Intra-Firm Transactions; What if EU MSs Subjected Their Taxpayers to Unlimited Income Taxation Whilst Granting DTR under a Netherlands-style Tax Exemption?

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1 Introduction

Earlier in this journal, I advocated a direct taxation approach where each Member State of the European Union ('EU MS') subjects all taxpayers, corporations and individuals, residing for tax purposes in the EU, which derive income from sources situated within its domestic territory to unlimited taxation.[2] That is, an approach where the EU MSs adopt worldwide taxation of all EU residents deriving income from domestic sources in each EU MS in which that taxpayer undertakes economic activities, irrespective of whether these EU residents reside within or outside the territory of the taxing EU MS. To secure single taxation, I further argued each EU MS to subsequently grant juridical double tax relief ('DTR') in respect of the foreign-source income of these EU taxpayers under the juridical DTR method currently being applied to active income in the Netherlands, i.e., the "credit for domestic tax attributable to foreign income" method. I arrived at the conclusion that the effect of adopting such an approach would be that the tax burden imposed by each EU MS on the proceeds from both domestic and cross-border, i.e., intra-EU, economic activities would be the same. Hence I argued that such an approach could provide a basis for a taxing system without unilaterally imposed distortions of the internal market, i.e., a direct taxation system devoid of primary EU law obstacles. In cases where the Treaty on the Functioning of the European Union ('TFEU') applies, such an approach would provide the desired equilibrium between the EU MSs' autonomy in the field of direct taxation and the internal market without internal frontiers.

This article assesses, once more, the implications of adopting such an approach. What would be the outcome, in terms of tax burdens imposed unilaterally by EU MSs, in cases where taxpayers carry out intra-firm (notional) transactions / internal dealings (hereafter: 'intra-firm transactions') that are recognized as a taxable event for income tax purposes under the functionally separate entity approach? This question may be considered of particular relevance if put into the perspective of the actual primary EU law issues relating to the imposition of "exit taxes" by various EU MSs, i.e., a latent tax claim on a hidden reserve that immediately becomes due, on outbound transfers of property from the territory of a taxing state to another state. For instance, the question as to whether the "exit taxes" imposed by the Netherlands, Denmark and Spain in the field of business income taxation are compatible with the fundamental freedoms is currently pending before the Court of Justice.[3] Would primary EU law discriminations and restrictions also fade out in these cases under the advocated approach? The answer is in the affirmative.

In the following sections, first, I illustrate the operation of the current Dutch juridical DTR mechanism in cases where taxpayers carry out intra-firm transactions (section 2). For that purpose, I return to the 'Base case', i.e., that of the hypothetical taxpayer 'Johnson'. To illustrate the tax effects where taxpayers derive taxable income from carrying out cross-border intra-firm transactions, I introduce such transactions in the 'Base case'. For this purpose, I distinguish between intra-firm *provisions of services* and intra-firm *supplies of goods*. Regarding the latter, I further distinguish between intra-firm transfers of stock and intra firm transfers of capital assets. Subsequently, second, I illustrate the overall effects in a cross-border, intra-EU, context, under the advocated approach (section 3). In doing so, again, I conduct the thought-experiment in which I assume that both EU MSs involved adopt the same methodology on both sides of the tax border. This enables me to illustrate

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[2] See Maarten F. de Wilde*, "What if Member States Subjected Non-Resident Taxpayers to Unlimited Income Taxation whilst Granting Double Tax Relief under a Netherlands-Style Tax Exemption?"*, Bulletin for International Taxation, 2011 (Volume 65), No. 6 and Maarten F. de Wilde, *"Currency Exchange Results; What if EU MSs Subjected All Taxpayers to Unlimited Income Taxation Whilst Granting DTR under a Netherlands-style Tax Exemption?"*, Bulletin for International Taxation, [**XXXX/YYYY**].

