures on taxation, have gone a long way in facilitating the Single Market for funds, which is greatly beneficial to the investment management sector in the UK and to UK investors, savers and pensioners. We therefore welcome the opportunity to respond to this consultation.

Our responses to selected questions raised in this public consultation paper are included in the appendix to this letter. [redacted]

Yours sincerely

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Appendix

IMA response to HMT's consultation – The Government's review of the balance of competences between the United Kingdom and the European Union: call for evidence on taxation

Impact on the national interest

Q1 What evidence is there that EU-level action on taxation advantages the UK?

UCITS Directives

Harmonised EU regulation of funds under the UCITS Directive has opened up the European market for funds and fund managers to the great benefit of the UK asset management industry and of investors. Asset managers are now free to set up and manage funds in any EU jurisdiction, and the UCITS product passport enables funds to be distributed across Europe to retail investors with minimal disruption and administrative burden.

Also, from July 2013, the AIFMD will provide a passport for non-UCITS funds to be marketed to professional investors.

However, in addition to the harmonised regulatory framework, to fully realise the benefits and potential economies of scale of the Single Market, the harmonisation of certain tax aspects of funds would be beneficial.

Indirect tax

Under Article 113 of the Treaty on the Functioning of the European Union (TFEU), the EU has competence to harmonise indirect tax only. Initiatives to achieve harmonisation in VAT treatment (including the objectives set out in the Green Paper on the future of VAT and the EU review of the VAT treatment of Financial Services) have significant potential benefits to the investment management sector. These include giving UK funds and asset managers certainty on VAT treatment of the services they provide, and providing a level playing field for cross border provision of services.

We welcome the EU's role in bringing about tax harmonisation in certain areas to support the funds industry, but we are disappointed that no progress has been made for years on these dossiers. The EU suffers from sclerosis on tax matters because of a failure to get unanimous agreements from Member States.

Enforcement of treaty provisions

In recent years the Court of Justice of the European Union (CJEU) has found consistently that levying dividend withholding tax on dividend payments to recipients in EU Member States (where no dividend withholding tax is levied domestically) is in breach of the principles of discrimination and free movement

of capital in the TFEU. The case most relevant for funds is the recent *Santander*[1] case in France, but this was preceded by a series of other cases that underline this principle. These cases strengthen the Single Market ideals and should help movement toward a more harmonised tax framework within the EU.

We believe that the provisions in the treaty are beneficial to investors and savers in the UK. Where enforced, they ensure that UK persons can freely invest across borders without tax acting as a distortion or a barrier to investment.

Q2 What evidence is there that EU-level action on taxation disadvantages the UK?

Tax initiatives at the EU-level do not always reult in benefits to the Single Market or, therefore, to the UK. The impending EU Financial Transaction Tax (FTT), for example, has the potential to be enormously damaging to the operation of the financial markets across Europe and, if implemented as proposed, will also result in significant detriment to UK savers, even though the UK is not expected to join the Enhanced Co-operation process.

The design of the tax betrays a deep misunderstanding of how businesses and financial services operate. The UK's influence at the heart of EU decision-making is desperately called for to temper such badly-conceived initiatives.

Q3 What do you think are the main considerations in determining the appropriate level for decisions to be made on tax policy?

The UK investment management industry operates on a multinational and often global basis, and it and its customers often benefit from tax policy decisions that are applied across borders (where appropriate, and where implemented consistently). We believe that on matters related to UK's multinational businesses, the UK should look to facilitate and support tax policy on a multinational basis.

Q4 Are there any other impacts of EU action on taxation that should be noted, including as regards the process for taking action (for example unanimity versus qualified majority voting)?

See response to Q1 on how the requirement for unanimity results in lack of action on tax matters.

Future options

Q5 How might the UK benefit from the EU taking more action on taxation? Please provide specific examples, identifying where possible the pros and cons.

[1] Cases C‑338/11 to C‑347/11 - Santander Asset Management SGIIC SA v Directeur des residents á l'étranger et des services généraux and Others [2012]

At present, managers who wish to merge or reorganise funds (both domestically or cross-border between EU Member States) are faced with a complex range of differing tax consequences. A merger or reorganisation of funds within the EU is more likely than not to result in a tax event, and this is most prevalent at the investor level. A manager may wish to merge funds if he is seeking greater efficiencies and cost savings, to the medium-term benefit of investors in those funds, but if that merger will trigger a tax event, it is unlikely to happen.

Most Member States impose a tax charge on fund mergers but there are exceptions, most notably in the United Kingdom and France. Tax legislation in the UK provides for a capital gains tax rollover relief for funds where a merger occurs or where there is a reorganisation of the share capital in the fund, provided certain conditions are met. The result is that the 'new' assets are deemed to have been acquired at the same date and the same cost of the 'old' assets, and does not trigger a taxable event for the investor. This applies to domestic, foreign and cross-border mergers – in effect, tax neutrality is achieved.

Some States simply lack the certainty in domestic law to be able to exclude the possibility of taxation. The result of this differing treatment of mergers across the EU is the discriminatory taxation of investors in funds, which goes against one of the principal aims of the UCITS Directive. From an investor's perspective, a merger of funds should always be tax neutral as the investors are not realising their investment in the fund.

It is therefore essential that mergers, whether they are domestic, foreign or cross-border, are tax neutral throughout Europe at both the fund and investor level. IMA asserts that the only way to achieve this is at the EU level through a separate EU fund tax directive, based on the concepts in the EU Merger Directive, which should allow for funds to operate across the EU with no tax implications at the level of the fund or the investor. Without this, a fully harmonised and efficient tax framework for funds will be difficult or even impossible to achieve.

Q6 How might the UK benefit from the EU taking less action on taxation? Please provide specific examples, identifying where possible the pros and cons.

See response to Q2 above on the proposal for a Financial Transaction Tax.

Q7 How could action on taxation be undertaken differently?

We do not believe that EU action on taxation is in itself a bad thing. Indeed, as highlighted above, the UK investment management sector and UK investors have benefitted from EU legislation on tax matters.

However, new taxing initiatives (the FTT is a good example) are often badly thought through, and the EU does not have an effective mechanism for consulting with the public and business on the impact of action on taxation.

a **Could more action be taken at the national level? If so, what domestic legislation would be needed on taxation in the absence of EU legislation, for example to take account of issues around international trade and cross-border transactions?**

The UK affords domestic funds unilateral relief from double taxation where dividends are also taxed in the source country, and therefore in the context of funds, it is unlikely that double taxation will arise.

Whilst not directly applicable to the UK, most Member States have not introduced equivalent domestic legislation nor legislation that is compatible with the CJEU judgements on levying withholding tax and continue to levy withholding tax on dividends paid to funds in other Member States.

b **What action could best be taken at other international levels (by a different body or institution)?**

No comment.

Q8 **What future challenges and opportunities might the UK face on the balance of competence on taxation? What impact might different scenarios for the future development of the EU have on the national interest?**

No comment.

General

Q9 **Are there any general points on competence you wish to make that are not captured above?**

No.

Individual response: private citizen, blogger, ex-think tanker

Questions 4, 8 and 9

There is a significant problem with the structure of the current review, especially in this area of competence, since serious consideration of any further transfer of power has consequences far beyond taxation. Without far more robust 'Opt Out' mechanisms, which can be used without the quasi-moral disdain of all other members, a move to QMV is a daunting long-term prospect. Whilst there is certainly scope for this aiding certain economic areas, the potential benefits are outweighed by the lack of responsiveness of a future system. However unlikely, it is within the realms of possibility that a future UK (or other member state) will, at a national level, want to commit to a radically different economic policy, for example along more socialist or more monetarist lines, a Friedman-esque negative income tax, or indeed a system not yet codified. Assuming that QMV brings a strong level of harmonisation, or at least permissible bands of taxation, such extremes will be impossible. In the wake of a global financial contraction, it would be unwise and intellectually arrogant to assume either that the current short-mid term crop of European leaders knew what tax areas were best for their nations in perpetuity, or that such arrangements could realistically operate effectively for all member states.

Question 9

(This seems as good a place as any) Furthermore, whilst Messrs Liddington, Haig et al repeat that this review is not a 'shopping list' nor an evaluation of the EU as a whole, asking to review a competences as wide as taxation or the single market necessarily entails consideration of what the purpose of the whole EU is, should be and should not be. Arbitrary dividing lines, and a failure to include competences relating to democratic deficit/participation/accountability means both that the review will fall short of its stated aims, and certainly of its potential. A wider, more flexible review might resemble a genuine 'cost-benefit analysis', which would be no more 'subjective' than the current review, which, despite appeals to objectivity, repeatedly requires the submission of counterfactual conjecture and opinion.

Balance of Competences Consultation – Taxation Response

February 2013

The Law Society of England and Wales is the independent professional body, established for solicitors in 1825, that works globally to support and represent its 166,000 members, promoting the highest professional standards and the rule of law. The Law Society welcomes the opportunity to comment on the consultation paper.

The Tax Law Committee of the Law Society places great weight on the UK tax regime being stable and predictable, and tax law (whether statutory or case law) being accessible. Indeed with the possible exception of the first principle[1], a good starting point in assessing the impact of the EU on the UK tax system is whether EU action has furthered or detracted from the principles for corporate tax reform published by HMRC/HMT[2] in 2010: namely stability, aligned with modern business practice; avoiding complexity; and maintaining a level playing field.

Question 1 - What evidence is there that EU-level action on taxation advantages the UK?

1. A number of EU measures in the field of taxation have been of benefit to the UK, in particular the Parent-Subsidiary Directive[3], Mergers Directive[4], Interest and Royalties Directive[5] and progress towards increasing cooperation between national governments, for example with regard to information exchange and mutual assistance in the recovery of tax liabilities.

2. The UK has a long-standing policy of not imposing withholding tax on dividends, not an approach shared by all Member States. That, coupled with the relative ease with which businesses can be established in the UK and the increasing use of English as an international business language, means that the UK could be a natural location for an intermediate holding company for investors into Europe. The enactment of the Parent-Subsidiary directive, providing for no withholding tax to be imposed on dividends paid by qualifying subsidiaries, enhances the UK's relative competitive advantage.[6]

3. Whilst a decision upholding a challenge to HMRC's legislation might have an impact on tax receipts and/or require refunds with interest or damages to be paid, the ability of the taxpayers concerned to enforce their rights under the Treaties could be seen to be of a longer term benefit to the UK.

[1] The lowering of rates while maintaining the tax base.

[2] Box 2.A Corporate Tax Reform: delivering a more competitive system (November 2010).

[3] Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

[4] Council Directive 2005/19/EC of 17 February 2005 amending Directive 90/434/EEC 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States.

[5] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

[6] This is because, if there was not already a double tax treaty providing for no withholding tax, a UK resident company could not receive dividends from EU subsidiaries on a tax-free basis. This would adversely affect the attractiveness of the UK as a holding company jurisdiction.

4. Another benefit that has accrued from EU action has been the enactment of the Arbitration Convention[7] which provides a means by which double taxation is avoided (by virtue of the fact that Members States seeking to bring profits into charge in more than one country are bound within time limits to reach agreement) is avoided. This is an improvement over the position under many double tax treaties where there is no timetable and little scope for the affected taxpayer(s) to influence the contracting states in reaching agreement on what measures to take.

5. While the impact on the UK's competitiveness position of the Mergers Directive has not been as marked as that of the Parent-Subsidiary Directive, we suspect that it has helped facilitate the reorganisation of businesses and operations in Continental Europe of UK-headquartered groups.

6. It continues to be a principle of international law, subject to any contrary agreement reached between contracting states, that one country will not enforce another country's revenue laws. The Mutual Assistance Directive[8] enables the UK to require another Member State to enforce a UK tax liability in that Member State (and similarly the UK to enforce a tax liability of another Member State). This, together with the Savings Directive, may have assisted HMRC in reducing evasion.

7. The agreements reached between countries as regards phasing out of tax practices under the Code of Conduct group may have reduced the scope of Member States to reduce tax on favoured types of business (e.g. headquarters of companies) by what could be regarded as "aggressive" special tax regimes and so reduce the potential that, in aggregate, all Member States seeking to rely on tax incentives harm their respective tax bases in a "race to the bottom".

8. One might argue that there has been some "levelling off" of differences between Member States' tax systems given the recent jurisprudence of the CJEU[9], which perhaps means that taxpayers know where they stand with greater certainty when they operate from a number of Member States or are seeking to relocate or establish subsidiaries or branches in other Member States.

9. Whilst harmonisation is a sensitive topic, and even matters such as the Common Consolidated Corporation Tax Base (CCCTB) can elicit much debate, this form of "harmonisation of approach" between Member States and their tax authorities could be seen to have certain benefits for individuals and businesses. State Aid restrictions and the Code of Conduct have also gone to create a more level playing field between Member States.

Question 2 - What evidence is there that EU-level action on taxation disadvantages the UK?

10.Where the UK's tax legislation has been found to be incompatible, particularly where it is perceived to be anti-avoidance legislation, one perspective might be that this may put the UK tax base at risk. However, given that the CJEU has merely identified that the legislation in question contravenes the obligations to which the UK subjected itself when it joined the EU, the tax in question should not have been assumed to be available to the UK exchequer. Essentially what the CJEU does is to assess the degree of interference with one or more of the four freedoms resulting from the measure in question and evaluate whether such interference goes beyond the minimum level of interference needed to achieve the UK's policy, taking account of alternatives open to the UK.

[7] EU Convention on the Elimination of Double Taxation (90/436/EEC).

[8] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC.

[9] Court of Justice of the European Union, formerly known as the European Court of Justice. "CJEU" is used throughout this paper to refer to the institution both before and after the change of name.

11.One of the principal concerns is a perception that the Court may be placing less emphasis on its Bachmann principle of cohesion of the tax system as it seeks to ensure that taxpayers have an "effective" remedy for infringements of EU law. This focus on effective remedies can lead to unwinding assessments and revisiting tax liabilities incurred many years previously, and in our view has caused significant uncertainty, both for taxpayers and the wider public finances. There is a perception that the CJEU focuses principally on the measure(s) alleged to restrict the four freedoms without taking into account whether there are countervailing benefits in the tax regime which partly or fully compensate for the restrictive measure.

