

CONFLICTS IN THE INTERNATIONAL TAX LAW AND ANSWERS OF THE EUROPEAN TAX LAW

Éva ERDŐS*

ABSTRACT: *This study tries to show the essence of the international tax law, and gives a definition of it, as the origine of the international tax conflicts, but secondly the international tax law solved the international tax conflicts. One device of the solving method of the international tax law is the international treaties between the Member States about the avoidance of the double taxation. We should give a definition to the European tax law, as the result of the European tax harmonisation, but the main question is, that how can the European tax law connect to the international tax law? The European tax law is one part of the international tax law, it contents the 27 Member State's national tax law, and their legal sources and own solutions of the international tax law's conflicts. Furthermore in one hand the international tax conflicts are originated from the international and European tax law, but in second hand the international and European tax law is a legal-field, which gives solution for these conflicts and for the international tax problems. What kind of conflicts have the international and European tax law, and what kind of solutions have in the European tax law? This study try to show the most knowing international tax conflicts- as double taxation, tax evasion, tax discrimination - and the relief from it, the solutions and answers of the European tax law, like legal sources of the European tax law, and the cases of the European Court of Justice.*

KEYWORDS: *international tax law, European tax law, tax discrimination, double taxation, avoidance of the double taxation, tax conflicts, tax cases, European Court of Justice.*

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1. DEFINITION OF THE INTERNATIONAL TAX LAW

1.1. The elements of the International tax law

Sovereign states have independent tax regulations, these tax systems vary widely. The principles often coincide with the methods of taxation that leads in the international relationships to injustice causing for example double taxation.

International tax law is an aggregation of regulations that tend to reach:¹

*Associate professor, PhD, Head of Department of Financial Law, University of Miskolc, Faculty of Law and Political Sciences, HUNGARY.

¹ IBFD International Tax Academy: Introduction to Principles of International Taxation, Price Waterhouse Eastern Europe, Budapest, 1994. p.1-2.

a.) equitable and fair taxation on the area of international economic relations with the following instruments:

- the principle of „paying ability”: scheduled taxation (fixed rate, or by source, but not with different tax rate for each individual tax-payer),
- VAT² and the progressive income taxes (VAT does not make any difference between tax bases in aspect of tax liability because the same % must be paid after the same product or service; progressive income tax means more the income, more the tax),
- the principle of equality (the same tax-law „treatment” is used for the same circumstances),

b.) elimination of „distortion” in the international investments, for example regional incentives (tax benefits of companies established on tax free zone, more favourable, lower tax rate; or the usage of any other incentives).

The tax: historical category, it is always connected to the states existence and functioning, it can be derived from a state sovereignty each and every sovereign state has individual tax-law and tax system.

The tax system of a state: aggregation of taxes used commonly at the same time on the territory of the state.

Right of taxation: concerning the sovereignty of the state, each state decides individually (these make the difference between the tax systems of the states):

1. What are the taxes imposed – *type of taxes*. How many and what kind of tax is in a state? (EVA is only in Hungary nowhere else in the EU)
2. Whom and what does it want to tax? Who will be the *taxpayer*? What will be the *subject of the tax*?
3. What is the order of *tax base calculation amongst each tax*? (this is since 2002 a topic in the EU, the corporate income tax is to be unified, so there won't be high conflicts in calculation of tax base)
4. How is the *tax rate* in the individual taxes?
5. What *tax exemptions* are there?
6. What tax preferences are used? (After the regime has changed Hungary had a characteristic to give the foreign investors high tax preferences from corporate income tax, these regulations had to be abrogated in the year to year changing corporate tax rules since the mid 90's).

The items listed above, not only determine the states national tax system, also those elements within the tax system in which each state's tax norms may be different. They do differ, because the international taxation does not know in two or more states completely equally regulated taxes and tax rules.

These differences lead to *conflicts in the area of international tax law*.

Most common international tax law conflict is the problem of double taxation.

² VAT = Value Added Tax

1.2. The definition and border of international tax law:³

a.) *In narrower meaning:*

In narrow sense the international tax-law is the aggregation of those national rules, which arise from the conflict of tax-law norms occurring from each states sovereignty, they trigger the tax-law conflicts, i.e., it is the law of national tax-law conflicts arising from the diversity or tally (duplication) of each nations internal tax regulations and the different or even the same tax systems. These fall under each nation's internal tax legislation which conflicts with other nations internal fiscal rules, in the international tax-law relations. (double taxation).

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

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

c.) *In the broadest sense, international tax law:*

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

- international bi- and multilateral treaties
- treaties about the avoidance of double taxation,
- EU treaties and secondary legislation,
- results of harmonisation (EU, OECD, UN treaties),
- the international customary law,
- the international case law, mainly the decisions of the European Court.

