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ECJ and Mutual Agreement Procedures

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The Mutual Agreement Procedure (Article 25 OECD Model Convention) is a rather helpful tool to sort out all kind of interpretation conflicts between two contracting states. If tax treaties are in an intra-Union setting replaced by a Directive and if the content of the OECD Model Convention is transformed in such a Directive, the Court of Justice would become competent to solve all interpretation issues. There does not seem to be room for a MAP any more. However, the author explains that the settled case-law of the Court of Justice allows to give some room for the MAP, although the Court of Justice has to have the last word.

1 Avoidance of double taxation in the EU

Double taxation within the EU still remains a problem: Although a tightly knit network of double taxation agreements exists between the Member States of the EU, these do not cover all taxes that can trigger double taxation. Above all, however, one cannot guarantee that the rules, largely based on the OECD Model Conventions, are interpreted in a uniform manner. As a result of varying interpretations of one and the same convention provision, existing double taxation may still remain in place. Arbitration procedure provisions designed to solve such conflicts are far from being comprehensive. The European Court of Justice (ECJ) has not yet closed this gap, and – on the basis of quite convincing legal arguments – holds that double taxation per se does not represent a violation of the fundamental freedoms.[1] Nonetheless, the European Union's legislator and its Member States need to act – even if they are not under pressure by judicature.

The EU Commission has recently launched new initiatives in this direction: On 12 April 2013, it presented a working paper during a 'Stakeholder Meeting on Direct Taxation', in which it puts forward various options for the avoidance of double taxation for discussion.[2] In these, the Commission most notably puts the case for the introduction of arbitration procedures, if necessary on the basis of a Directive. The most extensive proposal provides for the adoption of a Directive on the distribution of taxation rights between the state of residence and the source state, and the avoidance of double taxation by the state of residence. These rules, however, would only apply in the absence of a double tax convention (DTC). Hence, they would only be of a subsidiary nature.

A harmonization of the rules on the distribution of taxation rights between the Member States is urgently needed. Having different bilateral rules between twenty-eight states is not acceptable in a Single Market, since they give rise to conflicts. The aforementioned proposals submitted by the Commission for solving these difficulties, however, do not go far enough: That is, the bilateral agreements should generally be replaced with European Union law.

The appropriate form of legal proposition for rules designed to avoid double taxation in the EU is the Directive, because it allows Member States considerable flexibility in its transposition: In its role as a state of residence, a Member State aiming to eliminate double taxation could be left with the choice of either applying the credit method or the exemption method.[3] The decision to opt for one of the two methods, which forms part of the

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1 For more details, see *Lang*, Treaty Override und Gemeinschaftsrecht, in *Lehner* (publisher), lectures in commemoration of Klaus Vogel (2010), 59 (75), with further notes on the current state of the discussion. See also *Rädler*, Entspricht unser Außensteuerrecht der Neuordnung unserer Außenwirtschaft im Gemeinsamen Markt? StuW 1960, 730 (731).

2 See *Lang*, Die Vermeidung der Doppelbesteuerung in der EU – jüngste Initiativen der EU-Kommission, SWI 2013, 206 (206ff).

3 See *Lang*, Direkte Steuern und EU-Steuerpolitik – Wo bleiben die Visionen? IStR 2013, 365 (370).

basic choices of the convention policy of each state, would therefore remain at the discretion of the Member States. It would then be even easier than before for Member States to change from one method to the other – i.e., without a revision or renegotiation of a DTC, but merely by amending national law -, and the Directive could, where applicable, allow the States to choose the method on the basis of the income type or take the decision in favour of one of the two methods depending on the taxation level in the other Member State. The States would hence be given the opportunity to prevent the risk of double non-taxation or low taxation on a short-term basis and in a differentiated manner. A State that can switch from the exemption to the credit method as required would thus have a better and more accurate instrument at its disposal for avoiding politically undesirable low taxation than with a 'subject-to-tax' clause.[4] The distribution of taxation rights as such, however, would be prescribed by the Directive and would have to be implemented by the Member States in a uniform manner.