12.We recognise that the CJEU is making a decision in principle which is then referred to the domestic courts to apply in the context of the Member States concerned. But nonetheless, the proceedings before the CJEU may in fact deal only with certain aspects of a country's taxation system without taking account of balancing factors in other parts of the tax system. On a reference from a national court or in an action brought by the European Commission against a Member State, there is no general right to intervene before the CJEU. Thus the CJEU proceedings are inevitably limited by the facts and circumstances presented to the Court by the Commission, the parties in the reference, and the United Kingdom government should it choose to exercise its right to intervene. This compares with the more considered and integrated tax system that might be expected to result from legislation which has benefitted from broad consultation both on policy and implementation. Of course, we recognise that any adverse "knock-on" consequences of CJEU judgments may also be attributed to the "fault" of the relevant Member States not taking active steps to review whether their domestic legislation is compliant with the EU principles but instead hoping to preserve taxing rights which they could not expect to preserve.

13.There can be circumstances where CJEU decisions may affect more than one Member State – for instance where a decision on one Member State's regime may have an effect on another State's (other States') regime(s). So, for instance, any Member State that had provided a VAT exemption for claims handling in the insurance sector (as the UK had done) could find that the domestic legislation exempted activities required under the VAT Directive to be liable to VAT following *Arthur Andersen & Co*[10]. We are also conscious that, while certain CJEU decisions might be said to make the UK (or any other Member State's) tax law less clear, the resulting doubt over the scope of the UK's (or another Member State's) legislation has to be balanced against the need for there to be a level playing field across the EU – and the value to UK business of such a level playing field being established and maintained. On some occasions, uncertainty has also been exacerbated in the UK by the rather narrow way in which HMRC has sought to implement decisions of the CJEU, requiring individual taxpayers to litigate further, either in the domestic courts or before the CJEU again[11].

14.A related point is that CJEU intervention in tax issues may overlay tax legislation in individual Member States and so generate uncertainty, perhaps exacerbated by the sometimes Delphic nature of judicial pronouncements of the CJEU and inconsistency in the approach to particular tax issues as decisions come before different Advocates-General and judiciary of the CJEU.

15.This is not helped by a perception that, unlike a decision in the UK courts, which would distinguish or otherwise "explain away" a previous decision which the court in question was choosing not to follow, the CJEU on occasions just does not refer to a previous decision on the legal issue in question, or takes it on itself to rephrase the carefully worded questions put to it by the local referring

[10] C-472/03 *Staatssecretaris van Financiën* v *Arthur Andersen & Co. Accountants c.s.*

[11] See, for example, C-446/03 *Marks & Spencer plc* v *David Halsey (Her Majesty's Inspector of Taxes)* on the extent of the availability of cross-border group relief.

Court. However, such uncertainty can also arise in cases heard before the domestic courts as different tiers of judges reach, possibly conflicting, decisions.

16.In one regard, it could be said that EU level action on taxation potentially disadvantages the UK (but if it does so, it affects other Member States too). We refer to the need in certain circumstances for proposed tax measures to be approved by the Commission from a State Aid perspective. On the other hand, certain Member States might be viewed as innately more pre-disposed than the UK to provide aid to “national champions” or enterprises associated with a Member State (e.g. airlines). On that basis, the need for Commission approval may in fact assist enterprises from Member States such as the UK which wish to do business in such “intervention-minded” Member States. Again, this concerns the level playing field provided by EU law and defended by the CJEU to the benefit of UK business.

17.The European Commission will on occasion take steps to challenge a Member State’s approach to taxation by issuing a reasoned opinion to the State concerned in effect asking the State to justify its legislation or, if not, to change it. Where the State disagrees with the Commission the dispute is referred to the CJEU. This has happened to the UK on several occasions, whether in relation to VAT - for instance whether zero-rating was limited to transactions where there was a social purpose in not imposing VAT - or direct tax, such as the UK’s group relief rules.

18.A consequence of challenge is that additional tax may be due (e.g. as a result of the restriction of zero-rating) which may benefit the State concerned but also restrict its scope to adjust its tax regime to take account of social or economic factors.

19.The response of tax authorities to "CJEU-proof" legislation and/or draft legislation in a compliant fashion has led to significant complexity in certain areas in the UK such as: the introduction of domestic transfer pricing; thin capitalisation rules; and expansion of dividend exemptions to non-UK dividends but with a series of complex exclusions to the exemptions that apply to both UK and non-UK dividends etc. It has also led to the introduction of certain tax provisions which require an accompanying understanding of EU law, e.g. the proposed s.742A(3) ITA 2007 where, under the amended transfer of assets abroad rules, it will be necessary to assess whether an individual's liability to tax under those rules would constitute an unjustified and disproportionate restriction on a freedom protected under Title II or IV of the TFEU.

20.It might also be argued that the judgments given by the CJEU are not always sufficiently clear in order to be helpful to national courts that have to apply the principles to the case before them. However, we appreciate that the CJEU needs to adopt judgments that can be applied in a multitude of different legal systems, and that this constrains the degree of precision that it can provide. We also note a trend towards giving stronger guidance as to the conclusions that the national courts may wish to reach, but this is not always the case. Finally, it can sometimes be difficult to identify broader principles from a judgment, which leads to the risk of multiple references on similar matters – but again we recognise that the CJEU may in such cases deliberately be seeking to develop its case-law gradually, so as to ensure that all relevant factors are taken into account and to avoid unnecessary disturbance to national legal systems and tax regimes.

21.We also consider that part of the problem in this regard may in fact lie with the UK interpretation. A good example is the manner in which EU VAT legislation has often been transposed into UK law, using terms not readily apparent from the original text and with additional contributions from the draftsman that years later get struck down when a case is brought. This type of issue is presumably why there has been a move towards implementing regulations, to try and create a more level playing

field and remove Member States' ability to implement directives in the manner in which they wish to read them, pending a challenge.

22.There are also examples of EU legislation that has proved complex but of limited effect. One example is the EU Savings Directive (EUSD)[12], which whilst it has limited "retail" avoidance by taxpayers banking in their next door Member State and not declaring the resulting income, is very straightforward to circumvent for those who can. The ongoing EUSD review and proposals to tighten up the approach and mechanisms adopted are a clear statement that the Directive originally adopted in 2003 has not fully achieved its objective.

Question 3 - What do you think are the main considerations in determining the appropriate level for decisions to be made on tax policy?

23.A key consideration in determining the appropriate level for decisions to be made on tax policy is the extent to which action at the level of a Member State or at the level of the EU will best achieve the goals of a Member State, consistent with the obligations to which the Member State has subjected itself. For example, the UK government perceives it to be in the UK's interest for its citizens (individual or "corporate") to be able to trade freely with persons based in, and to invest in, inter alia, other Member States.

24.This would suggest that while there can be drawbacks in having to negotiate with 26 other Member States, if changes are to be made to the VAT system applicable throughout the Union, it might still be preferable to a regime where any individual Member State had a freer hand to introduce changes to VAT/turnover taxes in its own country, but which may (in)advertently favour persons based in that Member State or disadvantage those based outside the State.

25.Indeed, it is clear from the Commission's papers on more streamlined VAT regimes in Member States, that there can be drawbacks – different forms and different interpretations of underlying legislation – if each Member State can determine its own VAT regime.

26.Conversely, there would seem to be no reason why the UK should not have the freedom to introduce a tax on, or remove tax from, an asset or activity where the incidence of that tax had no actual or potential impact on persons in other Member States which was less favourable than its impact, actual or potential, on UK based persons.

27.Where policy is determined at Member State level, rather than EU level, relevant local factors might be given more weight by HM Treasury than they would by the Commission. It could also be that taking decisions locally gave certain groups greater influence on tax policy than if decisions on policy were made at an EU level – so for instance tax policy in Member States with highly developed financial services groups might differ from tax policy in Member States with substantial manufacturing capacity or a significant proportion of their population still involved in agriculture. It may be debateable whether this approach is consistent with the single market, but equally each Member State is likely to be in the best position to determine the scope of tax measures that best suits its economy and provides resources for its planned expenditure.

28.To the extent that it is seen to be necessary, in the interests of the single market, for tax policies in specific areas to be developed at EU level, this tension would best be resolved by ensuring that it is

[12] Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments.

the Member States (and not just the Commission in isolation) that are responsible for that development, and that it is the broad parameters of the policy that are set at EU level. Member States should then be afforded a significant degree of latitude in developing systems and operational procedures more attuned to the needs of the local population/tax-paying community unless in relation to any particular Member State the Commission can demonstrate such latitude is being exploited in ways that undermine the rationale for developing EU level tax policy in the particular case.

29.While there could be advantages in seeking to reach, e.g. via a forum such as the OECD, agreement with the widest number of countries on fundamental tax issues exercising many countries' exchequers, such as how to secure a fair allocation of profits from international business using the internet to sell remotely, it is possible that certain countries may perceive that their interests are served well by the current international tax architecture.

30.Accordingly, it may be easier to reach agreement with a small number of Member States which obtain a significant proportion of their tax revenues from corporate income tax. So HMT will doubtless be considering whether active participation in the design of the CCCTB would assist the likelihood of the UK receiving an appropriate share of the profits realised for such businesses, particular if such businesses "play off" Member States to produce tax incentives that operate as a "race to the bottom". Against that having a harmonised tax base could reduce the scope for targeted incentives such as the patent box. That of course is affected by whether the UK's economy is better served by a less highly taxed, broader base with less incentives or a tax regime with higher rates (not least because tax incentives are less valuable as rates fall).

31.This characteristic of the VAT regime should be noted in the context of proposals for the CCCTB. The draft directive does not contain much of the detail that would be required for a properly functioning tax system. Differences in local implementation would undermine a great deal of the purpose behind it. Without significant fleshing out of the rules, business will be left in a position of considerable uncertainty.

Question 4 - Are there any other impacts of EU action on taxation that should be noted, including as regards the process for taking action (for example unanimity versus qualified majority voting)?

32.From a VAT perspective there is an argument that implementation of a Directive by enactment of legislation locally gives scope for differences between Member States (whereas production of regulations with direct effect gives less scope for differences between Member States) that may impede intra-EU trade. However, it is imperative that the development of regulations involves representatives of the business community or other sectors potentially affected to ensure that regulations are sufficiently precise and attuned to the operational requirements of those who have to self-assess liabilities.

Question 5 - How might the UK benefit from the EU taking more action on taxation? Please provide specific examples, identifying where possible the pros and cons.

33.Concern has recently been expressed that despite a significant level of sales taking place involving UK resident individuals, certain (principally US-headquartered) multi-nationals have been paying no or little UK corporation tax. This stance, on the limited information available, would seem to be justified

based on the structures used by the groups (e.g. sales companies located in lower tax jurisdictions) using UK resident companies either to perform low risk activities meriting limited remuneration on normal transfer pricing methodologies or to carry on activities that are merely introductory and which are asserted not to constitute permanent establishments of overseas resident companies. It would appear too, from the published material that levels of royalties paid on respect of intellectual property or other “intangibles” are difficult for HMRC to challenge.

34.The Commission has proposed the possible adoption of a CCCTB which, in very broad terms, would allocate profits and losses made by relevant corporate groups among Member States by reference to certain factors – e.g. sales, employees etc.

35.To the extent that (i) the issue identified in paragraph 33 above was a perceived “mis-allocation” of profits among Member States, and (ii) agreement could be reached on the relative weighting of the factors (as that would influence the level of tax revenues allocated to each State) this might address the issue identified in paragraph 33.

36.However, to the extent that the perceived mischief identified in paragraph 33 resulted from the level of royalties attributable to intangibles or other services provided from lower or no tax countries located outside the EU e.g. Bermuda or Switzerland, the adoption of the CCCTB by all Member States would at best only ameliorate the problem.

37.In addition the UK (and clearly certain other Member States, such as Ireland and Luxembourg) has concluded that there are benefits to individual countries of having a competitive tax system. To the extent that the CCCTB limited the scope for introducing tax incentives in a particular country (because the tax base was determined by the CCCTB, not local rules on profit computation), this would mean that the UK (and other countries) could only compete on the tax rate or quality of tax administration.

38.Overall, the Society suspects it is likely that co-ordination among Member States on cross-border tax issues reduces the burdens on business (if the alternative is conflicting regimes, uncertainty or tax authorities trying to enhance their jurisdictions’ tax “take” at the expense of other countries).

39.HMRC may also believe less tax is lost to evasion as a result of co-operation.

40.There are also a number of missed opportunities where developments in EU financial regulation have not been matched in relation to EU taxation. As an example, through the various UCITS directives, but particularly UCITS IV, funds in one Member State can be managed from another; funds can more easily merge cross border; and "master-feeder" structures can be adopted that allow more straightforward marketing of funds to investors across Europe. However, although these are all now possible as a regulatory matter, the tax rules of each jurisdiction have hampered taxpayers' ability to take advantage of the increased flexibility. For example, a corporate fund managed cross border may be treated as subject to tax in the jurisdiction in which the manager is resident. Equally, a cross-border reconstruction under which an investment in a local fund is exchanged for an investment in a fund in another Member State may give rise to tax liabilities and/or result in a worse tax position going forward, where the same position would not apply in a purely domestic transaction. Whilst, arguably, this may amount to a breach of one of the fundamental freedoms, a better approach would be to adopt a "UCITS Tax Directive" setting out on an EU wide basis the rules that are to apply.

41.The Common Customs Tariff (CCT) is, of course, a tax raised on the import of goods into the EU. The Society expresses no view as to whether the tax, once collected, is distributed fairly between the member states. The following points are based on practitioners’ experience of customs cases:

(a) The CCT has been subject in some cases to serious abuse and avoidance. This particularly applies to abuse of the system of tariff preferences for developing economies;
(b) Where abuse has been uncovered enforcement has sometimes been weak and has resulted in failure to collect duties which should have been paid (examples include tuna from various then 'Lomé' countries, orange juice imported from countries having association agreements and misuse of the local content rules in relation to electronic products);
(c) In addition to strengthening the systems for enforcement of the CCT rules, improvements could also be made to the automatic acceptance of Certificates of Origin issued by the country of export which are very often just a rubber stamp.

42. More generally, the CCT is, of course, an essential part of a common trading zone which the EU is. A common external tariff is essential for the trading zone to work. We would simply question whether steps should be taken to improve enforcement to make sure that tariffs due are actually paid and collected.