The international tax law is the law of international and national tax law conflicts, and of rules established by national law related to international finances (for example foreign tax payers, the activities of foreigners or the conflict of "local" taxpayers.) This is the international and national conflict law and the national substantive law, for example; unilateral rules in cases where the tax responsibility of foreigners is questioned.

In cases falling under the first interpretation (a.) international tax law creates the collision, however in the second and third cases (b., c.) it finds solutions to conflicts, resolves the international tax-law conflicts.

The international tax law includes:

- a) *international treaties concluded in subject to avoid double taxation:* they resolve to overwrite the states internal tax-law (for example Hungary has one with each EU state, but with the USA the amendment has not yet in 2011 entered into force),
- b) *the European tax harmonisation:* its aim is to close the member states tax rules. This means that there is a supra national law - the tax law of the EU - that has priority against national law.

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

b.1. with primary source of law: founding treaties and their amendments, it is important to mention that these rules enforce without any specific national legislative act,

³ Basic themes in international taxation in IBFD International Tax Academy: Introduction to Principles of International Taxation, Price Waterhouse Eastern Europe, Budapest, 1994. p. 3.

b.2. with secondary source of law: In the directives of the European Council (Acting by unanimity or qualified majority with the proposal of the Committee, in the subject of taxation), or for example the Code of Conduct for Business Taxation -that is implemented individually in the member states. The tax preferences of foreigners had to be repealed in Hungary as a result of this.

b.3. Case decisions of the European Court: In connection with Hungary almost all cases entering the court were cases involving taxation. (pl. case of registration tax, HIPA case about the local business tax, Cartesio case - home transfer taxation decisions, Parat case - decisions concerning the reimbursement of the VAT on state aid.)

*International tax-law as the law of conflict and collisions:*⁴

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

Distinction between international private law and international tax law:

- the international private law by the collision of states law uses the „or-or” principle too, and resolves the conflicts with conjunct principles, despite this the international financial law allows too the double or multiple dispensation of justice, but tries to overcome the overlapping by international treaties or by the harmonisation of European tax law;
- fiscal law is public law the international tax-law, in which taxes are levied (mandatory rules, parties assignment above and below), thus international private law allows the parties to choose (dispositive rules), (the right to choose between different state laws, thus in tax-law cases there is no right to choose).

The characteristics of international tax law relationships:

- parties are in relation of dependency,
- regulates with mandatory rules,
- it is part of public law,
- creates tax law conflicts,
- resolves these conflicts: this happens with conjunct principles, that are principles to the international tax law, and they usually limit the borders of EU law and the double taxation treaties.

2. INTERNATIONAL TAX-LAW CONFLICTS

2.1. The most common conflicts of the international tax

1. conflict of double taxation (for example: an income is taxed in two states at once)
2. tax avoidance, evasions' conflict
3. conflicts concerning tax heavens, off-shore firms
4. conflict because discrimination between foreign and domestic taxpayers
5. harmful tax competition
6. conflicts arising out of breach of international tax law principles

⁴ Basic themes in international taxation (1994) no. p. 3-4.

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

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

For example in the international taxation there are principles and conjunct.

Connecting criteria (conjunct principles).

Principle of residence: in general, a state levies a tax by the *domestic residence*, the domestic residence is determined by the connecting criteria,

taxation by residence principle	×	×
	A. state	B. state
taxation by source principle		X

who is concerned as domestic in the tax law (for example Hungarian PIT - who is a Hungarian citizen and has a permanent residence in Hungary - or habitual residence is in Hungary - if he stays in one place for 183 days in a year, or where the centre of existence is, i.e. the place of most important family and economic ties). This is considered as *personal connecting criteria*.

Source principle: where the income is generated, there must also the tax be paid.

This is the *economic, territorial connecting criteria*.

The principle of general and proportionate sharing of taxation: everyone has to contribute the general and proportionate sharing of taxation in proportions to property and financial conditions in the state of residence. Everyone shall contribute to public services where it is actually availed. By the general and proportionate sharing of taxation the citizens obtain a part of the paid taxes in form of public services.

Tax heaven: it is illegal, but the actual violation is not realized, but the principle of discrimination is harmed, and the international taxation principle, the prohibition of harmful tax competition is also violated.

2.1.2. Conflict of tax evasion/tax avoidance

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

- a) *tax avoidance*: it is at the border of criminal grade, it can be allowed, there is no illegality.
- b) *tax evasion*: it always has a purpose that violates the law.
- c) *fraud*: the highest rate of tax evasion, it falls under criminal law provisions, and it can lead to tax evasion, and there is always violation of law.