[3] Specifically, the Amsterdam Court of Appeal has requested a preliminary ruling regarding the (in)compatibility of the Netherlands' "exit tax" imposed under the Netherlands Corporate Income Tax Act of 1969 on corporate emigrations. See case C-371/10 (*National Grid Indus BV*) *Hof Amsterdam* (Amsterdam Court of Appeal), 15 July 2010, published in the unofficial tax reporter *Vakstudienieuws* (V-N) (2010)/35.6. The European Commission takes the view that the Netherlands' "exit tax" infringes primary EU law and decided to refer the Netherlands together with Denmark and Spain to the Court of Justice because of their "exit tax" provisions. See European Commission, Press Release IP/10/1565 (24 November 2010).

the advocated approach's non-discriminatory and tax neutral operation on the one hand, as well as, on the other excluding the distorting effects of tax disparities from the assessment.

2 The current Dutch DTR mechanism's operation regarding intra-firm transactions

2.1 A *pro rate parte* tax treatment of resident taxpayers

The juridical DTR mechanism for active income from foreign sources currently applied in the Netherlands, notwithstanding its common reference as an "exemption method", operates as a credit mechanism. Currently, it is exclusively available to resident taxpayers. The Netherlands (individual or corporate) income tax attributable to the foreign-source income is credited against the Dutch tax calculated by reference to the taxpayer's worldwide income. The DTR mechanism applies in both intra-EU and third-country scenarios.[4] Please note that issues involving the recognition of taxable income (the 'concept of taxable income') and the geographical allocation of taxable income ('transfer pricing') are not discussed in this article.[5] The concepts and principles adopted in the Netherlands in this respect, which, notably, *grosso modo* concur with those commonly applied in international taxation, are taken as given (e.g., the 'return to equity' to constitute the taxable base, the 'reality', 'matching', 'realization' and 'prudence principles' to attribute the taxable base to tax years, as well as the utilization of the '(functionally) separate entity approach' and the 'at arm's length principle' to allocate the accordingly recognized yearly taxable base to taxing jurisdictions).

It should be mentioned that the Dutch State Secretary for Finance is currently considering replacing this DTR mechanism for a base exemption. At least to the extent that it concerns foreign source business income.[6] Draft legislative bills are expected to be proposed in the autumn of 2011. The adoption of a base exemption mechanism would, for instance, entail the impossibility of cross-border loss set-off and the imposition of "exit taxes" upon intra-firm outbound property transfers (i.e., property transfers between head office to the permanent establishment ('PE')). These implications can be understood as unilaterally imposed restrictions impeding the proper functioning of the internal market. Viz., the heavier tax burden unilaterally imposed upon the crossing of intra-EU tax borders clearly makes it less attractive for economic operators to operate their businesses in an intra-EU cross-border environment. Hence, by introducing a base exemption for foreign income the Netherlands would make the outward-bound crossing of their tax borders more tax cost inefficient. This necessarily entails various market access restrictions. The introduction of a base exemption mechanism should therefore be considered undesirable.

Let us return to the Dutch-style DTR mechanism as applied today. Under Dutch international tax law, intra-firm, notional transactions, as well as the notional at arm's length proceeds from these transactions, i.e., notional proceeds from notional services provided as well as notional proceeds from notional supplies of goods (stock and capital assets), are not recognized as a taxable event to the extent that it concerns the calculation of resident taxpayers' worldwide taxable income. Due to the operation of the tax base reservation[7] such notional proceeds are not taken into consideration for the purpose of calculating a resident taxpayer's worldwide income. Accordingly, briefly put, a Dutch resident taxpayer's worldwide income does not increase or decrease as a consequence of the occurrence of an intra-firm transaction.

This, however, is untrue to the extent that it concerns the DTR calculation. Notional proceeds from intra-firm transactions are recognized for the purpose of calculating DTR under the Dutch-style "tax exemption" method. Accordingly, the amount of relief granted is influenced by the presence of intra-firm dealings. This makes sense. In reality, taxpayers do not actually make a profit on the rendering of an intra-firm transaction. All this happens within the context of a single taxpayer. The only

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[4] In respect of income derived from sources situated in a state with which the Netherlands has not concluded a double tax convention, the application of the DTR method is available subject to the requirement of meeting a 'subject to tax clause'. This is not further discussed.

[5] For a brief elabouration of the existence, geographical source and nature of taxable income under Dutch international tax law, see Maarten F. de Wilde & Geert T.W. Janssen, *The Netherlands - Key practical issues to eliminate double taxation of business income* - , Amersfoort : SDU Fiscale & Financiële Uitgevers, 2011. - (Cahiers de droit fiscal international = studies on international fiscal law ; vol. 96b), at section 2.