Question 6 - How might the UK benefit from the EU taking less action on taxation? Please provide specific examples, identifying where possible the pros and cons.

43. The Society is not convinced that the proposals on the Financial Transaction Tax are in accordance with the Treaties, or that they will enhance the single market in financial services. The extra-territorial effect proposed by the tax will have an adverse effect on Member States not imposing the FTT (which include the UK) and indeed outside the EU. However, the existence of the Mutual Assistance Directive probably results in the effects for non-participating Member States being worse than for non-Member States.

44. The Society notes that there may be some residual concerns over whether enforcement in the UK of judgments or claims for tax of other countries is retrograde. For example where there are differences in the threshold test for liability which dictates when it can be enforced on an EU wide basis. The Society's perception is that such enforcement usually follows a procedure not dissimilar from that in the UK courts, and any occasional "hard cases" may in fact serve to reduce the scope for evasion across the EU as a whole.

Question 7 - How could action on taxation be undertaken differently? For example: (a) Could more action be taken at the national level? If so, what domestic legislation would be needed on taxation in the absence of EU legislation, for example to take account of issues around international trade and cross-border transactions? (b) What action could best be taken at other international levels (by a different body or institution)?

45. The Society is concerned that although legislation in Member States has moved towards greater compliance with EU law, the approach of tax authorities has not and can vary significantly between Member States. In the VAT arena, various current or proposed measures such as the one-stop shop and simplified/aligned VAT reporting/invoicing will go some way to assist, but there is more that needs to be done.

46. As a longstanding member of the OECD, and significant past contributor to OECD working parties, the UK might well conclude that the OECD would be an institution through which policy making and recommendations might be made and/or influenced.

47.As with any organisation where members have widely differing interests, with businesses at different levels of sophistication and with different degrees of dependency on domestic and international markets, it may be hard to achieve consensus on important tax matters. For example, were the United States to perceive that "playing off" the tax regimes of European countries and/or the current US regime for the taxation of companies with overseas operations gave US headquartered groups a substantial competitive advantage, it might be difficult to reach agreement on changes to the tax treatment of corporate income.

Question 8 - What future challenges and opportunities might the UK face on the balance of competence on taxation? What impact might different scenarios for the future development of the EU have on the national interest?

48.The Society has no comment on this question.

Question 9 - Are there any general points on competence you wish to make that are not captured above?

49.The Society considers that it would be difficult to give a definitive answer to the question of whether EU action on taxation matters has been good or bad for the UK - in part because the answer depends on the capacity in which one is judging the impact. From the point of view of a specific taxpayer, substantive challenges to tax rules may be viewed as an advantage; as a general taxpayer, the decrease in tax revenue might be viewed as a disadvantage.

50.Possibly a distinction can also be drawn between the ability to claim repayments of tax as a result of an EU challenge which would be disadvantageous to the general taxpayer and the ability to force the government to make the rules EU compliant for the future. The latter situation may provide advantages to both the general and individual taxpayer as it enhances the ease, and therefore attractiveness, of doing business in the UK - for example, in the case of the dividend exemption recently introduced in the UK corporate tax regime at least in part to address the non EU compliant differential treatment from a tax perspective of companies receiving UK source and overseas source dividends.

51.When the UK acceded to the Union it accepted that action could be taken to enable individuals and businesses to exercise the four internal market freedoms – of goods, services, persons and capital. The Society notes that some action on taxation at EU level is necessary to ensure smooth operation of the internal market.

52.A significant body of case law has developed in the CJEU, particularly since 1997, calling into question the compatibility of individual Member States' tax regimes with the four freedoms.

53.A substantial amount of that case law has resulted from UK taxpayers challenging provisions in the UK tax regime – whether charges; the regime for taxation of dividends; cross-border loss relief; the UK CFC regime; or Stamp Duty Reserve Tax. Successful challenges initiated from other Member

States have also contributed.[13] Even if particular statutory provisions have not been challenged by taxpayers, individual advisors may have suggested to HMRC (or its predecessor bodies) that UK domestic legislation was incompatible with the EU law, and so caused potential charges not in fact to be imposed or enforced.

54.Further, the European Commission has, whether of its own motion or prompted by complaints by taxpayers, on several occasions challenged the compatibility of UK domestic legislation with EU law for example, in relation to the UK VAT grouping rules, section 13 Taxation of Chargeable Gains Act 1992 and section 720 Income Tax Act 2007.

55.Given that that the UK is a relatively open economy enabling both external businesses to invest in the UK and UK-headquartered businesses to invest outside the UK, these developments have the consequence of requiring the UK to treat inbound and outbound investment in a similar manner compared to purely domestic investment, i.e. maintaining a level playing field. While this clearly limits the ability of the UK to design its own tax system, overall it may prove to be a catalyst for a more open system that is attractive to investment.

[redacted]

[13] Examples include: C-324/00 *Lankhorst-Hohorst GmbH* v *Finanzamt Steinfurt*; C-371/10 *National Grid Indus BV* v *Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam*; and C-168/01 *Bosal Holding BV* v *Staatssecretaris van Financiën*.

NFU Consultation Response

To: [redacted]
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The Government's review of the balance of competencies between the United Kingdom and the European Union: call for evidence on taxation

In answering the questions raised in this call for evidence on taxation we have primarily limited our responses to those areas of taxation required for the proper functioning of the internal market which is essential to our members.

Impact on the national interest

1 What evidence is there that EU-level action on taxation advantages the UK?

An EU wide policy in some areas of taxation is essential for the proper functioning of the single market. For example a common system of import duties ensures parity across the EU allowing access to the single market and the free movement of goods.

Another important area of EU level action on taxation is the common system of Value Added Tax. We believe that having a common destination based system of Value Added Tax for businesses simplifies cross border transactions and avoids double taxation. We do not however accept that there is a need to remove the ability of member states to use reduced rates of VAT or a need for harmonised rates of VAT across the EU.

2 What evidence is there that EU-level action on taxation disadvantages the UK?

We recognise that a common set of taxation rules across all Member States often results in additional complexity. We therefore welcome recent measures aimed at reducing the VAT administrative burden for businesses and making it less onerous to make supplies to businesses in other countries.

Whilst we do not have specific examples of current EU-level action particularly disadvantaging the UK, we are concerned by recent proposals that EU level taxation should be used far more widely than simply ensuring the proper functioning of the single market. For example that EU level taxation might be used as an alternative method of funding the EU budget, that the VAT system could be adapted to raise further revenues and to support wider EU social policies, etc.

Whilst we believe that debate on the subject of further EU-level action on taxation could result in positive proposals beyond those required for the proper functioning of the single market, they should be accompanied by a full impact assessment on a member state by member state basis to demonstrate that they would not create significant distortions. In addition where taxation proposals only have adverse implications for some EU citizens requiring counter measures in the form of social support it should be a requirement to include within the taxation impact assessment clearly identified and quantified proposals for national or EU level social support measures.

3 What do you think are the main considerations in determining the appropriate level for decisions to be made on tax policy?

We believe that the current balance of competencies for taxation generally works well, but that the safeguard of unanimity on taxation proposals is important.

There remains a need for EU level action on indirect taxation in areas which affect the proper functioning of the single market. However it is also essential that at a national level Member States should continue to be required to ensure equitable taxation treatment for all EU citizens and abide by state aid rules.

We believe that unanimity at EU level is essential for areas of taxation beyond those required for the proper functioning of the single market. Whilst there may be areas where further EU level taxation would be possible in terms of supporting wider EU policy this does not necessarily mean it would be desirable. Indeed in some instances Member States have already taken action which may have a greater and more positive impact than action which might be proposed at EU level.

Member States should, if they wish, retain competency for taxation at a national level, including the setting of rates above the minimum required for the proper functioning of the single market. This ensures that they retain as wide a range of policy tools as possible to support and encourage national growth and investment and address national social needs.

4 Are there any other impacts of EU action on taxation that should be noted, including as regards the process for taking action (for example unanimity versus qualified majority voting)?

We believe that maintaining unanimity in the area of taxation is essential.

Taxation is an area where changes can have an extremely material impact in one member state and not in others. In our opinion qualified majority voting in this area would not be an appropriate system given that the intricacies and the full impact of proposals for some Member States may not be fully appreciated by the majority of Member States.

Future options

5 How might the UK benefit from the EU taking more action on taxation? Please provide specific examples, identifying where possible the pros and cons.

We believe the UK can benefit from EU level action on taxation but that this would primarily be to the extent that it is required for the proper functioning of the single market.

We see no reason why taxation measures to support wider EU level ambitions should not be proposed and discussed at an EU level. However it is essential that all proposals are fully assessed for both their benefits and any negative impact both at an EU and member state level.

6 How might the UK benefit from the EU taking less action on taxation? Please provide specific examples, identifying where possible the pros and cons.

We believe that the current balance is the right one and that some actions must always be decided at EU level in order to protect the functioning of the single market.

There is a clear risk that limiting the taxation competency at EU level would have a detrimental impact on the ability of UK businesses to access the single market putting them at a disadvantage to their European counterparts.

We do however believe that improvements to the process of obtaining state aid clearance for national tax legislation would be beneficial. Reducing the length of the process, which can delay implementation of national legislation and create uncertainty, should be a priority.

7 How could action on taxation be undertaken differently? For example:

a Could more action be taken at the national level? If so, what domestic legislation would be needed on taxation in the absence of EU legislation, for example to take account of issues around international trade and cross-border transactions?

We do not believe there is a case for significant change. We would be concerned that if more action were taken at a national level it could result in legislation which is overly complex or burdensome thereby disadvantaging UK businesses. In addition there is a risk that by not having EU level legislation UK businesses would find that they either have more than one level of taxation to contend with or that they are fiscally disadvantaged reducing their access to the single market and reducing their competitiveness.

In addition taking more action on taxation at a national level rather than an EU level would presumably result in an increased need to seek state aid clearance. This would need to be balanced against any perceived benefits.

b What action could best be taken at other international levels (by a different body or institution)?

Further international level action could certainly be advantageous for businesses involved in international trade. For example the OECDs current work on developing guidelines to address uncertainty and risks of double taxation in the application of VAT to international trade is to be welcomed. If wider international agreement on the operation of the destination based system for VAT in relation to business to business supplies were achieved this would be a very positive step.

Given the growing public perception that large multinationals are avoiding considerable amounts of Corporation Tax by exploiting current transfer pricing rules there may also be a case for an international agreement on amending these rules or an alternative approach such as the allocation of profits on a country by country basis. This is however a general observation as we do not claim to be qualified to comment further on this subject.

8 What future challenges and opportunities might the UK face on the balance of competence on taxation? What impact might different scenarios for the future development of the EU have on the national interest?

One potential challenge could be where measures on taxation, which are not essential for the proper functioning of the single market, are proposed at an EU level but do not achieve unanimous support.

Recent developments suggest there is a potential risk where a limited number of Member States instead decide to proceed with enhanced co-operation in the area of taxation where unanimity has not been achievable. Whilst this alignment of taxation systems may be entirely reasonable there should be a requirement for Member States agreeing joint taxation measures to fully evaluate the impact on all other Member States and for the measures to be challenged at an EU level should they be found to create distortions to the proper functioning of the single market.

General

9 Are there any general points on competence you wish to make that are not captured above?

The National Farmers Union welcomes this opportunity to comment on the balance of competencies review with respect to taxation. The NFU represents more than 55,000 farming and growing members and in addition some 40,000 countryside members with an interest in the countryside and rural affairs. Regulation is a key issue for farm businesses who regularly report (see NFU Confidence Survey http://www.nfuonline.com/Our-work/Economics-and-International/News/Weather-and-costs-cast-cloud-on-confidence/) that administrative burdens and bureaucracy are stifling their ability to become more productive and competitive. Much of the regulation that impacts on farmers' and growers' businesses stems from policy and legislation set in Brussels, so this review is an important opportunity to re-establish clear boundaries between domestic and EU competency.

The Government's review should recognise that farmers and growers operate in a single market with the principles of equal access at its heart. This is especially important for primary food producers as the European single market in food is the bedrock of the European Union. There is a persuasive logic to establishing common rules that remove barriers to the free movement of goods and services within this single market and facilitate fair competition. However these common rules should apply the principles of better regulation:

- Proportionality – Regulators should intervene only when necessary. Remedies should be appropriate to the risk posed, and costs identified and minimised
- Accountability – regulators should be able to justify decisions and be subject to public scrutiny
- Consistency – rules and standards must be joined up and implemented fairly
- Transparency – regulators should be open, keep regulations simple and user –friendly
- Targeting – Regulation should be focused on the problem and minimise side effects

The Balance of Competences between the United Kingdom and the European Union: Taxation

Written evidence submitted by
[redacted] **Oxford University Centre for Business Taxation (OUCBT)**

February 2013

Executive Summary

1. In July 2012, the government of the United Kingdom (UK) initiated the Balance of Competence Review, which aims at examining the impact of the UK's membership in the European Union (EU) on its national interests. The review covers several substantive areas of EU competence and is divided into four semesters. This submission has been written in response to the Call for Evidence in relation to tax matters, which was issued by the HM Treasury in November 2012 (Semester 1).

2. The OUCBT is an independent academic organisation that has no collective view. This written submission represents the view of the author, Anzhela Yevgenyeva (Research Fellow at the OUCBT),[1] which was discussed with Prof. Judith Freedman and Dr. John Vella. Details of the independent status of the OUCBT and its sources of sponsorship can be found at: http://www.sbs.ox.ac.uk/centres/tax/about/Pages/Funding.aspx.

3. The analysis draws attention to the problematic legal and practical issues in the division of competences between the EU and the UK in the field of taxation. It primarily focuses on direct taxation. However, many competence issues discussed below, such as those related to the procedural and substantive conditions defining the use of the enhanced cooperation procedure, apply equally in a wider tax policy context.

4. Since the EU may influence UK tax policy through several mechanisms, this evidence distinguishes the actions undertaken under:

   (i) the special legislative procedure (Article 115 of the Treaty on the Functioning of the European Union (TFEU)),
   (ii) non-binding coordination (Article 288 TFEU),
   (iii) the enhanced cooperation procedure (Article 20 of the Treaty on European Union (TEU) and Articles 326-334 TFEU),
   (iv) the preliminary ruling procedure (Article 267 TFEU), and
   (v) the infringement procedure (Articles 258 and 260 TFEU).