2.1.3. Conflicts concerning tax heavens, off shore companies

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

2.1.4. Conflicts because discrimination between foreign and domestic taxpayers

Discrimination can be

- a) positive: it can occur in the form of tax relief, for example when in Hungary the foreign off-shore companies had to pay only 3% instead of 18% (until 2004.)
- b) negative: a foreign taxpayer does not receive the same tax benefits as a domestic (for example. Bachman-case: A German dentist is settled in Belgian, he starts its work there, and he is not subject to those tax relief as a German enterpriser; In Hungary until '96 foreign individuals could not be self-employed

This is linked to two other important international tax law principles:

- *national treatment principle* = principle of equity: the foreign tax payer has to be the subject to the same reliefs and exceptions as the residents, this is violated for example when the state grants the foreign investors investment tax credits, so the foreign capital can be lured to the.
- *the principle of competitive neutrality*: to each taxpayer, whether foreign or domestic has to be granted the neutral economic environment.

2.1.5. Harmful tax competition

A tax competition is harmful when it bends the economic competition (for example investment tax credits granted for foreign investors) it can occur in a single state or even in the EU, i.e. also between states. We can talk about it, if someone does not contribute to public services at the place of usage. ECOFIN Council rules 2008: Code of Conduct for Business Taxation: it is not a source of law, it is not executable, and it is not enforceable, but prevails by voluntary law abiding. The Code of Conduct requires Member States to refrain from introducing any new harmful tax measures (“standstill”) and amend any laws or practices that are deemed to be harmful in respect of the principles of the Code (“rollback”). The Code covers tax measures (legislative, regulatory and administrative) which have, or may have, a significant impact on the location of business in the UNION. The criteria for identifying potentially harmful tax measure include: ⁵

- an effective level of taxation which is significantly lower than the general level of taxation in the country concerned ;
- tax benefits reserved for non- residents ;

⁵ http://e.europa.eu/taxation_customs/taxation/company_tax/harmful_tax_practices/index_en.htm _2009_10_01.

- tax incentives for activities which are isolated from the domestic economy and therefore have no impact on the national tax base;
- granting of tax advantages even in the absence of any real economic activity (off shore rules);
- the basis of profit determination for companies in a multinational group departs from international accepted rules, in particular those approved by the OECD;
- lack of transparency.

2.1.6. Conflicts arising out of breach of international tax law principles

The main conflicts are the cases of tax discrimination, when the countries ignore the rules of equity and neutrality, and make anti discrimination with foreign and inland taxpayers.

The other example of this collision, if two states use the same connecting criteria, or violate the discrimination or sustain regulations that lead to harmful tax competition.⁶

2.2. Origin of conflicts concerning double taxation:

a.) the national tax law establishes connecting factors between taxpayer and the taxing state

- according to citizenship, residence, habitual residence, family ties (personal factors) and
- according to the source of income, location of property or the place of activity (these are the economic factors);

b.) overlap in the jurisdiction of individual nations may occur:

- different connecting factors (see above) determine the tax liability for the same tax subject (for example in the case of income from country A and B → the *principle of source*: A levies taxes and B levies taxes after the *principle of residence*. This leads to economic double taxation);
- or in both national jurisdiction is the same connecting factor used: but each state is establishing different criteria to the varying factors. (for example: the principle of residence is determined in country A by the time of habitation, but in country B the determination is the residential availability. This too leads to double taxation.)

In both cases the problem can be eliminated if both countries follow the principle of territory, so each country levy taxes only the income generated on its own territory. This can be managed with the internal legislation too, but if the principles are mixed even in the internal legislation, like in the Hungarian PIT statute, in that the local individual residence after the total income - either from domestic or foreign sources - while the non-residences have to pay tax after the internal income. The bi- or multilateral international agreements dealing with the question of the avoidance of double taxation can hand a solution.

The conflict is rooted in the different taxation concept and principles of the sovereign countries. The solution of this collision is the treaties between the countries about avoidance of double taxation. The main purpose of these treaties is the avoidance of double taxation on income earned in any of these countries. Under these agreements, a credit is usually allowed against the tax levied by the country in which the taxpayer

⁶ See above in the point of II.1.5.

resides for taxes levied in the other treaty country and as a result the tax payer pays no more than the higher of the two rates. Further, some treaties provide for tax sparing credits whereby the tax credit allowed is not only with respect to tax actually paid in the other treaty country but also from tax which would have been otherwise payable had it not been for incentive measures in that other country which result in exemption or reduction of tax.

3. SOURCES OF INTERNATIONAL TAX LAW⁷

During the International transactions tax rules can have basically 4 different sources:

- a.) the domestic tax law of the country, that is involved in the international transaction
- b.) the other (the third country)- also is involved- countries law
- c.) and the relevant potential tax preferences between the states,
- d.) and the European tax law sources.

The domestic tax rules define the main base of the applicable law (meaning that in both domestic and international transactions should be applied). The international rules define, if there is a taxation difference between international or domestic transaction.

These rules can only be applied in international transactions, and involve such rules like tax credits for foreigners or the rules of tax withholding and the source of income.

