

## MEANS TO COMBAT TAX EVASION IN THE EUROPEAN UNION

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### 1. How is the freedom of movement defined?

Free movement of capital, persons, services and freedom of establishment is the heart of the EU single market and it is the pillar of EU.

For citizens, these freedoms are able to perform many and varied operations abroad such as:

- opening bank accounts;
- buying shares in the European space or real estate;
- investing in places that offer the best return.

For companies, these freedoms offer the opportunity to invest in other enterprises, to become their owners to participate actively in their management.

Before 1990, there was free movement of capital in practice in some Member States. Moreover, even if that freedom exists in theory, many financial transactions with other Member States claimed prior authorization of the national, the term procedure known as "control of trade." This control allowed national authorities to prevent transactions that a citizen or a company wanted to achieve in another Member State and show that financial integration in the single market was not yet real.

Complete liberalization of capital in the EU was adopted in 1988 (Directive 88/361/EEC) and has been applied since 1990 in most Member States, while some specific transitional periods were agreed. Liberalization of capital movements resulted in the development of EMU and was referred to provisions of the Treaty of Maastricht entered into force in

November 1993. Were thus prohibited all discrimination and all the obstacles created by national tax laws.

### 2. Interpretations of the concept of tax evasion in the EU law

Definition of tax evasion was done by several judgments of the European Court of Justice and applies to all Member States.

In narrower sense, tax evasion is to avoid or reduce taxes by moving assets or capital from one country to another (most often due to a tax haven or a country with tax privileges) and not declaring the income it generates.

In a more general sense, tax evasion is similar to tax fraud and it refers to having a behavior with the sole purpose of reducing the tax burden to the taxpayer.

General definition is subject to confusion between the Member States and the European Court of Justice on its interpretation.

Indeed, in its first sense, tax evasion, although it is similar to tax fraud, while it differs in that it is legal. In this sense, tax evasion is taking behavior with the purpose of decreasing the tax burden to the taxpayer, without this behavior to break the law and therefore can be considered as tax fraud.

The second meaning refers to "tax fraud" and is therefore an illegal behavior. The meaning of the Court this term represents the behavior of a taxpayer seeking a tax advantage through purely artificial means.

It is important for the European Court of Justice to draw correctly the border between legitimate search of a favorable income tax (and to respect freedom of movement among EU) and tax evasion in the strict sense of purely artificial means. The border between the abuse of law, tax evasion and fraud is extremely fragile, hence it is difficult to address this problem.

### 3. Assessments of pronounced sentences of the European Court of Justice

#### • Case for Emsland-Starke

##### ✓ *Litigation*

A German company exporting agricultural products outside the EU was obliged to repay the aid granted by the European Commission on grounds that the products were returned to Switzerland within the EU the same means of transport. Emsland-Starke Society contest this decision.

##### ✓ *The first stage*

We mention that the Emsland-Starke company is a German company exporting agricultural products to companies Fogo and Lukow in Switzerland. These two companies are the principal Swiss and in the same person as the society-Emsland Starke.

##### ✓ *Interest in this transaction*

Under the European directive on agriculture, all agricultural products exported from the Union benefit from the "export refunds". The objective is to allow the export of agricultural products outside the Union with a grant.

Emsland-Starke company will receive a grant award from the European Commission and will be exempted from VAT for export operation.

##### ✓ *The second stage*

After receiving supplies from Emsland-Starke company, two Swiss companies decide to resend the same transport merchandise to Lumaca Italian society, the Community, according to transit procedure.

This allows the suspension of customs duties and applicable taxes until goods reach their destination in the community. Thus, Swiss companies are transiting goods on the territory of the European customs without paying duty.

The decision was that German customs requested the return of export duties obtained from Emsland-Starke company in Switzerland because exported goods were not consumed in that country. Business was subject to complaints of European justice that characterized the operation as an abuse of rights.

##### ✓ *Solution ECJ*

Court states that the goods were exported to Italy immediately, with the same means of transport, without download. Thus, the real objective pursued by the company Emsland-Starke was providing export subsidy.