[6] See the letter of the State Secretary for Finance of April 14, 2011 (*Brief Staatssecretaris van Financiën van 14 april 2011*), No. AFP/2011/248U, particularly the appendix, the 'Tax Agenda' (*Fiscale agenda; Naar een eenvoudiger, meer solide en fraudebestendig belastingstelsel*).

[7] The 'tax base reservation' is the common designation of the reservation that is consistently found in the DTR article in the Netherlands' double tax conventions on the basis of which the Netherlands, for the benefit of its resident taxpayers, reserves the right to include foreign source income items in the tax base.

thing that actually occurs is that the respective taxpayer employs its production factors, i.e., its workers and its property, in a cross-tax border context. No money is made by doing that. Value has not actually been added upon the rendering of an intra-firm transaction. Value is added upon the provision of goods and services to third parties. As regards the performed intra-firm transaction, merely the origin of the produced income, as derived in the course of the respective taxpayer's business operations has shifted from one taxing jurisdiction to another. Accordingly, the recognition of intra-firm transactions for DTR calculation purposes merely serves the purpose of supporting the geographical allocation of taxable business income, which has actually been produced, to taxing jurisdictions under an origin-based, supply-side, income allocation methodology, i.e., the transfer pricing methodology. Briefly put, all the Dutch DTR methodology in effect does is to support this allocation process equitably.[8]

The DTR mechanism entails a *pro rate parte* allocation of tax across taxing jurisdictions in cases where resident taxpayers carry out intra-firm transactions in the course of operating their cross-border business activities. In this respect, the following scenarios may occur:

a) Taxable profits recognized from intra-firm transactions arise domestically;
b) Taxable profits recognized from intra-firm transactions arise abroad, and;
c) Taxable profits recognized from intra-firm transactions partially arise domestically and partially arise abroad.

Ad (a). In cases where notional business profits arise domestically, the amount of DTR provided decreases to the extent that positive amounts of notional income have been derived from intra-firm transactions having their origin in the Netherlands. The amount of DTR provided increases to the extent that negative amounts of notional income have been derived from intra-firm transactions having their destination in the Netherlands. Notional profits from intra-firm transactions arise domestically where resident taxpayers employ their workers (labour) and property (capital) in the Netherlands for the benefit of their overseas business activities. This is typically the case when the taxpayer's workers actually perform their activities within Dutch territory and when the taxpayer's property is situated within Dutch territory.

Ad (b). In cases where notional business profits arise abroad, the DTR methodology applies in a mirror-like fashion. The amount of DTR provided increases to the extent that positive amounts of notional income have been derived from intra-firm transactions having their origin in a foreign jurisdiction. The amount of DTR provided decreases to the extent that negative amounts of notional income have been derived from intra-firm transactions having their destination in a foreign jurisdiction. Notional profits from intra-firm transactions arise overseas where resident taxpayers employ their workers (labour) and property (capital) in that foreign jurisdiction for the benefit of their business activities in the Netherlands. This is the case when the resident taxpayer's workers actually perform their activities within the territories of that foreign jurisdiction and when the resident taxpayer's property is situated within the territories of that foreign jurisdiction.

Ad (c). A combination of the two scenarios is attainable as well. This occurs in the event that property at one time within the production process is transferred from one taxing jurisdiction, for instance from the jurisdiction in which the 'head office' is situated, to the other taxing jurisdiction, for instance to the jurisdiction in which the PE is situated. In such a case, a division needs to be made for DTR calculation purposes. This makes sense as the respective asset is employed in the taxpayer's production process in both taxing jurisdictions consecutively. In accordance with commonly applied income allocation concepts, the transferred property, for DTR calculation purposes, is considered to be transferred overseas at fair market value (i.e., the intra-firm transaction is recognized for income allocation purposes for which an at arm's length remuneration should be taken into consideration).