Treaties excluding double taxation are changing the national tax rules on the basis of income taxes. They often provide source rules to avoid double taxation, or they allow special tax withholding. If there is a conflict between tax convention on income and the national tax law, the main rule is, that on the taxpayer applies the best (with the lowest cost) rule. In fact the main problem is that there is no higher -supranational- international tax law, which would be valid for all nations.

In the tax-law of the big international organisations, principles can be discovered (for example EU), or the various agreements between sovereign states (GATT, OECD) contain such provisions, that generally applies to international transactions.

Similarly significant are the guidelines of the European Union, primary and secondary legal sources that in some cases - if they contain favourable rules for the taxpayer - heading the national tax-law provision.⁸ The German court made an example for that⁹, when it placed the legislation of the European Union in advantage against the domestic tax-law. Indeed, in a case according to German tax-law, sales-tax exemption would have prevailed based on principles adopted by the EU member countries. The German entrepreneurs did not pay tax referring to the EU principle, however the tax office referring to the German tax-law identified tax deficit. The German financial court ruled in the favour of the tax payers, so basically it repealed its own specific domestic tax-law rules. This was forced by the competitive neutrality within the regulations of EU member states. So the European Union's laws take precedence over domestic law also in the field of tax law.

⁷ Base companies and general principles of international tax law IBFD International Tax Academy Introduction to principles of International Taxation, Budapest , 1994. p. 213

⁸ H. Rieger, Prinzipien des Internationalen Steuerrechts als Problem der Steuerplanung in der multinationalen Unternehmung 86. (1978.)

⁹ Tax strategy of Austria in: Ausztria Európában Dr. Nagy Imre Zoltán, Pénzügyi Szemle, 1994. 12. sz. 987. o.

Legal sources of international tax law:

1. legal sources of international tax-law in a strict sense - law of (national) tax-law conflicts
 - a) Tax rules of conflicting nations (Constitution, laws, government decrees, ministerial decrees)
2. legal sources of international tax-law in a broader meaning
 - a) Tax regulations of individual nations
 - b) Rules for resolving conflicts in the international tax-law:
 - b.1. international treaties to avoid double taxation
 - b.2. certain international organisations model conventions
 - b.3. Tax-law sources (primary and secondary and *acquis communautaire* of EU)
 - b.4. Cases of the European Court of Justice.

Such (Hungarian related) cases are:

- registration tax matters, Court of Justice of the European Union C-290/05. case
- decision on the local practice of trade tax (*HIPA*) C.-283/06 and C-312/06. combined case
- *Cartesio*-case C- 210/06. case
- *Parat Automotive Cabrio* case. C- 74/08. case
- *CIBA* case C- 96/08. case
- *European Commission vs. Hungarian Republic* C- 274/10. case
- (enforcement procedure on law harmonization)

4. THE CLASSIFICATIONS OF TAX SYSTEMS - IN TERMS OF INTERNATIONAL TAX-LAW

The sovereignty of nations in connection with the international transactions involves the right to defy the applicable law.

There are *two main considerations* in determining the field of taxation:

- the residence (residence, location, place of residence). This is the personal principle.
- and the principle of source.¹⁰ This is the principle of territory.

These connecting rules (that connects the tax system with the tax payer) can be divided on two aspects:

- personal and
- economical.

The principle of personal connection is followed by the principle of residence, while the economic connection is followed by the principle of source.

The personal principle can be determined by:

- citizenship,
- residence or
- place of residence of the individuals, the place of business or location for the firms.

Those tax systems that limit their „tax powers” by personal connection, fallow the principle of residence, which is also called universal, total principle, and that is a

¹⁰ Kingson: The coherence of international Taxation, 81. Col. L. Rev. 1151, 1152-53. (1981); J.E. Bischel and R. Feinschreiber, *Fundamentals of International Taxation* 4-5. (2nd. ed. 1985.)

worldwide principle of establishing absolute, complete and general tax liability. By the principle of residence *the tax payer* is determining in accordance with the jurisdiction.¹¹

The connecting rule of *economical* principle can be found by those tax systems, in which the tax payer is subject to taxation, where the governing rule is the property, location of property, location or source of income.

When the tax system applies the *source principle* that can also be called *principle of territory*, than the tax system is limiting the tax powers, tax sovereignty.

In the tax system where the *source principle* is applied, the *tax subject* is determining in the aspect of taxation.¹² In a *residence-based* tax system the person becomes a taxable person, because its residence is on the territory of the questioned state. Thus the person residing in more state, often pays tax after its each economic interest -like multi-country income or assets located in another country-. Therefore, the taxpayers' tax liability is limitless. In the *source-based* tax systems, the tax liability is limited by the fact, that the income comes from abroad or is domestically, or whether the property is located in the state in question. The *source-based* -follows the place of income- taxation is applied mostly by the capital importing countries, thus the *principle of residence* by the capital exporting countries, however it is also common that a country follows both, *residence* and *source* principles.¹³ (Like does Hungary. see below).