The implementation of such a system in the form of a Directive would also establish the jurisdiction of the ECJ: When there is disagreement over the question whether a national provision aimed at implementing the Directive actually complies with it, or when the interpretation of a national provision runs the risk of violating the Directive, the national court can or must bring the case before the ECJ. In comparison, many of the bilateral provisions for the avoidance of double taxation currently in force have the disadvantage of lacking a superior authority for the resolution of interpretation conflicts. Even after exhausting all national judicial remedies, different interpretations can still persist, thus eventually maintaining double taxation or double non-taxation. Recently, remedy is increasingly sought in arbitration clauses, based on which arbitrators must be appointed and arbitration procedures must be carried out for each individual case. If it were possible and in certain cases required by national courts to refer to the ECJ by way of a preliminary ruling procedure, one could make use of the existing structures under European Union law to achieve a Europe-wide harmonization in the interpretation of the rules designed to avoid double taxation which replace the DTCs.

The ECJ is already vested with the authority to interpret DTCs: According to the convention signed between Austria and Germany, the jurisdiction of the ECJ for the resolution of DTC interpretation conflicts is part of their legislation in force.[5] The two States availed themselves of the opportunity to refer to the ECJ to resolve conflicts between Member States: They amended the rules on the mutual agreement procedure to the extent that the ECJ can settle the conflict between the authorities if these fail to reach a mutually agreed solution. The fact that the ECJ was never referred to in the first ten years since this convention entered into force shows that such provisions do not necessarily lead to an excessive workload for the Court. At the same time, this demonstrates the preventive impact of such court jurisdiction: Apparently, the mere possibility created for taxpayers to enforce a referral to the ECJ was, as a rule, sufficient to motivate the responsible authorities in both contracting states to solve open interpretation issues themselves in a satisfactory manner within a reasonable time.[6]

It is questionable, however, whether comprehensive rules for the avoidance of double taxation in a Directive do not generally rule out the implementation of such a mutual agreement procedure, or whether there are admissible possibilities under European Union law to implement a mutual agreement procedure prior to the introduction of a preliminary ruling procedure. From a legal policy perspective, it would definitely make sense to leave room for the implementation of a mutual agreement procedure: This could ensure that the national courts refer only those cases to the ECJ which cannot be solved between the administrative authorities on a bilateral level. As a result, the ECJ would not have to be bothered with cases in which the authorities agree on a solution that is also approved by the taxpayer. Only those legal questions that remain contentious even after efforts to reach an agreement have been undertaken would then be referred to the ECJ. This 'filter effect' would ensure that procedures before the ECJ remain the exception. Moreover, as previously shown in the relationship between Austria and Germany, the preventive effect may continue to apply: The authorities of the States involved have an additional incentive to reach a solution before the ECJ reaches a final decision, possibly arriving at a conclusion that is not satisfactory for any of the two authorities. Of course, there can be no guarantee that the ECJ will not solve the same contentious legal issue in a subsequent case, which is actually referred to it, in a different manner than the authorities of two States had done in a mutual agreement procedure. The reason is that the ECJ is not bound to a mutual agreement. After all, however, the ECJ would also benefit from the fact that two authorities using experts in DTC law have already reached a presumably well-founded solution, which the ECJ will probably use for guidance if it finds it convincing. In this respect, the solutions reached in a mutual agreement procedure can also serve as a model

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4 *Lang*, IStR 2013, 365 (370).

5 *Züger*, Der EuGH als Schiedsgericht im neuen DBA Österreich – Deutschland, SWI 1999, 19 (21 ff.); see also *Lang*, Überlegungen zur österreichischen DBA-Politik, SWI 2012, 109 (111).