To illustrate the practical effects of applying this DTR mechanism in these scenarios, things are further explored by means of numerical examples in sections 2.2 (effects under current Dutch

[8] Notably, presumed flaws in the income allocation methodology do not say anything substantive on the (im)proper DTR methodology's operation. Difficulties in income allocation, for instance, arise in cases where taxpayers employ mobile capital in a cross-border context (financial and intangible assets). Due to the volatile characteristics of mobile production factors, their geographical location can easily be transferred across taxing jurisdictions, for instance, to low-taxing jurisdictions. As a consequence of that, the adoption of origin-based income allocation factors has the consequence of tax base being transferred across taxing jurisdictions just as easily. Moreover, presumed flaws regarding the return to equity standard to recognize taxable income, for instance the distinctive tax treatment of debt and equity financing arrangements, also do not say anything on the (im)proper DTR methodology's operation. The advocated DTR mechanism's operation cannot be proved to be false by pointing at potential problematic effects in other tax areas. It should be assessed on its own merits.

international tax law) and 3 (effects under the advocated approach) hereunder. For this purpose, as said, I distinguish between intra-firm provisions of services and intra-firm supplies of goods. Regarding the latter, I further distinguish between intra-firm transfers of stock and intra-firm capital asset transfers.

2.2 The current Dutch DTR mechanism's operation explained: numerical examples

2.2.1 General

Let us return to the 'Base case'. The business income of a Dutch resident taxpayer 'Ben Johnson (Horticultural Company)', hereinafter: 'Johnson', from its Dutch source a), a branch situated within Dutch territory, adds up to € 140,000 (positive). Johnson's business income from foreign source b), a branch situated in EU MS X, Belgium, adds up to € 60,000 (positive). Johnson thereby derives business income in Belgium through a PE situated within Belgian territory, the territorial allocation of business income occurs in accordance with OECD concepts and principles and Johnson is eligible to be granted DTR under the Dutch-style DTR methodology for active foreign source income. Johnson's worldwide income equals € 200,000. Let us suppose that the income tax rate in Belgium equals a linear 18%. Further, suppose that the Netherlands applies a progressive tax rate. The tax brackets are arranged as follows:

Table 1. Tax Brackets

Rate (%)	Tax base	Aggregate Tax
10%	0 – 50,000	-
20%	50,000 – 100,000	5,000
25%	100,000 – excess	15,000

Johnson's tax liability in the Netherlands is determined in two steps. First, the Dutch tax on Johnson's worldwide income is calculated. The Dutch tax on Johnson's worldwide income amounts to € 5,000[9] + € 10,000[10] + € 25,000[11] = € 40,000. Second, the DTR is calculated by making reference to the Dutch tax that is attributable to Johnson's foreign income. The following fraction applies:

*(Foreign Income / Worldwide Income) * Dutch Tax on Worldwide Income*

In the example, accordingly, the application of the fraction leads to DTR amounting to € 12,000.[12] The Dutch tax payable is accordingly set at € 40,000 – € 12,000 = € 28,000, an effective average tax rate (hereafter 'EATR') in the Netherlands of 20% on the Dutch share of the international tax pie (i.e., € 140,000). The amount of DTR effectively granted with respect to Johnson's foreign income of € 60,000 also equals a 20% rate.[13] The amount of Belgian tax payable (€ 10,800[14]) is ignored for DTR calculation purposes in the Netherlands.

2.2.2 *Intra-firm provisions of services*

Now let us introduce an intra-firm transaction. Suppose that, in addition to the facts and circumstances set out in the above, one of taxpayer Johnson's workers in branch a) renders an intra-firm service (e.g. under a notional (financial) service, leasehold, or licence arrangement) for the benefit of the business activities carried on through branch b). Let us assume that the notional service rendered is recognized as an internal dealing upon a functional and factual analysis for which an at arm's length consideration should be taken into account. Suppose that the fair market value of the notional service rendered equals € 15,000, an amount determined in accordance with the at arm's length principle.

Under the DTR methodology, Johnson's worldwide income does not alter as a result of the intra-firm service rendering (i.e., an effect caused by the operation of the tax base reservation). It

[9] 10% * 50,000 = 5,000.
[10] 20% * 50,000 = 10,000.
[11] 25% * 100,000 = 25,000.
[12] 60,000 / 200,000 * 40,000 = 12,000.
[13] 12,000 / 60,000 * 100% = 20%.
[14] 18% * 60,000 = 10,800.

remains at € 200,000. This makes sense as taxpayer Johnson has not actually earned a profit on the rendering of the intra-firm service by its worker. Johnson does not actually make money at that time.