The *source principle* is followed for example in the states of South-America.¹⁴ The USA is following *the principle of residence* in accordance with its citizens, the *principle of place of business* in accordance with domestic firms, and the *source principle* for residual foreigners and foreign firms.¹⁵

In Germany the residuals and the domestic firms have unlimited tax liability, while those who are not residual and the foreign firms have limited tax liability.¹⁶ Finland and Sweden is following the German regulation.¹⁷

From this general sample France means an exemption, applying the residence principle for residues and the source principle for foreigners.¹⁸

Since France is following the source principle by taxiing the firms. Residual and non residual firms are both subject to the corporate income tax, but only in a rate, as part of the income comes from the work done in France. By contrast the principle of residence is applied for individual peoples.¹⁹

The Hungarian tax-law²⁰ is following the residence principle on the field of income taxation of natives (residence or place of residence is in Hungary) and the source principle

¹¹ A. Kneehle, Basic Problems in International Fiscal Law '35-36. (W. Weisflog trans. 1979.)

¹² See (9)

¹³ Base companies and general principles of international tax law IBFD International Tax Academy: Introduction to Principles of International Taxation P. 215.

¹⁴ A. Kneehle, Basic Problems in International Fiscal Law W. Weisflog trans. 1979.pp. 26-37.

¹⁵ The place of incorporation determines the residence of corporations in the United States I.R.C. § 7701 (a) (4) 1986.

¹⁶ The Taxation of Companies in Europe – Guides to European taxation (Int'l Bur. Fisc. Doc.) 39-40.(1985.)

¹⁷ See (14), p. 29.

¹⁸ See (14)p.p. 43-45.

¹⁹ Wisselink, France in International Tax Avoidance: A study by the Rotterdam Institute for Fiscal Studies 119, 123, 128-131. (1978.)

²⁰ Personal income tax of Hungary: The Act 1991. évi XC. tv. 1.§ (1), 3.§The concepts of the inlanding individual:

- the residence of the person

for the taxation of the foreign individuals. The Hungarian tax system by the corporate tax liability is mainly residence based, while levies taxes those firms that have residence in Hungary, but as seen by the individuals, the foreign based firms with place of business in Hungary and the foreign based firms also have to pay tax after incomes originating from Hungary.²¹

5. THE MOST IMPORTANT PRINCIPLES OF INTERNATIONAL TAX-LAW EQUITY AND NEUTRALITY

The most important principles of tax-law are the following:

- the principle of burden sharing
- contribution to local public services
- prohibition of discrimination: *the principle of equity and neutrality*
- prohibition of tax avoidance
- prohibition of harmful tax competition principles.

When a state determines its own tax system, two very important objective requirements should be calculated:

The first: the principle of equity, meaning, that all taxpayers should be treated in the same economic situation; one cannot be put at a disadvantage.²² The concept of equality is often referred to as horizontal equality,²³ which means that the taxpayer in the same position, after the same taxable income, has to pay the same level of tax, regardless of origin, place or type of the income, it is all the same that the respective is being domestic or foreigner or that the income is „produced” or „invested”.²⁴

The *equity based* tax system requires a taxation system that is fair even in a moral point of view and all taxpayer share the contribution of public expenditure.

Of course this principle encourages the taxpayers of law abiding and the observance to the tax rules simultaneously.

6. THE DEFINITION OF EUROPEAN TAX-LAW AND ITS CONNECTION WITH THE INTERNATIONAL TAX LAW

The European tax-law has been a very dominant and growing area of the international tax-law. The tax-law of the European Union is actually nothing more than the approach, harmonisation of tax regulations applied in the sovereign states tax system, it's not intended to create single and common tax, but the approximation of Member State's tax

-
- the using place of their location
 - the centre of their living
 - nativity.

²¹ Business tax of the companies: The Act 1991. évi LXXXVI. tv. 2.§ és a 6. sz. D. és E. chapter.

²² Base companies and general principles of international tax law in IBFD International Tax Academy: Introduction to Principles of International Taxation p. 217.

²³ P.B. Musgrove, United States Taxation of Foreign Investment Income p.p.121-122. (1969.)

²⁴ In spite of this vertical equity means a situation in which an income has the same taxation in the case of the taxpayers whose have different wealth and incomes. See in: Base companies and general principles of international tax law In: Base Company taxation , by A, Rapakko, Kluwer 1989. IBFD. Price Waterhouse, Budapest, 24.-26.October, 1994. 212.p.

regulation²⁵. In addition the European tax harmonisation is a process of law approximation, which main purpose is to create the Communities and Member States tax regulation needed for a properly functioning common market.²⁶ Otherwise the approximation of tax regulations is politically a very sensitive area, hence the prerogative of taxation is such an essential element of financial sovereignty, which none of the states are assigning to another state or international organisation, integration²⁷ It is meant under the *European tax law* the result of tax harmonisation i.e. the communal aggregate primary and secondary²⁸ law sources.