6 *Lang*, IStR 2013, 365 (370); *Lang*, SWI 2013, 206 (211).

for the ECJ. In addition, legal issues and issues of fact are often difficult to separate, and authorities in mutual agreement procedures are able to reach consent on both levels. Therefore, the risk of double taxation can often be warded off more effectively by means of a mutual agreement procedure rather than by having the ECJ provide the solution to a legal issue that, although binding, would then have to be applied by national courts in the two States to the case before them. If the facts established by the authorities and courts in the two States diverge even slightly, double taxation may continue to persist despite the binding solution to the legal issue by the ECJ.

2 The ECJ's monopoly on interpretation

If a question relating to the interpretation of European Union law is pending before a national court – and a Directive on the avoidance of double taxation would be part of European Union law -, the ECJ has the monopoly on interpretation. Each national court can refer to the ECJ by way of a preliminary ruling procedure, and even a court of final appeal must do so when there are doubts as to the interpretation of a provision in European Union law. The national legislator must not limit this power – which is an obligation for the court of last instance.

This was clearly expressed by the ECJ in the case of *Aziz Melki and Selim Abdeli.*[7] In this decision, the referring court asked:

> 'whether Article 267 TFEU precludes Member State legislation which establishes an interlocutory procedure for the review of the constitutionality of national laws, requiring the courts of that Member State to rule as a matter of priority on whether to refer, to the national court responsible for reviewing the constitutionality of laws, a question on whether a provision of national law is consistent with the Constitution, when at the same time the conflict of that provision with EU law is at issue.'

The ECJ established 'that while it might be convenient, in certain circumstances, for questions of purely national law to be settled at the time the reference is made to the Court […], national courts have the widest discretion in referring matters to the Court if they consider that a case pending before them raises questions involving interpretation of provisions of EU law, or consideration of their validity, necessitating a decision on their part […]. The lower court must be free, in particular if it considers that a higher court's legal ruling could lead it to give a judgment contrary to EU law, to refer to the Court questions which concern it […]. Any provision of a national legal system and any legislative, administrative or judicial practice which might impair the effectiveness of EU law by withholding from the national court having jurisdiction to apply such law the power to do everything necessary at the moment of its application to set aside national legislative provisions which might prevent European Union rules from having full force and effect are incompatible with those requirements which are the very essence of EU law[…]. This would be the case in the event of a conflict between a provision of EU law and a national law, if the solution of the conflict were to be reserved for an authority with a discretion of its own, other than the court called upon to apply EU law, even if such an impediment to the full effectiveness of EU law were only temporary […].'

Finally, the ECJ established:

> 'that Article 267 TFEU precludes Member State legislation which establishes an interlocutory procedure for the review of the constitutionality of national laws, in so far as the priority nature of that procedure prevents – both before the submission of a question on constitutionality to the national court responsible for reviewing the constitutionality of laws and, as the case may be, after the decision of that court on that question – all the other national courts or tribunals from exercising their right or fulfilling their obligation to refer questions to the Court of Justice for a preliminary ruling. On the other hand, Article 267 TFEU does not preclude such national legislation, in so far as the other national courts or tribunals remain free:
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> – to refer to the Court of Justice for a preliminary ruling, at whatever stage of the proceedings they consider appropriate, even at the end of the interlocutory procedure for the review of constitutionality, any question which they consider necessary,
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> – to adopt any measure necessary to ensure provisional judicial protection of the rights conferred under the European Union legal order, and
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> – to disapply, at the end of such an interlocutory procedure, the national legislative provision at issue if they consider it to be contrary to European Union law.'

The primacy of European Union law is an obstacle to the application of a national provision that is not in conformity with these principles:[8]

> 'In accordance with settled case-law, a national court which is called upon, within the exercise of its

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7 ECJ of 22 Jun. 2010, C-188/10 and C-189/10.

8 ECJ of 19 Nov. 2009, C-314/08, para. 81.

jurisdiction, to apply provisions of Community law is under a duty to give full effect to those provisions, if necessary refusing of its own motion to apply any conflicting provision of national legislation, even if adopted subsequently, and it is not necessary for the court to request or await the prior setting aside of such provision by legislative or other constitutional means.'