Notably, would the Netherlands have applied a capital and labour import neutrality (CLIN)-promoting base exemption mechanism, such an outbound intra-firm rendering of the service would have led to a taxable event (i.e., the imposition of an "exit tax" on the outbound intra-firm service), resulting in tax due on the notional, fictitious, item of income of € 15,000. The marginal tax due on this notional item of income would equal € 3,750, a marginal effective tax imposed at a rate of 25%.[15] Under a typical base exemption mechanism, the EATR in the Netherlands on the Dutch share of the tax pie calculated at € 155,000 (i.e., € 140,000 + € 15,000) would equal 18.5% instead of 20% (see for the latter percentage the following paragraph).[16] This reduction in the EATR can be explained as the combined effect of the recognized intra-firm transaction as a taxable event for tax purposes, on the one hand, and the income split effect on the other. Viz., the application of a typical base exemption mechanism moderates the internationally commonplace progressivity effects in the employed tax rate structures. The latter element affecting the EATR negatively would outweigh the first element, the recognition of the intra-firm service, which affects the EATR numerically in a positive fashion. Johnson would have benefited from this despite the increase in taxable income due to the recognition of the notional transaction for worldwide tax calculation purposes. In my view, levying such an "exit tax" is conceptually unsound, since it is distortive as the taxpayer does not actually derive an income by engaging in such an intra-firm transaction. A profit has not in fact been made. Notional income is no actual income. As seen from that perspective, it is difficult to appreciate why the tax burden imposed should nevertheless mutate.

Let us return to the application of the Dutch-style DTR method. The Dutch tax on Johnson's worldwide income remains at € 5,000 + € 10,000 + € 25,000 = € 40,000. The tax is imposed at an EATR of 20%.[17] Subsequently, the DTR is calculated. The amount of relief alters in comparison with the DTR available under the 'Base case' since an intra-firm dealing, the intra-firm service rendered by Johnson's worker, is recognized for DTR calculation purposes under the functionally separate entity approach. Contrary to the 'Base case' the application of the fraction entails DTR amounting to € 9,000[18] instead of € 12,000.[19] This reduction in DTR is caused by a reduced numerator, which for its part, is caused by the recognition of a notional remuneration, a negative amount, in Belgium. In terms of allocating business income under origin-based, supply-side, allocation factors (as is the case in international taxation today under the transfer pricing methodology), this makes sense. Viz., Johnson employs its production factor of labour, i.e., its Dutch worker, for the benefit of its activities overseas, in Belgium. In effect, due to the notional remuneration 'paid' in Belgium, the destination state, and 'received' in the Netherlands, the origin state, in return for the notional service rendered in the Netherlands for the benefit of Johnson's activities in Belgium, this entails a shift of tax base from Belgium to the Netherlands in accordance with the commonplace income allocation methodology ('transfer pricing').The Dutch tax payable is accordingly set at € 40,000 – € 9,000 = € 31,000, an EATR in the Netherlands of 20% on the Dutch share of the tax pie, calculated at € 155,000 (i.e., € 140,000 + € 15,000). The amount of relief that is granted regarding the foreign, i.e., Belgian, share of the tax pie effectively equals 20% as well.[20]

Now image the *mirror case* and suppose that one of the workers in branch b) renders the intra-firm service for the benefit of the business carried on through branch a). Under the DTR methodology, Johnson's worldwide income again does not alter in such a mirror scenario. The Dutch tax on Johnson's worldwide income accordingly still amounts to € 40,000, an EATR of 20%. Again, the DTR, as subsequently calculated, alters in comparison with the 'Base case' since an intra-firm dealing has been recognized for DTR purposes. The DTR calculated alters in the exact opposite manner as described in the previous paragraph. The application of the fraction entails DTR amounting to € 15,000[21] instead of € 12,000. In terms of allocating business income under origin-based, supply-side, allocation factors, this makes sense. Viz., Johnson employs its production factor labour, i.e., its Belgian worker in Belgium, which is now the origin state, for the benefit of Johnson's activities in the Netherlands, which is now the destination state. In effect, due the notional remuneration 'paid' in the