In summary, the tax-law harmonisation, so the *European tax-law*:²⁹

- The aim is not the establishment of a „Federal tax system, but the full implementation of the *requirement of national treatment* on the fiscal judgement field of movement of goods and services”, ultimately granting the enforcement of the uniform internal market, and in the 2. Art. of the Treaty of Rome enshrined four basic freedoms - goods, services, people (labour) and capital movements-

- Accordingly the main obstacles are those rules of the Member States that restrain the enforcement of the four basic freedoms, which result in *discriminative perception* of domestic and foreign goods and services, the problems *arising from the differences of the Member State's tax systems*, and the *double taxation*.

7. SOME CONFLICTS OF THE INTERNATIONAL TAX LAW AND THE ANSWER OF THE EU TAX LAW – CONCLUSIONS

In this conclusion let we see some case in front of the European Court of Justice, in which there were solutions of the conflicts of international tax law.

Forms of international tax collisions, tax conflicts:

1. Tax discrimination – tax avoidance

Case of Cartesio - The case numbered C-210/06. of the European Court of Justice, the Cartesio case: Lately the Court of Justice of the European Union made a judgement in the matter of interpretation of the Freedom of establishment in a Hungarian case – the Cartesio case.³⁰ The Cartesio Bt.³¹ (Deposit Company) raised the problem of international transfer of the seat to a Member State other then the Member State of incorporation of a company through the transfer of registration procedure which problem involved Hungarian national law, international private law, tax law and civil procedural law and Community Law of course. The Cartesio Educating and Servicing Private Partnership were founded in 20. May 2004 according to the Hungarian domestic law and was

²⁵ We cannot speak about the common company taxation.

²⁶ Erdős Gabriella - Földes Gábor - Öry Tamás - Véghelyi Mária: (2001) The Tax Law of the European Community, KJK Kerszöv, Budapest, 2001. 18. p.

²⁷ Erdős G. - Földes G. - Öry T. - Véghelyi M. (2001) uo.

²⁸ About the primary and secondary law sources: Várnay-Papp (2004) 145-199. p., About the primary and secondary law sources of the European tax law: Öry Tamás (editor): (2003) The European Tax Law, Osiris, 2003. 39-61. p., Erdős G.-Földes G.-Öry T.- Véghelyi M. (2001) 31-53. p.

²⁹ Öry T. (editor) (2003) 17-18. p.

³⁰ The judgement of the Court of the European Union on 16 December 2008 in the case numbered C-210/06. In the Cartesio Oktató és Szolgáltató Bt. registration of change case, on the basis of the request for preliminary ruling from the Szegedi Ítéltábla on 5 May 2006 (HL C 165,2006.07.15, 17.o.)

³¹ See the judgement: Európai Jog 2009/2. 43.-55.o.

registered at the Court of Companies Registry (Cégbíróóság) of Bács-Kiskun County. The company's seat (head office) is in Baja. The two members of the company are Hungarian citizens living in Hungary. The field of actions of the Private Partnership Company are the following: human research, education and training. In 11. November 2005 the Cartesio Private Partnership Company filed in an Application of amendment of the entry regarding the company seat to the Court of Companies Registry of Bács-Kiskun County in which it requested for registering its head office in Gallarate (in Italy). The Court of Companies Registry turned down the application and the reason of the judgement was that the Hungarian law does not allow the change of place of the head office to abroad while the personal law of the company is the Hungarian law. Cartesio filed in an application against this judgement to the High Court of Szeged. The Cartesio suggested to the High Court of Szeged a request for preliminary ruling on the basis of another judgement in the C-411/03 SEVIC System case³² that states if the Hungarian law differentiate between companies on the basis of the location of their seats it is contrary to the 43. and 48. Articles of the EC Treaty. The Hungarian law must not oblige Hungarian companies to have their seat in Hungary in the European Union. According to Cartesio the High Court must start a preliminary ruling procedure in this case under the 234. Article of the EU because there is no judicial remedy under national law against their decision. After all these antecedents the High Court of Szeged sent several questions – also about tax evasion – to the Court of Justice of the European Union:

Can 43. and 48. Articles of EC be understood as on the basis of them those national laws or practices, that differentiate between companies on the field of practicing their rights based on the location (in which Member State) of their seats, are incompatible with Community law?

Can 43. and 48. Articles of EC be understood as on the basis of them those national laws or practices, that prevents a national company from transferring its seat to another Member State, are incompatible with Community law?