[1] This analysis uses some conclusions made by the author in her doctoral research 'Direct Taxation and the Internal Market: Assessing Possibilities for a More Balanced Integration', conducted at the Law Faculty of the University of Oxford (unpublished, 2013).

5. Accordingly, the key conclusions can be summarised as follows:

5.1. **Legislative procedure.** In principle, the balance of competences between the UK and the EU under the special legislative procedure is secured by the unanimous voting requirement. The Treaty of Lisbon has further strengthened political control over EU legislative competence: any national parliament (chamber) can raise objections if it alleges that the principle of subsidiarity is infringed by a draft legislative act.[2]

5.2. **Non-binding coordination.** The use of non-binding instruments in the process of tax policymaking at EU level has recently become wider. Even though this development cannot be considered to be a factor that threatens the balance of competences between the EU and its Member States, it requires careful evaluation to ensure that the human and financial resources of the European Commission (hereafter, 'the Commission') are used effectively to generate a desirable policy impact.

5.3. **Enhanced cooperation procedure.** Unlike the special legislative procedure and non-binding coordination, which merely require some improvement to increase the quality of output, the enhanced cooperation procedure carries more serious challenges to the balance of powers between the EU and its Member States. In January 2012, authorisation to proceed with the enhanced cooperation in relation to the financial transaction tax (FTT) proposal was granted by the ECOFIN Council.[3] Concerns are raised by a wide 'extraterritorial' impact of the tax in the detailed proposal of the Commission, particularly when the 'non-participating states' have a limited ability to influence its substance at the stage of adoption under the enhanced cooperation procedure.

5.4. **Preliminary ruling procedure.** The far-reaching and pro-integration approach of the Court of Justice of the European Union (hereafter, 'CJEU' or 'the Court') in direct tax cases is widely criticised in the academic literature as invading the fiscal sovereignty of Member States. This analysis highlights some of the key problems generated by negative harmonisation, and some potential solutions to better account for Member States' interests.

5.5. **Infringement procedure.** Considering the proactive use of the infringement procedure by the Commission in the tax context (excluding technical non-communications, the category of 'taxation and customs union' cases constitutes the second largest group of pending investigations after environmental protection), as well as the fact that UK provisions are amongst the most frequently challenged, this submission draws attention to the ambiguity of the procedural framework under Articles 258 and 260 TFEU. Despite the overall

[2] 'Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level' (paragraph 3 of Article 5 TEU).

[3] Council Decision 2013/52/EU of 22 January 2013 authorising enhanced cooperation in the area of financial transaction tax [2013] OJ L22/11.

strengthening of the Commission's enforcement powers by the Treaty of Lisbon, this problem has not been addressed.

6. The EU state aid rules shape the way in which Member States can exercise their sovereign taxing rights, in particular when they intend to grant tax advantages of a 'selective' nature that are prohibited under Articles 107 and 108 TFEU. However, since the EU state aid rules and their impact on the UK's exercise of fiscal autonomy will be covered by the review on competition (Semester 2), this component has been left outside the scope of this analysis.

Responses to Questions in the Call for Evidence

Impact on the national interest

What evidence is there that EU-level action on taxation (dis)advantages the UK? (Q1 and Q2)

7. The *ex post* evaluation of EU actions in the tax field requires a complex approach that incorporates three major components: (i) the direct and indirect gains and losses of key stakeholders; (ii) the impact on tax revenues collected by the UK government; and (iii) a short-, medium- and long-term perspective. Furthermore, the result of such an assessment would be heavily influenced by the chosen baseline scenario and the scope of alternative policy options, as well as by whether the impact of EU tax-related actions is evaluated on its own or together with other EU policies and economic benefits associated with the Internal Market.[4] To address some selected issues would mean to compromise the objectivity of the analysis.

8. Since a full-scale analysis is not feasible in this short submission, this written evidence takes a narrower approach:

    8.1. To start with, it delimits the scope of EU actions on taxation. The EU may influence UK tax policy through five major mechanisms. First, the EU has the legislative power to adopt legally binding provisions under the special legislative procedure (Article 115 TFEU). Second, EU Member States may choose to cooperate through non-binding instruments, such as the Code of Conduct for

[4] For instance, on the issue of tax competition in the European Union, Davies and Voget demonstrate that EU membership increases international tax competition, as Member States are more perceptive to the tax rates within the Internal Market (Ronald B Davies and Johannes Voget, 'Tax Competition in an Expanding European Union' CBT Working Paper WP08/30). At the same time, Becker and Fuest show the beneficial impact of EU regional policy on the development of intra-union transport infrastructures for enhancing welfare and mitigating tax competition (Johannes Becker and Clemens Fuest, 'EU Regional Policy and Tax Competition' CBT Working Paper WP09/02).

Business Taxation,[5] and the Commission may use non-binding instruments, such as recommendations, for the purpose of tax coordination. Third, as a measure of 'last resort', nine or more Member States can initiate the enhanced cooperation procedure (Article 20 TEU and Articles 326-334 TFEU). Fourth, the fundamental freedoms and the principle of non-discrimination, as interpreted by the Court and applied in the context of specific legal and factual circumstances by domestic courts, affect the shape of national tax systems and the discretion of Member States' authorities to exercise their taxing rights. Negative harmonisation through the means of Article 267 TFEU (preliminary ruling procedure) and Articles 258-260 TFEU (infringement procedure) plays a central role in the context of direct taxation.

8.2. Then, it evaluates these actions against one condition: whether the different policy- and decision-making processes enable the UK government to ensure that its fiscal interests are adequately reflected in the measures undertaken at EU level.

Special legislative procedure

9. The Treaties of Rome and the subsequent Treaty amendments were silent on the issue of whether and to what extent closer economic cooperation between the Member States embraces the harmonisation of direct tax systems. Due to the lack of explicit reference to direct tax matters, the ground for legislative actions has been found in Article 115 TFEU.[6] However, the unanimous agreement required by the Treaty has been reached only in limited tax areas:

9.1. *Merger Directive* (Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States [1990] OJ L225/1 as amended by Council Directive 2005/19/EC of 17 February 2005 [2005] OJ L58/19). The Merger Directive addresses fiscal obstacles to reorganisations that involve companies located in two or more Member States. It provides the possibility of deferring the income or capital gains taxes that arise in relation to cross-border mergers, divisions, transfers of assets and exchanges of shares.

9.2. *Parent–Subsidiary Directive* (Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [1990] OJ L225/6 as amended by Council Directive 2003/123/EC of 22 December 2003 [2004] OJ L7/41). The Parent–

[5] ECOFIN Council Meeting Conclusions of 1 December 1997 concerning taxation policy (Annex 1: Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997 on a code of conduct for business taxation) [1998] OJ C2/1.

[6] Ex Article 100 of the EC Treaty (pre-Amsterdam Treaty numbering), Article 94 of the EC Treaty (post-Amsterdam Treaty numbering).

Subsidiary Directive deals with the double taxation of cross-border dividend payments between parent companies and subsidiaries that meet certain substantive requirements. The source country is precluded by the Directive from charging a withholding tax on cross-border dividends, whilst the resident state shall either provide a tax credit or exempt the relevant payment.

9.3. *Saving Directive* (Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments [2003] OJ L157/38). The Saving Directive eliminates fiscal distortions to the free movement of capital by making the saving income of individuals that arise in the form of interest subject to tax in the state of residence.

9.4. *Interest and Royalty Directive* (Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49). The Interest and Royalty Directive addresses the problem of double taxation in the context of cross-border interest and royalty payments between associated companies. A source state is precluded from charging withholding tax on royalty and interest payments provided that the beneficial owner of the interest or royalties is a company or permanent establishment situated in another Member State.

9.5. *Administrative Cooperation Directive* (Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC [2011] OJ L64/1). This directive deals with the exchange of information between tax authorities in different Member States.

9.6. *Mutual Assistance in Recovery of Taxes Directive* (Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures [2010] OJ L84/1). This directive regulates the conditions under which EU Member States provide assistance for the recovery of claims arising in another Member State.

10. The subject matter of these directives largely reflects the priorities that were established at the initial stage of European integration (Tax Harmonization Programme 1967).[7] Each legislative proposal drafted by the Commission in this area went through the lengthy process of political bargaining between Member States' governments. On many occasions, the scope of legislative actions has been narrowed down to what was politically acceptable. For instance, the adopted version of the Parent–Subsidiary Directive provided a choice to the resident state between two internationally accepted practices (exemption or credit) rather than imposing a uniform approach, and excluded the possibility of an optional fiscal consolidation. The application of the EU tax directives is conditioned by substantive criteria that delimit the scope of transactions and the list of companies

[7] Commission Memorandum to the Council of 8 February 1967 on Tax Harmonization Programme [1967] Supplement to the Bulletin of the EEC 8/3; Commission Memorandum to the Council of 26 June 1967 on Programme for the Harmonization of Direct Taxes [1967] Supplement to the Bulletin of the EEC 8/5.

covered under their provisions, as well as by the minimum shareholding requirements. Despite some obvious limitations, these legislative instruments contribute to the elimination of fiscal obstacles in the Internal Market, in particular in relation to double taxation, and simplify cross-border activities carrying tax implications. The mechanisms of administrative cooperation between tax authorities in a cross-border context supplemented the system of double tax treaties between EU Member States and enabled the Court to adopt a number of ground-breaking decisions addressing the breach of EU law.

11. The special legislative procedure secures the fiscal interests of EU Member States through the power of veto. Furthermore, the scrutiny of EU legislative proposals has been strengthened by the Treaty of Lisbon. Although the role of the European Parliament remains consultative, the Treaty of Lisbon introduced an additional layer of control over the principle of subsidiarity: any national parliament (chamber) can raise objections if it alleges that the principle of subsidiarity is infringed.[8] Unlike some other policy areas, EU tax proposals gain active feedback from national parliaments: for instance, more than ten Member States expressed concerns in relation to the Common Consolidated Corporate Tax Base (CCCTB) proposal.[9]

12. The quality of the EU lawmaking process has been enhanced through a comprehensive strategy of Better (Smart) Regulation:

    12.1. Its basic priorities were laid down by the Mandelkern Report on Better Regulation and the Commission's White Paper on European Governance (2001),[10] and have been followed by a number of steps taken to ensure more effective policies, regulation and delivery, including those ensuring that (i) the principles of subsidiarity and proportionality are respected;[11] (ii) the most effective policy option is chosen through the improvement of impact assessments, the consultation process and evaluation exercises;[12] and finally, (iii) the existing instruments are reviewed to decrease the regulatory burden.[13]

[8] Protocol (No 2) on the application of the principles of subsidiarity and proportionality of 13 December 2007 [2012] OJ C326/206 (Lisbon Treaty).

[9] Commission, 'Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)' COM(2011) 121 final. For the reasoned opinions sent by the national parliaments in the framework of the early warning procedure see IPEX Database <http://www.ipex.eu/IPEXL-WEB/dossier/document/COM20110121FIN.do#dossier-COM20110121> accessed 20 February 2013.

[10] Mandelkern Group, 'Report on Better Regulation' (13 November 2001) (Mandelkern Report); Commission, 'White Paper on European Governance' (Communication) COM(2001) 428.

[11] See Commission, Annual Reports on Better Lawmaking (2001–2006) and Annual Reports on Subsidiarity and Proportionality (2007–2011).

[12] For the most recent developments, see Commission, 'EU Regulatory Fitness' COM(2012) 746 final and the accompanying staff working documents: 'Review of the Commission Consultation Policy' SWD(2012) 422 final and 'Action Programme for Reducing Administrative Burdens in the EU' SWD(2012) 423 final.

[13] Involves a number of policy documents, starting with Commission, 'Codification of the Acquis Communautaire' (Communication) COM(2001) 645 final and Commission, 'Action Plan "Simplifying and

12.2. In two recent communications – the Communication on Better Governance for the Single Market and the Communication on EU Regulatory Fitness (2012) – the Commission has indicated the prospective directions of Better (Smart) Regulation.[14] The future strategy includes four key components, namely the further improvement of: (i) the policy evaluation of EU regulatory measures, and the impact assessment of legislative and non-legislative proposals; (ii) the simplification, codification, recasting and consolidation of EU legislation; (iii) the consultation of citizens and other stakeholders on policy initiatives; and (iv) the correct implementation of EU legislation.

12.3. In practice, positive developments can be seen, for instance, in the fact that the number of public consultations in the field of direct taxation has increased in 2010–2012: all major policy initiatives were offered for consultation with interested parties.[15] Impact assessments have been regularly undertaken and made available in the public domain.

13. At the same time, some problems remain:

13.1. The scope of impact assessments is often incomplete and their conclusions at times do not sit comfortably with the content of the legislative proposal. An example of this can be found in the Commission's recent proposal for an FTT.[16]

13.2. A further concern is that some important issues were not subject to public consultation, such as the general anti-avoidance rule that was suggested to Member States for adoption at national level by the Commission's

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Improving the Regulatory Environment"' (Communication) COM(2002) 278 final to the Commission's progress reports on the strategy for simplifying the regulatory environment (2006–2008).

[14] Commission, 'Better Governance for the Single Market' (Communication) COM(2012) 259 final; Commission, 'EU Regulatory Fitness' COM(2012) 746 final.

[15] The Commission has conducted the following consultations in 2001–2012:

- on factual examples and possible ways to tackle double non-taxation cases; on tax problems linked to cross-border venture capital investment (2012);
- on withholding taxes on cross-border dividends: problems and possible solutions; on financial sector taxation (financial transaction tax and financial activity tax) (2011);
- on taxation of cross-border interest and royalty payments between associated companies; on possible approaches to tackling cross-border inheritance tax obstacles within the EU; on double tax conventions and the Internal Market: factual examples of double taxation cases (2010);
- on a green paper on market-based instruments for environment and related policy purposes (2007);
- on Home State Taxation for SMEs (2004);
- on the experimental application of 'Home State Taxation' to SMEs in the EU; on the application of International Accounting Standards (IAS) in 2005 and the implications for the introduction of a consolidated tax base for companies' EU-wide activities (2003).