[15] 25 * 15,000 = 3,750.
[16] The tax due in the Netherlands would amount to € 5,000 + € 10,000+ € 13,750 = € 28,750. The EATR would equal 28,750 / 155,000 * 100% = 18.5%.
[17] 40,000 / 200,000 * 100% = 20%.
[18] (60,000 – 15,000) / 200,000 * 40,000 = 9,000.
[19] 60,000 / 200,000 * 40,000 = 12,000.
[20] 9,000 / (60,000 – 15,000) * 100% = 20%.
[21] (60,000 + 15,000) / 200,000 * 40,000 = 15,000.

Netherlands to the ‘recipient’ in Belgium in return for the notional service rendered in Belgium for the benefit of Johnson’s activities in the Netherlands, this entails a shift of tax base from the Netherlands to Belgium. The Dutch tax payable is accordingly set at € 40,000 – € 15,000 = € 25,000. An amount of Dutch tax payable, which, again entails an EATR in the Netherlands of 20% on the Dutch share of the tax pie, now calculated at € 125,000 (i.e., € 140,000 – € 15,000). The DTR provided with respect to the Belgian share of the tax pie effectively equals a 20% rate also.[22]

2.2.3 Intra-firm supplies of goods (stock transfers)

Suppose that, all other things being equal to the ‘Base case’, in addition, certain goods, for instance horticultural plants, say tulips, have been produced through branch a) to be sold on the market. Suppose that the manufacturing costs of the plants equal € 5,000 and their wholesale value equal € 12,000. Suppose that the goods are transferred to branch b) situated in Belgium and suppose that the goods are sold through branch b) in Belgium at the market-place at a resale price of € 20,000.

Under the DTR methodology, Johnson’s income does not alter upon the intra-firm supply of goods from branch a) to branch b). Again, this is caused by the operation of the tax base reservation. And again, this makes sense as taxpayer Johnson has not in fact derived a profit by just shipping the goods overseas to branch b).

Notably, under a CLIN-promoting base exemption mechanism, such an outbound intra-firm supply of goods would have led to a taxable event (i.e., the imposition of an “exit tax”), resulting in income tax due on a notional, fictitious, income item of € 7,000 (€ 12,000 – € 5,000). The marginal tax due on this notional income item would equal € 1,750, a marginal effective tax imposed at a rate of 25%.[23] Under a typical base exemption mechanism, the EATR in the Netherlands on the Dutch share of the tax pie calculated at € 147,000 (i.e., € 140,000 + € 7,000) would equal 18.2% instead of 20.3% (see for the latter percentage the following paragraph).[24] This reduction in the EATR can be explained as the combined effect of the recognized intra-firm transaction as a taxable event for tax purposes, on the one hand, and the income split effect, on the other. Viz., as said, the application of the base exemption mechanism moderates the internationally commonplace progressivity effects in the employed tax rate structures. The latter element negatively affecting the EATR would outweigh the first element, which affects the EATR numerically in a positive manner. Johnson would have benefited from this despite the increase in taxable income due to the recognition of the notional transaction for worldwide tax calculation purposes. In my view, levying such an “exit tax” is conceptually unsound, since it is distortive as the taxpayer does not actually derive income by engaging in such an intra-firm transaction. A profit has not in fact been made upon the transfer of the horticultural plants to the Belgian branch b).[25] So why pay tax on it?