According to the answers given in the judgement of the Court of the European Union in the present form of the Community law the 43. and 48. Articles of the EC should be understood compatible with that national law which prevents a company, founded in the Member State, from transferring its seat to another Member State and in the meanwhile keeping the nationality of the Member State where it was founded.

The real importance of the judgement in the Cartesio case is that it takes a hidden position in the issue of tax domiciliation of such companies that are willing to transfer their seat.

The issue of Freedom of establishment is necessarily brings forth the issue of tax domiciliation of the natural and legal entities in question. The 270/83. Commission v. France case points on it in which judgement the Court ruled that the 43. Article of the EC Treaty ensures the Freedom of establishment but the Article is also applicable in tax matters.³³ From the aspect of tax law the main question is the following, the Cartesio was registered in Hungary with Hungarian nationality but the fact that it wanted to transfer its seat into Italy would make it an Italian tax subject because the tax domiciliation would be in Italy. With this step it would avoid the scope of Hungarian tax validity; it would not

³² The Court made a decision in the case on 13 December 2005 (EBHT. 2005.I-10805.o.)

³³ Dr. Metzinger Péter: Companies and Freedom of establishment (the published critics of the Advocate Generals proposal in the Cartesio case) Európai Jog 2008/4.sz. 23.p.

pay tax to Hungary so it would be a quasi tax evasion. The transmission of the seat, and thus the tax residence, to another Member State would realize potential tax evasion because the company do not have to cease to exist, according to the 48. Article of the EC it is enough to use the Freedom of establishment and choose the taxation of the other Member State.

The issue³⁴ of residence and nationality raises the question of which state's tax subject is the company if the two statuses are separate – like in the *Cartesio* case?

At the judging of nationality the 18. § of the Act on International Private Law (Nmjt.³⁵) is authoritative which means that the international law binds the nationality of the companies as a basic rule to the principle of registration. The nationality, what is the personal law of the company, is a directive which defines the state according to which the functioning of the company should be judged. The personal law of the legal entity is that state's law (so the company has residence there) where it was registered. As not the principle of residence is the connecting principle in the Hungarian international private law but the principle of registration that's why the Hungarian law is only applicable on companies registered in Hungary independent from the fact where is its seat located. But the Gt.³⁶ (Act on Companies) which uses the principle of residence results an internal legal contradiction, so the Act on Companies is authoritative on companies having a seat in Hungary. The hidden problem, and the main issue in the meantime, of the *Cartesio* case is that the transfer of the real seat to an other Member State – according to international tax law – goes with the changing of the residence of the company (tax law nationality).³⁷ It means that if we recognise the right of the companies to transfer their seat freely, we recognise also that they have the right to transfer their residence and thus the state where they want to pay tax. As a matter of fact this is the point in international transfer of seat, id est the 48. Article means also that the company can choose its residence with the transfer of seat which means it can choose the state where it wants to pay tax.

The Court of the European Union points on it in the 81/87 *Daily Mail* case.³⁸ The question itself in the preliminary ruling included tax related elements in the *Daily Mail* case because it regarded to the 52. and 58. Articles of the EEC Treaty (today 43. and 48). Articles of the EC Treaty) whether these articles prevent the Member States from prohibiting the transfer of seat of a company without preliminary permission to another Member State if it would make tax avoidance possible in case of the already booked profit or if the company would avoid tax payment in the future? Actually the Court did not give a concrete answer to this question but it stated in its judgement that although the state of registration does not have the right to restrict the Freedom of establishment unduly but it can require that the actual seat and the seat written in the registration document should be the same. The judgement in the *Cartesio* case confirmed the decision in the *Daily Mail* where there is a reason when the state can restrict the Freedom of establishment of the company which is willing to leave the state, namely the Member State has the right to

³⁴ Metzinger (2008) 21-23.o. On the problem of nationality and residence see: Deák, Dániel: The effects of the decision in the *Cartesio* case on the interpretation of freedom of establishment: nationality, residence, export of capital, neutrality, transfers of seat *Európai Jog* 2009/2.szám 36- 42.p.

³⁵ 1979.évi 13.tv. a nemzetközi magánjogról (Act about international private law)

³⁶ 2006.évi IV. tv a gazdasági társaságokról (Acts of the Business Companies) 1.§-a

³⁷ Metzinger (2008) 22. o.

³⁸ The Court itself is referring to the *Daily Mail* case in its judgement in the *Cartesio* case.

require the accordance between the actual seat and the seat written in the registration document. In the Daily Mail case that state, which is following the principle of registration, could claim taxation requirements, as it would be unfair to expect from the mentioned state to give up its taxation right in such a situation when the internal company's tax residence is ceases to exist.³⁹ The judgement in the Cartesio case suggests the same, nationality and residence must not be separated, and the freedom of the movement of firms does not cause tax evasion in the domestic state.