[16] This argument is further elaborated in the CBT paper by John Vella and others; see 'The EU Commission's Proposal for a Financial Transaction Tax' (2011) 6 British Tax Review 607.

Recommendation C(2012) 8806 final of 6 December 2012 on aggressive tax planning.

13.3. Further improvement should thus be made in relation to the process of public consultations and impact assessment, particularly in relation to the scope of evaluation and in ensuring a due account of input in the legislative proposals of the Commission.

14. The unanimity voting requirement, which brings the advantage of securing the Member States' fiscal autonomy and their ultimate control over the decision-making process, has demonstrated two major drawbacks:

14.1. First, the flexibility of the EU legislative regime and its capacity to respond to emerging regulatory challenges by introducing amendments is low.

14.2. Second, fiscal obstacles that remain unaddressed by the EU legislators due to the lack of political consensus are still subject to the requirements of EU law and thus some crucial policy decisions are made by the Court.[17]

14.3. For instance, the Merger Directive created the possibility of deferring the capital gains tax that could be levied in the context of the cross-border transfer of assets if these assets remain connected to a permanent establishment in the Member State of the transferring company. In 2006 the Commission published the Communication on Exit Taxation and the Need for Co-ordination of Member States' Tax Policies,[18] and it has actively pursued infringement proceedings against countries maintaining restrictive exit tax regimes due to the alleged breach of fundamental freedoms. In 2011 the Court took the obligation of EU Member States to a new level by deciding that the possibility of deferral should be provided under a wider set of circumstances.[19] The recent judgment of the Court in Case C-123/11 *A Oy* (delivered on 21 February 2013) constitutes another example of the judicially constructed response to the issue not addressed by the Merger Directive.

Non-binding coordination

15. In 2010 Member States agreed upon the closer coordination of budgetary and economic policies, and introduced a new model of governance, 'the European Semester':

> Each semester is opened by the Annual Growth Survey (AGS), which is published by the Commission at the beginning of the calendar year. This sets the challenges

[17] For this and other relevant examples see Wolfgang Schön, 'Taxing Multinationals in Europe' (2012) 11 Working Paper of the Max Planck Institute for Tax Law and Public Finance, in particular 5.

[18] Commission, 'Exit Taxation and the Need for Co-ordination of Member States' Tax Policies' COM(2006) 825 final.

[19] Case C-371/10 *National Grid Indus* [2011] ECR I-0000; Case C-38/10 *Commission v Portugal* [2012] ECR I-0000.

that must be addressed by the EU in line with the Europe 2020 strategy. In March of each year the European Council agrees upon economic policy priorities on the basis of the AGS. Then, in April, Member States submit to the Commission their national reform programmes (economic policy) and stability and convergence programmes (budget policy), which explain the steps they will take in light of the agreed targets.[20] Following the assessment of these programmes, the Commission publishes 27 country-specific recommendations to coordinate their progress. In July the Council adopts recommendations for each Member State based on the recommendations of the Commission and the conclusions of the European Council, also taking into account the opinion of the Employment Committee and the Economic and Financial Committee. Finally, in the autumn, a thematic peer review and national follow-up assessment take place.

16. In its conclusions of 23-24 June 2011 the European Council assessed the first European Semester and emphasised the need for a 'pragmatic coordination of tax policies', in particular 'to ensure the exchange of best practices, avoidance of harmful practices, and proposals to fight fraud and tax evasion'.[21] Then, in November 2011, the Commission published the AGS 2012, which, unlike the first survey published in 2011, devoted substantial attention to tax matters. It included an annex on Growth-Friendly Tax Policies in Member States and Better Tax Coordination in the European Union that aims to 'further pave the way for tax cooperation to develop more efficient tax systems in order to emerge from the crisis in a better and faster way'.[22] In 2012 the European Council confirmed that 'structured discussions on tax policy issues, notably to ensure the exchanges of best practices' .[23]

    16.1. The Commission has defined five key objectives for growth-friendly tax reforms in the EU: (i) shifting the tax burden from labour towards other types of taxes such as consumption tax, property and environmental taxation; (ii) broadening tax bases rather than raising tax rates or introducing new taxes; (iii) improving tax collection and compliance; (iv) removing the tax bias towards debt-financing; and (v) reforming real estate and housing taxation.[24]

    16.2. In addition, the following three types of issues were addressed through tax coordination measures: (i) the tackling of tax evasion, fraud and the exploitation of loopholes between Member States' tax regulations that results in double non-taxation; (ii) the creation of better business conditions by removing double

[20] The existing coordination model under the European Semester distinguishes between those countries that participate in the Euro Plus Pact (eurozone countries plus Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania) and those countries that have chosen not to sign up (the Czech Republic, Hungary, Sweden and the United Kingdom). The differences are not discussed in this analysis, but, for instance, eurozone countries annually present stability programmes, while Member States that do not belong to the eurozone present convergence programmes.

[21] European Council Conclusions of 23–24 June 2011.

[22] Commission, 'Growth Friendly Tax Policies in Member States and Better Tax Coordination' (Annex IV to the Annual Growth Survey 2012) COM(2011) 815 final.

[23] European Council Conclusions of 28–29 June 2012.

[24] Commission, 'Annual Growth Survey 2013' COM(2012) 750 final.

taxation and other obstacles to the Internal Market; and (iii) the prevention of harmful tax competition from third countries.[25]

16.3. Pursuing its first priority, the Commission launched a public consultation on double non-taxation,[26] and adopted a package against tax evasion and avoidance.[27] Under its second priority, the Commission adopted the Communication on Double Taxation in the Single Market (2011), and is currently investigating the possibility of introducing a binding dispute resolution scheme for removing double taxation.[28] Finally, the third priority involves the reinforcement of the Code of Conduct on Business Taxation.

17. This coordination model carries two important developments for direct tax policymaking:

17.1. First, it introduces the coordination of national tax policies at EU level.[29] In many instances the country-specific recommendations, which are adopted by the Council, include suggested directions for domestic tax policies. For instance, in 2011 Austria was advised to reduce its effective tax rate on income, in particular for earners with a low income; France was advised to introduce tax simplification measures; the UK was advised to reform its taxation of property; and it was recommended to Italy and a number of other countries to address the problem of tax compliance.[30]

17.2. Second, this coordination model demonstrates the change from the 'autonomous' decision-making of the Commission to a closer cooperation with

[25] Commission, 'Growth Friendly Tax Policies in Member States and Better Tax Coordination' (Annex IV to the Annual Growth Survey 2012) COM(2011) 815 final.

[26] DG TAXUD, 'Consultation on Factual Examples and Possible Ways to Tackle Double Non-Taxation Cases' (2012) <http://ec.europa.eu/taxation_customs/common/consultations/tax/2012_double_non_taxation_en.htm> accessed 20 February 2013.

[27] Commission, 'Concrete Ways to Reinforce the Fight against Tax Fraud and Tax Evasion including in Relation to Third Countries' (Communication) COM(2012) 351 final; Commission, 'An Action Plan to Strengthen the Fight against Tax Fraud and Tax Evasion' (Communication) COM(2012) 722 final; Commission Recommendation C(2012) 8805 final of 6 December 2012 regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters; Commission Recommendation C(2012) 8806 final of 6 December 2012 on aggressive tax planning.

[28] Commission, 'Roadmap: Initiative to Address Double Taxation within the EU, including an Arbitration Mechanism for Double Taxation Disputes' <http://ec.europa.eu/governance/impact/planned_ia/docs/2013_taxud_001_arbitration_for_double_taxation_disputes_en.pdf> accessed 20 February 2013 (expected date of adoption: 2013).

[29] See also Article 11 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (2012), 'with a view to benchmarking best practices and working towards a more closely coordinated economic policy, the Contracting Parties ensure that all major economic policy reforms that they plan to undertake will be discussed ex-ante and, where appropriate, coordinated among themselves.'

[30] Based on Commission, 'Country-specific Recommendations 2012–2013' <http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm> accessed 20 February 2013.

Member States.[31] This results in a blurring of the difference between the open method of coordination and 'traditional' soft law.[32] The adoption of recommendations and communications, which was tested at previous stages of European integration, remains at the core of this coordination exercise.

18. While the use of recommendations and communications has become an integral feature of the EU regulatory environment, the Commission makes no attempt to address some problematic issues related to their adoption and effect created by the uncertain constitutional and legal footing of non-binding instruments in the Treaties. A more formalised procedural framework would ensure that the principles of good governance are respected in each case. It would introduce more certainty into the preparatory process, ensuring that compliance with the democratic standards of openness, transparency, respect for the participatory rights of interested parties, effectiveness and coherence are all duly observed. Furthermore, it may help to create more rigorous mechanisms of political control over non-binding measures, which would compensate the limits of judicial review, and contribute to the increased efficiency of tax coordination, which is currently limited.[33]

Enhanced cooperation procedure

19. The enhanced cooperation procedure can be established between nine or more Member States under the procedure envisaged by Article 20 TEU and Articles 326-334 TFEU:

    19.1. The first application of the enhanced cooperation procedure in a tax context is already underway: in October 2012 the Council gave a green light to Article 20 TEU as 'a last resort' option for introducing an FTT.[34] The authorisation decision of the Council was given in January 2013, shortly following the consent of the European Parliament.[35] The Commission presented a detailed substantive proposal in February 2013.[36]

    19.2. The use of the enhanced cooperation procedure is also being considered in the context of the Commission's proposal for the CCCTB Directive, which was

[31] Some examples of 'coordinated' instruments had been adopted before, eg, Code of Conduct for Business Taxation.

[32] On this point see, eg, Susana Borrás and Kerstin Jacobsson, 'The Open Method of Co-ordination and New Governance Patterns in the EU' (2004) 11 Journal of European Public Policy 185, 188-189.

[33] See, eg, Charles E McLure, 'Legislative, Judicial, Soft Law, and Cooperative Approaches to Harmonizing Corporate Income Taxes in the US and the EU' (2007) 14 Columbia Journal of European Law 377, 411.

[34] See Commission, IP/12/1138.

[35] Council Decision 2013/52/EU of 22 January 2013 authorising enhanced cooperation in the area of financial transaction tax [2013] OJ L22/11; European Parliament Legislative Resolution 2012/0298(APP) of 12 December 2012 on the proposal for a Council Decision authorising enhanced cooperation in the area of the creation of financial transaction tax.

[36] Commission, 'Proposal for a Council Directive Implementing Enhanced Cooperation in the Area of Financial Transaction Tax' COM(2013) 71 final.

published in March 2011.[37] In April 2012 the draft was approved with some amendments by the European Parliament under the consultation procedure. The Parliament explicitly stated that the alternative procedural arrangement with the limited participation of Member States should be initiated 'without delay' once it is confirmed by the Council that the legislative proposal lacks the political support of all governments.[38]

19.3. So far, Article 20 TEU has been relied upon only twice (in relation to bi-national divorce and EU patents), which makes the field of direct taxation one of the potential frontrunners in the application of this procedure.

20. The potential economic effects and other implications of the FTT[39] and CCCTB[40] proposals, including in the context of the enhanced cooperation procedure, are addressed in several papers from the Centre for Business Taxation. This contribution only outlines some concerns in relation to the balance of competences, in particular it questions whether the fiscal interests of non-participating Member States are sufficiently protected under the enhanced cooperation procedure:

20.1. As Weatherill rightly notes, 'the evolved patterns of mutual interdependence among the Member States make it implausible that closer co-operation between some will not affect the others to some extent'.[41] For instance, the introduction of the FTT may lead to double taxation due to the existence of conflicting national tax measures in non-participating Member States. It thus may influence the scope of taxing rights exercised by a non-participating country.

[37] Commission, 'Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)' COM(2011) 121 final.

[38] European Parliament Legislative Resolution 2011/0058(CNS) of 19 April 2012 on the proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB).

[39] John Vella and others, see 'The EU Commission's Proposal for a Financial Transaction Tax' (2011) 6 British Tax Review 607; followed by the examination of a proposal published by the European Commission on 14 February 2012 by John Vella, Joachim Englisch and Anzhela Yevgenyeva (forthcoming, 2013).

[40] See Michael P Devereux and Simon Loretz, 'How would EU Corporate Tax Reform affect US Investment in Europe?' CBT Working Paper WP11/18; Leon Bettendorf and others, 'Corporate Tax Consolidation and Enhanced Cooperation in the European Union' CBT Working Paper WP10/01; Leon Bettendorf and others, 'Corporate Tax Harmonization in the EU' CBT Working Paper WP09/32; Clemens Fuest, 'The European Commission's Proposal for a Common Consolidated Corporate Tax Base' CBT Working Paper WP08/23; Michael P. Devereux and Simon Loretz, 'Increased Efficiency through Consolidation and Formula Apportionment in the European Union?' CBT Working Paper WP08/12; Judith Freedman and Graeme Macdonald, 'The Tax Base for CCCTB: The Role of Principles' CBT Working Paper WP08/07; Ana Paula Dourado and Rita de la Feria, 'Thin Capitalization Rules in the Context of the CCCTB' CBT Working Paper WP08/04; Christoph Spengel and Carsten Wendt, 'A Common Consolidated Corporate Tax Base for Multinational Companies in the European Union: Some Issues and Options' CBT Working Paper WP07/17; Jack M Mintz, 'Europe Slowly Lurches to a Common Consolidated Corporate Tax Base: Issues at Stake' CBT Working Paper WP07/14; Michael P Devereux and Simon Loretz, 'The Effects of EU Formula Apportionment on Corporate Tax Revenues' CBT Working Paper WP07/06.

[41] Stephen Weatherill, 'If I'd Wanted You to Understand I Would Have Explained it Better: What is the Purpose of the Provisions on Closer Co-operation Introduced by the Treaty of Amsterdam?' in David O'Keeffe and Patrick Twomey (eds), *Legal Issues of the Amsterdam Treaty* (Hart Publishing 1999) 21, 27.

20.2. At the same time, the authorisation of this procedure is subject to *a qualified majority voting* at a meeting of the Economic and Financial Affairs Council (in the context of the FTT, for instance, the UK, as well as the Czech Republic, Luxembourg and Malta abstained). At the stage of the adoption, 'all members of the Council may participate in its deliberations', but *non-participating states do not* 'take part in the vote' (paragraph 3 of Article 20 TEU and Article 330 TFEU).