According to the solution of the Court, the implemented operation didn't allow the European directive to reach its goal of helping European companies to export goods outside the Community, under the free movement of capital. Moreover, Lumaca Italian society is forced to pay VAT on imports, creating an imbalance in relation to German society that produced only advantages, causing competitive distortions within the EU.

Judges show that the transaction is purely artificial legally and economically. Free movement has only been used to benefit Emsland-Starke society and not all participating parties, thus ECJ says that the German tax authorities are right.

#### • Case "Mark Spencer" 12/13/2005

The British company disputed the dispositions of the tax system "group relief". Therefore it notifies the European Court of Justice, holding that certain provisions of law are in conflict to the freedom of establishment.

✓ *Litigation*

M&S society, resident in Britain, had branches in several European countries including Germany, Belgium and France by a Dutch holding company. Since the mid-1990s these subsidiaries began to make losses, so that the leadership group decided to close down activities in Belgium and Germany, while French stores were sold to another company.

Following the assignment of activities, M & S decided to bring a claim for compensation of losses with profits made by European subsidiaries of UK parent company by applying the system of "group relief".

✓ *Regime of "group relief"*

Indeed, the British tax law allows a parent group to operate in certain conditions, compensation between profits and losses incurred by various subsidiaries.

This regime of "group relief" authorizes a company of the group (called the ceding company) to transfer its losses during a financial year to a company of the group (called the accuser company), so that the latter should be able to deduct the so-called loss of taxable income, thereby paying less tax. This benefit is conditional on the fact that foreign affiliates exert some activity in the UK with an agency or permanent establishment. Therefore, the subsidiaries established in other EU member states are not allowed to transfer their losses to a UK resident company under current UK tax law. Thus, British tax administration refused to impute to the company M & S the losses of certain foreign subsidiaries from the fiscal profit of the subsidiaries in the UK.

✓ *Position of the ECJ*

The case brought before the Court for M & S was whether the English tax system is contrary to freedom of establishment enshrined for the articles 43 and 48 of the EC Treaty, taking into consideration only the losses made by

subsidiaries resident in Britain, not those made in other Member State.

European Court of Justice ruled in favor of British Administration, giving the possibility to transfer losses to a subsidiary non-resident company to create the risk that the loss transfers to be held among a group towards companies established in the Member State imposing the higher quota.

**4. Conclusions**

The apparition of the concept of abuse of law is an instrument that allows Member States to combat tax evasion and aim to ensure a fair tax system between resident and non-resident companies.

ECJ will seek to respect the Community disposition provided for in Article 43 of the EC Treaty on freedom of establishment. In this context, the Court noted that the concept of office "involves the actual exercise of economic activity through settlements in that state for an indefinite period" or in other words "an actual implantation of a company in the host Member State and a year actual activities within its territory".

Thus, the ECJ prohibits Member States to adopt fiscal measures which have the effect of preventing a national to settle in another Member State and at the same time there are rejected tax measures that create obstacles to establishing businesses in other Member States than that of residence. Freedom of establishment should work both ways, prohibiting both the State of residence and the other state to take discriminatory measures.

ECJ also stresses that a Member State can not prevent a company from exercising the right of establishment on its territory because the transaction will result in a tax loss for it.

Situated at the junction of state, economy and society, taxation is essential to understanding the structure

of state and society and to analyze the phenomenon of globalization.

Opening the borders between Member States caused taxpayers to adjust to new rules of flexibility, with profit maximization at the center of all concerns. But this running after profits, even if encouraged by the legislature, includes some skepticism towards a tax legislation becoming more complex. To adapt to this new reality, the law builds the force, enabling companies to evolve into a framework that fosters competitiveness.

In Europe, case law on direct taxation which will assist Member States

to justify tax obstacles and the need to fight discrimination against tax evasion. Indeed, even if the ECJ continues to challenge the establishment and operation of foreign subsidiaries may be a general presumption of tax fraud, the company allows the resident to prove sufficiently effective in its activities abroad.

However, this finding remains precarious, as long as there will be no tax harmonization on a European scale, the procedure of abuse of rights in its fight against tax evasion will be limited.

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