2. *Double taxation:*

The case numbered C-96/08. of the Court of Justice of the European Union, the CIBA case: One of the latest judgements of the Court of Justice of the European Union is related to a Hungarian registered company's reclaiming of training contribution. The court examined in its preliminary ruling that the Hungarian national law about training contribution is contrary to EU law or not. The company was registered in Hungary but it had premises in the Czech Republic as well and it had to pay this training contribution to Hungary after its employees located there also, despite the fact that the company paid all the contributions payable in the Czech Republic to the Czech state so the problem of double taxation arose. Since the international treaties on avoidance of double taxation do not mention the training contribution the Court should decide in the case. According to the Court's judgement these kind of double taxations are contrary to the EU law despite the fact that the Court of the European Union generally does not want to intervene into double taxation and interstate taxation issues leaving the regulation of it to the Member States.

3. *Principle of tackle against the harmful tax competition:*

The repealed Hungarian off-shore rules: The application of the so-called „tax paradise” (off-shore) rules had been a legal way for tax evasion and tax optimisation until Hungary joined the European Union in 2004. The Act on Corporation Tax⁴⁰ regulated the preferential taxation of 'taxable persons operating abroad' (off-shore firm) until 1 January 2004. Such a foreign (non-resident) company is incorporated and established in Hungary according to the Hungarian Act on Business Associations, a limited liability company or share company with its headquarters in Hungary, that is owned in 100% by a foreign private person or legal entity⁴¹, the incomes from sales may originate only from abroad, proceeds commerce abroad, it has a license granting concessions to companies that operate in free zones⁴², it employs only Hungarian auditors, head senior executives, members of the board of supervisors, attorneys and employees, and the company and its members (shareholders) have only issued registered shares and do not have any direct or

³⁹ Deák (2009) p. 49. Deák, Dániel: The effects of the decision in the Cartesio case on the interpretation of freedom of establishment: nationality, residence, export of capital, neutrality, transfers of seat *Európai Jog* 2009/2.szám 36- 42.p.

⁴⁰ Act on Corporation Tax :1996.évi LXXXI. Tv. 4.§ 28.: 'taxable person operating abroad' (off-shore). This rule was introduced by the Alteration of Act on Corporation Tax in 1998 (1998.évi LXI tv. 1.§(2)).

⁴¹ 1996. évi LXXXI. Tv. 4.§. 28.f.) says: „the company has no members (shareholders) who are domestic persons; nor is there any domestic person among the members of the company's members (shareholders), or if one of the company's members (shareholders) is a public joint-stock company, no more than three per cent of the member's (shareholder's) subscribed capital is held by domestic person(s);” „

⁴² It has a license issued by the Minister of Finance after 31 December 1992 registered by the Minister of Finance prior to 31 December 1996 and thereafter by the state tax authority.

indirect business shares in other domestic business associations. Off-shore companies in Hungary had to pay only 3% corporation tax instead of 18%.

The elimination and abrogation of this rule, that is the complete eradication of it from the body of law on corporation taxation, can be evaluated as a special provision.⁴³ Off-shore firms, in case of existence of all the conditions detailed above, could be created in Hungary until 31 December 2002 and could claim for paying 3% corporation tax until 31 December 2005 so the off-shore firms and their tax reliefs were completely gone from the Hungarian legal material after January of 2006, since then these firms pay taxes like any other domestic firm does and no special provisions or denominations or other related preferences can be used by them. So the rule of tax haven ceased to exist in Hungary from 2006.

Legislators have brought tax haven regulation to an end and according to this there is no regulation like this. Legislators gave tax amnesty⁴⁴ to the owners of money invested into foreign off-shore firms last year which regulation may be considered as a tax refuge. The point was in tax amnesty that if one part of the income brought home from the off-shore firms (approximately the half of it) was invested in Hungarian State Papers until - at least - two years the incomes of off-shore firms - rescued into abroad - could be brought to home with a preferential taxation (10%) in 2009. This condition does not fit to the European Union regulation of the free movement of capital since the purchase of state papers are not motivated by market devices. According to this the parliament altered the amnesty provision on the government's proposal so that now on it will not clash into the norms of the European Union any more. However, tax amnesty was not applicable if it may have derived from crime only if the source of the incomes had a fully legal source.

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

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⁴³ The 2002 évi XLVII. tv. 303.§.(10) abrogated the favourable corporation tax regulations on „taxable person operating abroad (off -shore firms). Valid establishment until 31 December 2002, taxation validity (3%) until 31 December 2005.

⁴⁴ see: Act of 2008: LXXXI. 276.§ and 277.§ modifications of tax laws about tax amnesty provisions (applied until 30 June 2009) ; and 2009.évi LXXVII. tv. 175.§ ,231.§. and 233.§ about the extension of the deadline and the alteration of the public burdens policy. According to them the tax amnesty provisions could be used until the end of 2009 (31 December).