20.3. The non-participating Member States 'shall not impede its implementation by the participating Member States' (Article 327 TFEU). This obligation is further enhanced by the principle of sincere cooperation (Article 4 TEU). In turn, 'any enhanced cooperation shall respect the competences, rights and obligations of those Member States which do not participate in it' (Article 327 TFEU). The scope of protection, however, is far from clear.

20.4. The enhanced cooperation procedure is subject to a number of substantive and procedural conditions (in particular, Article 20 TEU and Article 326 TFEU), but their interpretation and practical implementation, as well as the scope of their judicial review, needs clarification.

20.5. Despite an exceptionally rare use of the enhanced cooperation procedure, it has already been challenged in the Court. In Joined Cases C-274/11 and C-295/11, Spain and Italy contested the Council decision that authorised the establishment of enhanced cooperation in the area of the creation of unitary patent protection. The case is pending before the Court. However, if the Court follows the approach taken by Advocate General Bot, the review of substantive conditions stipulated by the Treaty will have a very limited nature.[42]

Preliminary rulings

21. The far-reaching and pro-integration approach of the Court in tax cases has been widely discussed in the academic literature.[43] In some cases, the Court comes very close to the borderline of its competence by taking 'quintessentially legislative' decisions, which can be seen as contradicting the spirit of the Member States' veto power guaranteed by the EU Treaties.[44]

[42] AG Opinion of 11 December 2012 in Joined Cases C-274/11 and C-295/11 (*Spain and Italy v Council*).

[43] See, eg, Servaas van Thiel, 'Removal of Income Tax Barriers to Market Integration in the European Union: Litigation by the Community Citizen instead of Harmonization by the Community Legislature?' (2003) 12 EC Tax Review 4; Peter J Wattel, 'Red Herrings in Direct Tax Cases before the ECJ' (2004) 31 Legal Issues of Economic Integration 81; Suzanne Kingston, 'A Light in the Darkness: Recent Developments in the ECJ's Direct Tax Jurisprudence' (2007) 44 Common Market Law Review 1321; Eric CCM Kemmeren, 'ECJ should not Unbundle Integrated Tax Systems!' (2008) 17 EC Tax Review 4; Pasquale Pistone, 'European Direct Tax Law: *Quo Vadis*?' in Michael Lang and Frans Vanistendael (eds), *Accounting and Taxation & Assessment of ECJ Case Law* (IBFD 2007) 99; Mathieu Isenbaert, *EC Law and the Sovereignty of the Member States in Direct Taxation* (IBFD 2010).

[44] Michael J Graetz and Alvin C Warren, 'Income Tax Discrimination and the Political and Economic Integration of Europe' (2006) 115 Yale Law Journal 1186, 1207 and 1254; see also Michael J Graetz and Alvin C Warren, 'Dividend Taxation in Europe: When the ECJ Makes Tax Policy' (2007) 44 Common Market Law Review 1577.

22. The negative consequences of this situation should be acknowledged:

22.1. The Court is equipped with a limited number of tools (basically, the definition of obstacle and discrimination), so it cannot accommodate many important policy considerations (e.g. economic efficiency) that are seen as essential for complex policy decisions.[45] Taking critical decisions in the field of direct taxation, the Court cannot balance their externalities.

22.2. Analysing the 'trends, tensions and contradictions' in tax cases, scholars either demonstrate the failure of the Court to deliver a well-grounded and consistent result, or disagree upon the logical explanations of divergences.[46] This increases the complexity of national tax systems and deepens legal uncertainty.[47]

22.3. From an institutional perspective, the Court is criticised for lacking specialist expertise, which results in errors occurring in the legal interpretation of international tax law concepts.[48]

22.4. The removal of discriminatory tax provisions at the national level does not always contribute to the establishment of a more level playing field on an EU-wide scale: it could even move the EU further away from reaching the objectives of the Internal Market. This effect was demonstrated by de la Feria and Fuest (2011) through economic modelling.[49] Discussing Member States' reactions to *Marks & Spencer*,[50] where Member States had a choice between extending their group regime to cross-border situations or abolishing it, the authors demonstrated that various responses could increase the differences between Member States in the cost of capital and the levels of production.

23. The most radical solution for the current problems would be to restrict the competence of the Court in relation to matters of direct taxation, which would require a revision of the

[45] The problems related to the tax policy choices made by the Court of Justice are discussed, inter alia, by Graetz and Warren (see ibid). The discussion about the lawmaking role of the Court of Justice also has long roots in EU law scholarship; see, eg, Hjalte Rasmussen, *On Law and Policy in the European Court of Justice: A Comparative Study in Judicial Policymaking* (Martinus Nijhoff Publishers 1986); Karen J Alter, *The European Court's Political Power: Selected Essays* (OUP 2009).

[46] Michael Lang, 'Recent Case Law of the ECJ in Direct Taxation: Trends, Tensions, and Contradictions' (2009) 18 EC Tax Review 98; Mattias Dahlberg, 'The European Court of Justice and Direct Taxation: A Recent Change of Direction?' in Krister Andersson and others (eds), *National Tax Policy in Europe: To Be Or Not to Be?* (Springer 2007) 165.

[47] To this effect see, eg, Luc Hinnekens, 'Forum: European Court Goes for Robust Tax Principles for Treaty Freedoms. What about Reasonable Exceptions and Balances?' (2004) 13 EC Tax Review 65.

[48] See, eg, Peter J Wattel, 'Red Herrings in Direct Tax Cases before the ECJ' (2004) 31 Legal Issues of Economic Integration 81, 82.

[49] Rita de la Feria and Clemens Fuest, 'Closer to an Internal Market? The Economic Effects of EU Tax Jurisprudence' (2011) 12 CBT Working Papers.

[50] Case C-446/03 *Marks & Spencer* [2005] ECR I-10837.

Treaties.[51] The Treaties may also restrict the application of Articles 258 and 260 TFEU in relation to the matters of direct taxation, limiting the ability of the Commission to bring cases before the Court.[52]

24. However, these steps could endanger the integrity of the EU legal order, undermine the Internal Market and infringe the principle of the effective protection of rights under EU law. Therefore, one can question whether they are realistic or even desirable options.

25. Furthermore, the interventionist nature of the Court's jurisprudence is not surprising. As Barav rightly pointed out, '[j]udges have everywhere changed, improved and created the law, even though this has usually been presented as the outcome of a faithful, albeit constructive, interpretation of the law.'[53] The criticism against the Court can be turned against the legislators:

> 'As a result of this limited range of options, solutions prescribed by the Court are not always entirely satisfactory. Sometimes, indeed, they may be the direct cause of legal uncertainty which, in turn, can only be remedied by legislative action. But if such uncertainty is to be deplored, it is not so much because the Court has usurped the proper function of the legislator, but rather because the legislator has failed to act where action has been necessary and required by the Treaty. If the Court has become too deeply involved in making choices between competing policies, it is primarily because the Council has been unable or unwilling to make those choices. In the great majority of cases in which the Court has assumed the role of legislator, the alternatives have not been action by the Court or action by the Council, but rather action by the Court, sometimes in circumstances where such action is contrary to the intentions of the authors of the Treaty, or where the Court lacks the means to secure an entirely satisfactory result, and the non-observance of the Treaty itself, bringing into disrepute the entire fabric of Community law. The Court would thus have been in dereliction of its duty to ensure that in the interpretation and application of the Treaty the law is observed. In such circumstances, usurpation is to be preferred to disintegration'.[54]

26. Therefore, a more feasible solution would need to combine three elements:

    26.1. First, at the substantive level, the CJEU may adopt a more prudent approach by clarifying and strictly observing the dividing lines between restrictions that are

[51] Michael J Graetz and Alvin C Warren, 'Income Tax Discrimination and the Political and Economic Integration of Europe' (2006) 115 Yale Law Journal 1186, 1233. See also the example of some steps made by the UK towards this solution in Claudio M Radaelli and Ulrike S Kraemer, 'Governance Arenas in EU Direct Taxation' (2008) 46 Journal of Common Market Studies 315, 331-332.

[52] ibid 1235.

[53] Ami Barav, 'Omnipotent Courts' in Deirdre Curtin and Ton Heukels (eds), *Institutional Dynamic of European Integration: Essays in Honour of Henry G Schermers* (Kluwer Academic Publishers 1994) 265, 265.

[54] Alex Easson, 'Legal Approaches to European Integration: The Role of Court and Legislator in the Completion of the European Common Market' (1989) 12 Journal of European Integration 101, 119 (citations omitted).

prohibited by the freedom of movement and those that cannot be considered to infringe the Treaties.[55] A wide interpretation of the latter and broadening the scope of permissible justifications for the former can go some way towards re-establishing what might be considered a more acceptable balance between the EU and national fiscal interests.

26.2. Second, at the procedural level, a greater respect could be given to the division of competences between the CJEU and Member States' courts under Article 267 TFEU, with a sufficient degree of discretion left to the latter in the application of the Court's interpretation of EU law to domestic tax provisions, particularly in the assessment of proportionality.[56] The limitation of retrospective effect could help Member States to manage the budgetary implications of case law: this possibility can be linked to a number of qualifying conditions, such as the uncertainty surrounding the application of EU law in a specific case.[57] Introducing the possibility of responding to an Advocate General's Opinion may also contribute to a better account of the specific national legal context in the Court's jurisprudence.

26.3. Third, at the policy level, EU Member States should consider the introduction of follow-up meetings to discuss the implications and potential coordinated policy responses to the most important judgments of the Court. This could be more effective than the Commission's autonomous attempts to stimulate coordinated policy responses from national authorities by adopting interpretative communications (e.g. on the cross-border transfer of losses and exit taxation).[58]

Infringement procedure

27. The recent drop in the number of preliminary ruling has been accompanied by a more pro-active use of infringement proceedings, making direct taxation the largest group of pending investigations in the Commission's portfolio (103).[59] This figure was even more striking in its 2009 peak with 298 direct tax cases pending before the Commission.[60]

[55] See, eg, Suzanne Kingston, 'A Light in the Darkness: Recent Developments in the ECJ's Direct Tax Jurisprudence' (2007) 44 Common Market Law Review 1321, 1358-1359.

[56] See, eg, Pasquale Pistone, 'Ups and Downs in the Case Law of the European Court of Justice and the Swinging Pendulum of Direct Taxation' (2008) 36 Intertax 146, 148. There will always be some room for disagreement on the interpretative path taken by the Court of Justice, with scholars arguing the need for more abstract or concrete rulings; see on this matter Gareth Davies, 'Abstractness and Concreteness in the Preliminary Reference Procedure: Implications for the Division of Powers and Effective Market Regulation' in Niamh Nic Shuibhne (ed), *Regulating the Internal Market* (Edward Elgar 2006) 210.

[57] Michael J Graetz and Alvin C Warren, 'Income Tax Discrimination and the Political and Economic Integration of Europe' (2006) 115 Yale Law Journal 1186, 1224 and 1234-1235.

[58] Commission, 'Tax Treatment of Losses in Cross-Border Situations' (Communication) COM(2006) 824 final; Commission, 'Exit Taxation and the Need for Co-ordination of Member States' Tax Policies' (Communication) COM(2006) 825 final.

[59] Commission, 'Internal Market Scoreboard' (September 2012, No 25) 20.

[60] Commission, 'Internal Market Scoreboard' (July 2009, No 19) 20.

28. Judgments delivered in the framework of Articles 258 and 260 TFEU, which had previously been exceptionally rare, became much more frequent in the last decade. In 2012 infringement cases constituted a quarter of all direct tax rulings that were decided in Luxembourg. According to the information reported by the Commission, the UK direct tax provisions were among the most frequently challenged in 2005–2012.[61]

29. These developments in the pattern of negative harmonisation could be viewed as representing increasing pressure from the Commission. However, the infringement procedure has its benefits: it leaves more flexibility to the Commission and the EU Member State to find a politically acceptable solution that is in line with national tax policies and would also satisfy the requirements of EU law.

30. EU Member States should put more effort into clarifying the procedural ambiguity of infringement proceedings. Despite the overall strengthening of the Commission's enforcement powers by the Treaty of Lisbon, this problem has not been addressed.

What do you think are the main considerations in determining the appropriate level for decisions to be made on tax policy? (Q3)

31. An examination of each proposal through the lens of Article 5 TEU provides the key to determining the appropriate level of decisions. Any EU action should respect three principles:

    31.1. The principle of conferral: EU institutions have only the power that has been attributed to them by Member States through the EU Treaties. In the case of direct taxation, EU actions should be limited to measures that 'directly affect the establishment or functioning of the internal market' (Article 115 TFEU).

    31.2. The principle of subsidiarity: in areas other than those defined as the 'exclusive competence', the EU 'shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States (…), but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level'. This provision thus envisages a two-level test, 'necessity' and 'added-value', to define the appropriate level for actions.

    31.3. The principle of proportionality: 'the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties.' It sets criteria for choosing the best policy option and instrument.

32. Since tax proposals are subject to unanimous voting, an ultimate decision on the appropriate level (subsidiarity) and the scope (proportionality) of EU actions is taken by each Member State. Basic considerations are outlined in the EU impact assessment form.[62] If fully addressed, these questions allow an objective assessment against the

[61] Based on Commission, 'Infringement Cases by Country' <http://ec.europa.eu/taxation_customs/common/infringements/infringement_cases/bycountry/index_en.htm>accessed 20 February 2013.

[62] Commission, 'Impact Assessment Guidelines' (Guidelines) SEC(2009) 92 final, 5.

criteria set in Article 5 TEU, as well as an evaluation of the impact of legislative proposals on the functioning of the Internal Market:

32.1. The identification of the problem includes the evaluation of a proposal in light of 'the necessity and value added test'.[63]

32.2. The definition of policy options includes a consideration of the proportionality principle, and their assessment against the 'criteria of effectiveness, efficiency and coherence'.[64]

32.3. The consideration of impact addresses the direct and indirect implications of economic, social and environmental nature, as well as their assessment against 'the baseline in qualitative, quantitative and monetary terms'.[65]

32.4. The comparison of the available policy solutions should 'weigh-up the positive and negative impacts for each option' evaluated by category of impact and by potential stakeholders.[66]

33. To take a well-grounded decision, the UK government should ensure that a comprehensive impact assessment is also conducted at the domestic level, addressing the benefits and risks of EU actions for the UK.[67] The evaluation of potential policy options should include a consideration of international, EU and domestic policy instruments in view of choosing the best solution and/or synergy of actions undertaken at various levels.