3 Room for the mutual agreement procedure

According to these principles, it is evident that any national regulation stipulating that a mutual agreement procedure must necessarily take place prior to a referral to the ECJ would be in violation of European Union law and should be disapplied. The power of the national court to refer to the ECJ for the interpretation of European Union law – in this case, of the Directive – at any stage of a case pending before it, must not be compromised. According to the ECJ case-law quoted above, even if the national court were only temporarily – i.e., until the conclusion of the mutual agreement procedure – prevented from introducing a preliminary ruling procedure and could do so any time after conclusion of the mutual agreement procedure, this would be a violation of European Union law.

As long as the national court, however, is free to agree to the introduction of a mutual agreement procedure or refer to the ECJ outright, these concerns do not apply: There would be no issue, for instance, if the responsible authority of the respective Member State must be informed that the question on the interpretation of a national provision based on the Directive on the avoidance of double taxation is pending before a national court, and the national court is considering the reference for a preliminary ruling, and the responsible authority subsequently has the possibility to request from the national court to wait until a mutual agreement procedure is introduced and concluded. The decisive factor here is that the national court is not obliged to comply with this request. It must be equally inadmissible to enforce a suspension of the proceedings through judicial remedies so as to obtain a mutual agreement procedure. Therefore, decision on this request must not be subject to a re-examination by the next higher court, since this would all the more limit the court entitled to request a preliminary ruling in its powers granted by European Union law.

The national court will only refrain from applying for a preliminary ruling procedure if it expects that the introduction of a mutual agreement procedure is the more appropriate form of legal protection in a given case. This will apply, for instance, if it offers the possibility of a quick agreement that is also acceptable to the taxpayer. The advantage of a mutual agreement procedure, however, may lie in precipitating a concordant view of the facts of the case on both sides. A hearing of the taxpayer by the court can facilitate this assessment. The court, however, will also have to consider whether the sole intention of the national authority is to prevent or at least delay a decision by the ECJ.

The ECJ will eventually be referred to if the mutual agreement procedure fails to reach a positive outcome within the period granted by the national court. Even in the case of a mutual agreement, however, it is possible that the national court will nevertheless decide to refer to the ECJ. This will be particularly the case when the national court does not view the solution reached through the mutual agreement approach as convincing. In so far as this is admissible under national law, a taxpayer who is content with the mutual agreement will be able to deny the court the possibility to request a preliminary ruling by withdrawing the legal remedy, thus revoking the court's jurisdiction to decide on the case.

It may be disputable whether it is also possible in the case of a court of last instance to await the completion of the mutual agreement procedure before requesting a preliminary ruling. After all, the court is bound by an obligation to make a reference. This, however, does not mean that, in such cases, the court must immediately request a preliminary ruling procedure in a specific case after its jurisdiction has been established. After all, the Supreme Court is usually master of its own procedure and can itself determine the sequence of procedural steps to take. It is, however, essential that a preliminary ruling is obtained before reaching a final decision where there is a dispute over the interpretation of European Union law. Yet the Supreme Court will allow for a mutual agreement procedure only if it anticipates that the taxpayer will then withdraw his legal remedy after a mutual agreement is achieved. Should the proceedings remain pending before the court, the Supreme Court will still have no other choice but to request a preliminary ruling. As a result, the mutual agreement procedure would prove to have been unnecessary and the proceedings as a whole would have lasted longer.

4 Outlook

Whether and when a Directive on the avoidance of double taxation will be adopted to replace the existing network of DTCs is anyone's guess. Obviously, the Commission regarded such provisions as too ambitious to propose them. If one, however, were to take the objective of the Single Market seriously, there is no way around such provisions in the medium and long term. In any event, the considerations presented here have shown that it is possible to combine the advantages resulting from the ECJ's jurisdiction with those of the familiar mutual agreement procedure in a manner compliant with European Union law.