34. Since the UK government declares that 'consultation on policy design and scrutiny of draft legislative proposals should be the cornerstones of [a new approach to tax policymaking]',[68] it should also aim at undertaking public consultations in the context of major EU legislative proposals on taxation. This will help to verify the robustness of the evidence prepared at EU level, as well as to ensure a more UK-tailored evaluation of EU actions.

Are there any other impacts of EU action on taxation that should be noted, including as regards the process for taking action (for example unanimity versus qualified majority voting)? (Q4)

N/A

[63] ibid.

[64] ibid.

[65] ibid.

[66] ibid.

[67] Mentioned to be a target in HM Government, 'Impact Assessment Guidance: When to Do an Impact Assessment' (August 2011), see 'Annex B: Guiding Principles for EU Legislation' <http://www.bis.gov.uk/assets/biscore/better-regulation/docs/i/11-1111-impact-assessment-guidance.pdf> accessed 20 February 2013.

[68] HM Treasury, 'Tax Policy Making: A New Approach' (June 2010) <http://www.hm-treasury.gov.uk/d/junebudget_tax_policy_making.pdf> 3.

Conclusion

35. UK citizens and businesses should be able to benefit from the Internal Market by exercising the right for cross-border movement and non-discriminatory treatment as envisaged by the EU Treaties. However, the UK government is concerned about the tension between the underlying requirements of the Internal Market, which are associated with the elimination of fiscal obstacles for cross-border movement, and the ability of the UK to retain flexibility in designing the tax system. To address these concerns, this written evidence has discussed the major instruments that define the impact of the EU on the UK tax system.

36. It has come to the conclusion that while UK fiscal interests are secured through the unanimity voting procedure in the legislative process, the use of more flexible methods for building the Internal Market, first and foremost the enhanced cooperation procedure, requires more attention. In a two-speed Europe, which is what we are moving into, this issue could well become the main competence concern the UK will have to face: having only a limited possibility of intervening in the process of enhanced cooperation, which undermines the value of unanimity. If the UK government seeks to ensure 'maximum flexibility to shape national tax policy',[69] it should look beyond the traditional concerns regarding the EU legislative process and the Court's jurisprudence, and closely examine ways to protect its fiscal interest in the context of the concerns highlighted in this evidence.

[69] HM Treasury, 'The Government's Review of the Balance of Competences between the United Kingdom and the European Union: Call for Evidence on Taxation', point 3.5.

pwc

HM Treasury
Balance of Competences Review: Taxation
HM Treasury, 1 Horse Guards Road
London. SW1A 2HQ

28 February 2013

[redacted]

Dear Sirs

PwC comments in relation to the call for evidence on tax (balance of competences review)

We set out below our main comments on the November 2012 call for evidence by HM Treasury on the tax element of the analysis of the balance of competences between the EU and the UK. The scope of the paper was described as being primarily Articles 113 and 115 of the Treaty on the Functioning of the European Union (TFEU) though comments were also welcome on the effect of Articles 45, 49-55, 56-62, 63-66 (the freedoms on movement of people, goods, services and capital), Article 107 (fiscal State aid) and Articles 110-112 (taxation).

Given the complexity of the issues we have found it difficult to respond to the questions in the format suggested but have instead attempted to identify some key themes. As you know, we sent various representatives to the meeting on this at the Treasury on 1 February. If you would find it useful, we would be happy to meet with Treasury specialists again to discuss further the range of opinions we formed on the questions posed in the consultation document.

Decided Government policy will ultimately drive whether certain things are seen as advantages or disadvantages. Fundamentally, we are assuming in writing this response that retaining the UK's sovereignty in direct tax while providing a platform for British business to benefit from a single EU market is what is seen as most important from a Government policy perspective. We have not addressed the consequences of significant changes in EU membership. Nor have we considered the impact of the possible development of a 'two-speed community', with a core group of Member States being more generally active than others, bar recognising that the Eurozone (without the UK) and the enhanced cooperation procedure (which could involve the UK either as a participant or non-participant) allow for that to a certain extent on specified matters.

Importance of the courts

We believe that the Court of Justice of the European Union (CJEU) has been a significant influence on the way that EU tax competences have been clarified and applied. We think it would be unhelpful therefore for us to comment on the scope of the relevant competences without reference to the CJEU.

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There has been a marked change over the years in the way the CJEU has handed down decisions. More recently, we have noted a trend for the CJEU to interpret the TFEU less completely, leaving domestic courts to provide further interpretation and Member States having to adjust legislation to comply without complete clarity as to the end result. This inevitably leads to uncertainty and further challenges in the domestic courts and the CJEU. If greater certainty for business is a policy aim for either the UK Government or the EU, Member States could be assisted more in implementing interpretative decisions by EU institutions. For example, the UK was required to implement into domestic law aspects of the judgment of the CJEU in the Marks v Spencer cross-border loss case but, several years later, another action is being considered to determine if UK law now reflects the points of European law being made by that judgment.

Long-running infraction or infringement proceedings do not really benefit any of the stakeholders. This applies both at the initial stages of an infraction case when the Commission challenges the Member State to 'explain or adjust' and if that case or a case brought by a domestic court referral proceeds to the CJEU. The UK's cross-border loss relief proceedings mentioned above have been running for around 12 years. If a policy objective of Government is to interpret CJEU judgments in a manner that preserves the status quo as much as possible and has the least impact on the existing domestic rules, the existing system often provides scope for that. If though the policy objective were to seek to reduce the number of referred cases and increase the speed of resolution of disputes, the UK's court system – by which a challenge to the implementation of a judgment 'reverts' to the lowest court - could be compared unfavourably with other systems which apparently direct subsequent action to a higher or the highest court. Further, when a matter of EU law is concerned, it could also be possible for the parties to request that the European Commission appear as an expert witness in a Member State's domestic court.

Furthermore, if more clarification in CJEU decisions were to be an objective, it would help if there were to be a chance for the parties to comment between the delivery of the Advocate General's opinion and the court's judgment.

Tax and trade barriers

Assuming that a key consideration in making tax policy is the desire to promote and facilitate the free movement of goods and services in the EU in order to help growth in trade and domestic economic activity, there are a number of activities that have been beneficial. The two primary tax provisions mentioned (in Articles 113 and 115) have helped to assist the establishment and functioning of this EU 'internal market'

In this regard, various measures have reduced the administrative burdens on business or removed barriers to trade. An example of this is the agreement on VAT invoicing requirements. A future benefit should be obtained if the current feasibility study on a common VAT return results in agreed action. The Fiscalis programme has facilitated networking, joint actions and training amongst tax personnel (the 2020 version, which will replace the 2013 version from 1 January 2014, will focus, in particular, on IT capacity building which should also bring distinct benefits).

There is also an opportunity to make sure that decisions on tax policy reduce the opportunities for fraud of the type witnessed in Missing Trader Intra Community (MTIC) fraud. The EUROFISC mechanism for Member States to enhance administrative cooperation has provided benefits in this respect.

There are other elements of tax rules which are fundamental to the efficiency of the internal market. It is hard to conceive of such a market without a standard customs regime, for example. Equally, vastly different VAT regimes would be a major constraint on that market and valid attempts are now being made to reduce the number of variations in what has been in practice only a partly-harmonised regime across the EU (although this could have a particular impact on the UK's wide range of zero-rated goods and exemptions). How much direct tax impinges on that market is less clear-cut, although the so-called Parent/ Subsidiary, Interest & Royalties, Tax Mergers and Savings Directives have provided benefits in their respective areas. Those benefits could have been greater had the scope of the Directives not been limited by difficulties in obtaining wide agreement, resulting in understandable but largely politically driven compromises.

Certainty, simplification and transparency

Most taxpayers are particularly keen to have legal certainty about their affairs. That applies especially in cross-border situations, including those involving more than one EU Member State. Equally, governments are not helped by disputes over competence or, in particular, challenges about the appropriate implementation of Directives where EU competence is established. If the policy aim is to create greater certainty for British business in cross-border transactions, EU Member States should be encouraged to use their best endeavours to enact Directives or give effect to CJEU decisions and to point out the extent to which jurisdiction on particular issues lies outside domestic law.

There is a fundamental point about the level of complexity that is created by having one set of UK law which involves a lot of complex rules but then overlaying on top of that EU law which is more principles-based in nature. Apart from the sheer quantity of tax law that taxpayers and HMRC have to contend with, the interaction of the two systems provides additional challenges.

If greater simplicity in tax systems is a policy priority, the existing EU concept of proportionality has at least been an advantage. It has required that action by the EU institutions should not go beyond what is necessary to achieve the objectives of the Treaties. Complexity can arise however as a result of rules not being adequately reviewed and removed or adapted where they don't work as intended. In this respect, complexity could be reduced in future by the use of sunset clauses in new Directives, Regulations, etc to ensure the proper review of the rules and their operation. For most purposes this could be an initial review period of, say three years, with extensions then being agreed every three or five years. These reviews could also potentially include an opt-out for Member States.

Allied to simplicity is the concept of transparency in the activities of EU institutions. There could also be better coordination with the OECD/ UN as organisations which influence a larger group of participating territories. If from a policy perspective greater transparency were considered a desirable outcome, the whole consultation process could be improved and indeed it could be more comprehensive. At the earliest stages, discussion typically takes place with a few interested parties, the identification of which is unclear and often seems to involve individuals who are from an academic rather than business background. When a draft proposal appears, it has often seemed that views within the EU institutions are already fairly entrenched and change has been difficult. There have been few opportunities to challenge impact assessments, though the process of compiling them has sometimes been outsourced – perhaps an Ombudsman could oversee this element. There could also be greater transparency around the discussions of final proposals in Council and of any compromises which are agreed.

Further discussion

Please do not hesitate to contact me [redacted] if you want to set up a meeting to explore our views further.

Yours faithfully

[redacted]

For and on behalf of PricewaterhouseCoopers LLP

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Your reference:
Our reference: COR/716/2012

David Gauke MP
Exchequer Secretary to the Treasury
HM Treasury
1 Horse Guards Road
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Dear David

12 February 2013

Thank you for your letter of 10 December 2012 to inform me of the launch of the Balance of Competence on Taxation: call for evidence. I want to make some general points rather than responding to each of the questions in the consultation separately.

Northern Ireland like the rest of the UK is dependent on international trade and exports if we are to achieve the higher levels of growth that we need. I recognise the importance of ensuring that there is a level playing field within the internal market and therefore fully accept that as a nation we need to meet our EU and wider international obligations to promote trade and remove harmful restrictions. That said, it is also absolutely vital the Government retains maximum flexibility to shape UK tax policy to suit UK economic circumstances.

One important element of these circumstances that you have not referred to is the UK's continuing work on the development and extension of devolution and fiscal powers are a key part of that. The UK should be able to determine the respective powers it either devolves to local administrations or how the tax system should be adjusted by central Government to respond to the individual needs of its nations and regions – needs which in Northern Ireland's case are unique in the UK context given the land border we share with the Republic of Ireland.

As you know the Executive regards the early devolution of corporation tax powers as vital if we are to be able to rebalance our economy and compete with the Republic of Ireland for international investment. The other area where we are experiencing difficulties and where a regional approach is needed relates to taxes that are, or were, environmental in origin. The Government has recognised this in the recent progress we have made in relation to Air Passenger Duty and the Carbon Price Floor. However, there are other areas where I believe the tax system should be tailored to the individual needs of the Devolved Administrations and state aid regulations as currently specified constrain us in this. As you will be aware the suspension of Northern Ireland's Aggregate Levy Credit Scheme is a prime example of this and one which is having a detrimental impact on the local economy.

Similarly current EU vires on VAT restricts our ability to put in place differential rates within the UK – for example reduced rates for hospitality and tourism which is an issue I have also raised with the Treasury given the lower rates that are applied in the Republic of Ireland. Greater flexibility in this regard would enable Northern Ireland to level the playing field with the Republic of Ireland which is a key objective of the internal market.

I am also concerned about the indirect tax proposals highlighted, and in particular the proposal for a Financial Transaction Tax that in my view could adversely affect UK competitiveness in financial services, a sector with is also important to Northern Ireland as we seek to attract Foreign Direct Investment.

As I said at the outset, this is an important issue. Fiscal powers are key economic levers and it is vital, particularly in the current climate that we can use them to maximum effect. I look forward to the Treasury's findings in this regard once this exercise has been completed.

Yours sincerely

SAMMY WILSON MP MLA

BALANCE OF COMPETENCES BETWEEN THE UK AND THE EU

TREASURY CONSULTATION ON TAXATION

SCOTCH WHISKY ASSOCIATION VIEWS

Overview

The Scotch Whisky Association (SWA) welcomes the opportunity to provide input to the UK government's Balance of Competences review.

The SWA is the industry's officially recognised representative body, responsible for protecting and promoting Scotch Whisky both at home and abroad. The Association's members export to over 200 markets worldwide; in 2011 industry exports were worth £4.23 billion, representing nearly 25% of all UK food and drink exports. (With member companies also owning the import and sales teams in many overseas markets, the real value to the industry and UK plc is far higher.)

Sales of Scotch Whisky within the 27 EU Member States totalled more than half a billion bottles, or about 42% of the industry's volumes. The EU is vital to the industry's long term sustainability, both as an internal market and as a strong voice in international trade negotiations.

The trade environment within the EU internal market, in which one set of common rules applies, is immeasurably simpler than the alternative in which 27 different regulatory regimes would operate. The EU rules, agreed with considerable and very helpful input from UK officials and MEPs, impact on almost every facet of trade in Scotch Whisky. These include: spirits definitions; protection of 'geographical indications' (such as Scotch Whisky); labelling; taxation; a standardised range of bottle sizes; holding and movement of excisable products; and environmental issues.

While the internal market is not perfect, the existing arrangements permit the UK Government to help shape the rules which govern it; they also greatly facilitate the resolution of problems from the inappropriate application of EU rules. Securing and maintaining an optimal trading environment requires a strong UK presence when legislation is being prepared or amended.

The influence of the EU extends well beyond the single market. The Commission, again with considerable input from UK officials, has been a strong and effective supporter of the industry's wider interests in international trade negotiations whether at the multilateral, regional or bilateral level. It has also successfully secured the removal of tax and other discrimination against Scotch Whisky in third countries using the World Trade Organisation's dispute settlement mechanism. As the world's foremost internationally traded spirit drink, Scotch Whisky derives enormous benefit from the EU's expertise and negotiating muscle in the areas of trade policy and market access globally.

Consequently, the SWA is a strong supporter of maintaining the UK's active involvement within the EU. In the fields of internal market regulatory harmonisation and international trade policy, we see no issues which require subsidiarity or to be repatriated to national level.

The section below provides views on the consultation questions of most relevant to our sector.

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Impact on the national interest

- EU action against tax discrimination within the EU and in third countries has been of critical importance for the Scotch Whisky sector.

- When the UK joined the EEC in 1973, there was tax discrimination against Scotch Whisky in several Member States, including Denmark, France and Italy. The UK's bilateral negotiations were unsuccessful and complaints followed at EU level. The cases were referred to the ECJ and the Court's decisions led to the removal of discrimination in those countries and provided a level playing field for Scotch Whisky.

- The principle of non-discrimination has been repeatedly used by the Commission, at the SWA's prompting, in, e.g. enlargement negotiations, to remove preferential taxation favouring domestic products or high tariffs. Hungary, Lithuania, Poland, Romania and Turkey have all had to remove (or are removing) tax and tariff protection which distorted competition against Scotch Whisky.

- The Commission has also been a very forceful advocate when dealing with tax discrimination in third countries. It has secured victories in WTO Dispute Settlement cases in Japan, Korea, Chile and the Philippines. It has also secured victories at WTO without the need for a Panel Ruling (India, Thailand). In acting for the 27 it carries more weight, and has greater consolidated experience and expertise, than one country alone.

- The Electronic Excise Movement and Control System (EMCS), introduced in 2011, largely runs well and has been a positive force in ensuring the smooth tracking and transit of excise goods within the EU.

- Less positively, EU tax Directives require Member States to apply minimum rates according to category: on spirits the rate is €550 or €1,000; on beer it is €187 and on wine it is zero. The alcohol component of wine, beer and spirits is identical and they all compete in the market. The minimum rates skew the market heavily in favour of wine and beer and against spirits. This regime serves little practical purpose, entrenches the principle of discrimination against spirits and could well be removed while maintaining the movement and holding regulations.

- In a similar vein, many Member States (at least 15) are allowed derogations from the broad principle that competing products should be taxed identically. These also distort the market and protect national spirits. The poor controls on these sectors often mean low- or no-tax distillates leak into commercial sales channels.

Future options

- The excise tax structures for alcoholic beverages within the EU should ensure all alcoholic beverages can be taxed according to alcohol content across the Union.

- The Commission is due to review some of the excise tax derogations over the next 2-3 years. We hope this will result in the removal of the preferential regimes, such as for French Overseas Department rum, and improvements in the operation of low tax facilities in countries in the east of the EU. These issues are better pursued through the EU processes than on a national basis.

Conclusion

The SWA firmly believes the UK's EU membership and the Single Market in particular have provided significant benefits for Scotch Whisky. Scotch Whisky is the EU's most important Geographical Indication (GI) spirit, and the UK government has a vital role in ensuring the trade environment is appropriate for our sector and other UK businesses through the EU mechanisms. The Association therefore sees no advantages, and many disadvantages, in altering the current balance of competences in this area.

Edinburgh
February 2013

UK MUSIC

[redacted]
Balance of Competences Review: Taxation
HM Treasury, 1 Horse Guards Road
London
SW1A 2HQ

22nd February 2013

[redacted]

We are writing to you in response to the HM Treasury call for evidence on Taxation as part of the Government's review of the balance of competences between the United Kingdom and the European Union.

UK Music is the umbrella body representing the collective interests of the UK's commercial music industry, from songwriters and composers to artists and musicians, studio producers, music managers, music publishers, major and independent record labels, music licensing companies and the live music sector.

UK Music exists to represent the UK's commercial music sector in order to help drive economic growth and to promote the benefits of music on British society. The members of UK Music are listed as an annex.

UK Music welcomes the UK Government's Balance of Competences review between the UK and the European Union. We value the opportunity to provide an analysis of what the UK's membership of the EU means for the UK national interest and how that might impact on our sector. We would like to focus this initial submission on the issues of copyright and withholding tax (ie tax withheld at source), and in particular in response to question 5[1] of HM Treasury's call for evidence.

The European Union and Copyright

Intellectual property is the economic framework which underpins the music industry and other British creative industries. Copyright is the currency of that framework. Every song or recording made by a creator or artist can be licensed for value in the UK and globally, therefore generating a substantial positive balance of export income for the UK from copyright licensing. It provides an incentive to industry to invest in new creative content.

UK membership of the European Union provides a fundamental basis for copyright industries such as music. Copyright law is harmonised in several areas

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[1] Q5. How might the UK benefit from the EU taking more action on taxation? p. 27

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by EU Directives under EU competence. Changes made at an EU level on copyright, such as the 1993 Term of Protection Directive, as well as the soon to be implemented 2011 Term Directive, demonstrate how changes made to copyright within the European Union can have a positive impact on UK creators such as composers, songwriters and musicians, as well as the wider industry.

Respect for international copyright obligations, such as the Berne Convention, is imbedded within the membership of the European Union. UK Music relies on certainty offered by the European copyright framework. Our industry is one of the few sectors which can deliver improved rates of growth, exports and quality employment. We ask Government to support a harmonised copyright framework which will allow us to do all those things.

Withholding Tax

There is limited EU competence for tax. Yet, the operation of national tax systems directly impacts the flow of royalties from EU territories, across borders back to the UK.

Withholding tax is tax withheld at source. When claiming tax relief or exemption for foreign income in the form of royalties, individual creators and music industry companies and collecting societies are directed to HMRC to claim relief or exemption either by filling in a claim form from the relevant country's tax authority or to apply for a certificate of residence.

The process incurs compliance costs and delays, complex administration necessary to deal with different tax rules by different member states and exposure to double taxation if appropriate tax treaties are not in place.

The international success of UK music industry, which generates £3.8 billion for the economy, and its strength as one of the three net exporters of music in the world, means that the problem for the UK is more acute than for other Member States.

The UK bears a loss in terms of revenue left abroad as well as a compliance cost.

The UK and Sweden are the only territories in Europe which are at risk of a net loss of tax revenues when comparing tax withheld by other states on income remitted to the UK compared to tax withheld on income remitted by the UK to other member states for music royalties.

The UK's commercial music sector is largely made up of individual creators and small and medium enterprises. The delays and complexity connected to the withholding tax procedures is extremely damaging to businesses with small or limited cash flows.

The lack of harmonised processes for administering withholding tax also increases the complexity and cost of cross border licensing, to the detriment of UK's successful creative industries. Some competency does exist at a European level within the Interest and Royalties Directive, the latest amended version of which is

UK MUSIC

now with the Council of Ministers. But even this is limited and applies only to cross border transactions between "associated companies" which therefore only benefits major multi-national companies and a small number of music companies exporting from the UK. Further, the definition of royalties does not specifically include music.

The Government should consider the distortion and/or restriction of trade between EU territories with regard to taxation on performers. The cost of doing this is sometimes more than the tax due to be repaid. The cost for small developing acts to appoint professional advisers when visiting another territory is disproportionate to the income that will be received. This could be reformed via the consideration of a de minimis fee across EU Member States under which no tax is withheld, which is consistent with the approach of HMRC's Foreign Entertainers Unit. The approach of the UK Government in this regard is not reciprocated however as UK artists, musicians and bands are effectively being discriminated against by various EU Member States.

To address the problem of 'triangulation', (the conflict between multi-lateral copyright licences and bi-lateral tax treaties), we recommend that the UK leads a process of coordination with other Member States to get much greater visibility to how each Member State will apply tax rules to cross border transactions.

The scope could cover the application of tax rules, encouraging transparency, streamlining processes, and the issuing of appropriate guidelines in order to address further problems associated with withholding tax where competency does not exist. This guidance should be made available in all EU Member States, with advice on how to claim back overpaid amounts. These guides should also be available in all EU languages and easily accessible in a single information portal. This could have the benefit of enabling automation and self service, as well as reducing admin and bureaucratic delays.

UK Music would happily sit with officials to help draft a UK template for such guidance.

As outlined initially in this response, there is benefit to the UK music industry where competency exists at a European level, such as harmonisation of intellectual property, development of the single market and the digital agenda.

This benefit could be greatly enhanced by simpler and less cumbersome cross border withholding tax practices.

We look to the Government to give this issue priority in their continued discussions with European institutions and Member States.

Yours sincerely,

[redacted]

Jo Dipple, CEO
UK Music

UK MUSIC

UK Music's membership comprises of:

· AIM – Association of Independent Music - representing over 850 small and medium sized independent music companies

· BASCA - British Academy of Songwriters, Composers and Authors – with over 2,000 members, BASCA is the professional association for music writers and exists to support and protect the artistic, professional, commercial and copyright interests of songwriters, lyricists and composers of all genres of music and to celebrate and encourage excellence in British music writing

· The BPI representing over 440 record company members

· MMF - Music Managers Forum - representing 425 managers throughout the music Industry

· MPG - Music Producers Guild - representing and promoting the interests of all those involved in the production of recorded music – including producers, engineers, mixers, re-mixers, programmers and mastering engineers

· MPA - Music Publishers Association - with 260 major and independent music publishers in membership, representing close to 4,000 catalogues across all genres of music

· Musicians' Union representing 30,000 musicians

· PPL is the music licensing company which, on behalf of 50,000 performers and 6,500 record companies, licences the use of recorded music in the UK

· *PRS for Music* is responsible for the collective licensing of rights in the musical works of 92,000 composers, songwriters and publishers and an international repertoire of 10 million songs

· UK Live Music Group, representing the main trade associations and representative bodies of the live music sector

The Wine and Spirit Trade Association

Introduction

The Wine and Spirit Trade Association (WSTA) is the UK organisation for the wine and spirit industry representing over 340 companies producing, importing, transporting and selling wines and spirits. We work with our members to promote the responsible production, marketing and sale of alcohol and these include retailers who between them are responsible for thousands of licences.

We work with Government Departments such as Defra, the Food Standards Agency and BIS to ensure UK implementation of EU regulations is as smooth as possible for the alcohol industry.

We also work with our European colleagues through Comité Vins and Spirits Europe to ensure that existing and future European legislation relating to wines and spirits does not adversely impact businesses in our sector.

1/ Food safety and labelling

The production and labelling of wines and spirits is governed by EU law. The EU's common market organisation for wines and spirits means that product labelling, descriptions and definitions are harmonised across all 27 member states and provide protection for EU product denominations.

This arrangement has facilitated trade between EU member states which has been broadly advantageous for the UK and its consumers.

However, the single market has in some instances created issues in relation to imports of some products from outside the EU which are not always compliant with EU standards, but many of these have been (or are being)dealt with via bilateral agreements between the EU and third countries.

We therefore believe that it would not be possible or desirable for the UK to attempt to repatriate powers on specific legislation governing the production of wines and spirits and aromatised wines.

2/ Consumer Protection Policy

Consumer Protection Policy at EU level has been reviewed recently and a new Directive on Consumer Rights will come into force on 13 June 2014. While UK Consumer Protection Policy has always been relatively high compare to other EU member states, the new Directive will introduce improved consumer protection principles such as stronger withdrawal rights, increased clarity of prices and more transparency.

The Commission's efforts to harmonise Consumer Protection Policy across all member states will in time provide EU consumers with the needed guarantees and safeguards to have the confidence to shop across borders and, as such, should be welcomed.

According to a recent report for the European Commission, cross-border online shopping in the EU has increased from 6% to 11% between 2006 and 2011. This is in part due to improvements in EU Consumer Protection Policy. (ref: 'Consumers' attitudes towards cross-border trade and consumer protection", EC May 2012').

3/ Excise Duty

Directive 2008/118 on the general arrangements for products subject to excise duty is the key directive governing the structure of excise duty across the EU. This sets the basis upon which excise duty is levied on alcoholic drinks.

The Directive allows EU member states to set their own rate of excise duty and also to charge a 'zero rate' on some products such as wine where for instance 15 out of 27 EU member states do not currently charge any excise duty at all.

Having an EU directive which sets the basis upon which alcoholic drinks are taxed provides certainty for operators who trade across borders, but within a single market, as they only have one taxation system for 27 member states.

We believe it right for the UK to retain sovereignty over setting its own excise duty levels within the parameters of this Directive, but we believe the structure of excise duties (i.e. the basis upon which taxation is levied on alcohol) should remain under EU control.

This is illustrated by several European Court of Justice cases which have been brought against some EU member states who were thought have set levels of excise duty on some products at a rate which was unfairly disadvantageous to other products.

One such case was brought against the UK in 1983 (European Commission vs UK, ECJ 170/78). The European Court of Justice ruled that still wine and beer were competing products and that taxing wine in excess of the equivalent rate of beer in a beer-producing and wine-importing country was against the Treaty of Rome, since it discriminated against products of other Members States. As a result of this ruling, the UK was required to bring wine and beer duty rates into line and rates for wine and beer have moved in parallel ever since.

4/ Environmental Legislation

Regulation aimed at 'greening' supply chains has not yet been adopted at EU level, but is under active consideration. Although the EU is the right level at which to address most environmental issues, a badly constructed EU Regulation based on poor evidence could prove excessively burdensome for business, especially SMEs and micro businesses, potentially leading to insolvencies and discouraging new start-ups.

Where a future EU Regulation is adopted, standards should be reasonable and adoption progressive; it should encourage efficiencies; and enforcement should be devolved to national level. Above all, new regulation should not be a barrier to international trade.

5/ Working Time Directive

Different sectors need additional labour at different times. For example, elements of the UK wine and spirit supply chains need extra hours in the run up to Christmas. **We believe that working time should be decided at national (or business) level and would encourage the UK government to negotiate removal of the Directive. At worst, the UK government must preserve its current 'opt out'.**