Let us return to the application of the Dutch-style DTR method. Taxpayer Johnson first realizes the profit, calculated at € 15,000 (€ 20,000 – € 5,000) upon the sale of the goods at the market-place. At that time, Johnson’s worldwide income amounts to € 215,000, i.e., € 200,000 + € 15,000.[26] This makes sense as Johnson actually derives an income from the selling of the plants at the market-place. At that time, the Dutch tax on Johnson’s worldwide income amounts to € 43,750,[27] which equals an EATR of 20.3%.[28] The profit of € 15,000 needs to be divided between the Netherlands and Belgium as value has been added in both jurisdictions (from an origin-based perspective that is). In terms of allocating business income under origin-based, supply-side, allocation factors, this makes sense. Viz., Johnson employs the combination of its production factors of labour, i.e., its Dutch workers (wholesale activities) and Belgian workers (retail activities), and capital, i.e., the plants, for the benefit of its activities in both the Netherlands and Belgium. In effect, due to a notional remuneration ‘paid’ in Belgium to the ‘recipient’ in the Netherlands in return for the notional supply of goods from the Netherlands to Belgium, this entails a transfer of Johnson’s worldwide tax base as

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[22] 15,000 / (60,000 + 15,000) * 100% = 20%.

[23] 25% * 7,000 = 1,750.

[24] The tax due in the Netherlands would amount to € 5,000 + € 10,000+ € 11,750 = € 26,750. The EATR would equal 26,750 / 147,000 * 100% = 18.2%.

[25] In cases falling within the scope of application of the TFEU, the levying of such a tax conceptually infringes the freedom of establishment. See for a comparison Court of Justice, cases C-9/02 (*De Lasteyrie du Saillant*) and C-470/04 (*N.*). Contra, Court of Justice, cases C-250/95 (*Futura*), C-414/06 (*Lidl*) and C-337/08 (*X Holding*). See on the Court of Justice’s ambiguous approach in this respect Maarten F. de Wilde, *On X Holding and the ECJ's Ambiguous Approach towards the Proportionality Test*, 19 EC Tax Review 170 (2010).

[26] The latter amount is calculated as 20,000 – 5,000 = 15,000.

[27] 10% * 50,000 + 20% * 50,000 + 25% * 115,000 (i.e. 100,000 + 15,000) = 43,750.

[28] 43,750 / 215,000 * 100% = 20.3%.

increased by € 15,000 from Belgium to the Netherlands. The profit realized out of the sale of the goods at the market-place attributable to branch a) equals € 7,000.[29] The profit share attributable to branch b) equals € 8,000.[30] Under the DTR mechanism subsequently applied, the fraction equals € 13,837.21.[31] The Dutch tax payable is accordingly set at € 43,750 – € 13,837.21 = € 29,912.79. The amount of Dutch tax payable that can be attributed to the profit realized out of the sale of the goods that is attributable to branch a), i.e., € 7,000, equals to € 1,424.42.[32] Consequently, the amount of Dutch tax payable accordingly determined entails an EATR in the Netherlands of 20.3% on the Dutch share of the tax pie, which is calculated at € 147,000 (i.e., € 140,000 + € 7,000[33]).[34] The amount of DTR provided with respect to the Belgian share of the tax pie effectively also equals a 20.3% rate.[35]

Now imagine the *mirror case* and suppose that the goods were produced through branch b) and subsequently transferred to branch a), from which they are sold at the market-place. Again, Johnson's worldwide income does not alter upon the intra-firm supply of goods from branch b) to branch a). Again, taxpayer Johnson first realizes a profit of € 15,000 upon the sale of the plants at the marekt-place. Again, things result in an overall worldwide income of € 215,000, amounting to Dutch tax calculated at € 43,750, i.e., an EATR of 20.3%. The profit of € 15,000 needs to be divided between Belgium and the Netherlands as value has been added in both jurisdictions (from an origin-based perspective that is). In terms of allocating business income under origin-based, supply-side, allocation factors, this makes sense. Viz., Johnson employs a combination of its production factors of labour, i.e., its Dutch workers (retail activities) and Belgian workers (wholesale activities), and capital, i.e., the plants, for the benefit of its activities in both Belgium and the Netherlands. In effect, due to a notional remuneration 'paid' in the Netherlands to Belgium in return for the notional supply of goods from Belgium to the Netherlands, this entails a transfer of Johnson's worldwide tax base as increased by € 15,000 from the Netherlands to Belgium. This time the profit realized out of the sale of the goods at the market-place that is attributable to branch a) equals € 8,000.[36] The profit share attributable to branch b) equals € 7,000.[37] Under the DTR mechanism subsequently applied, the fraction equals € 13,633.72.[38] The Dutch tax payable is accordingly set at € 43,750 – € 13,633.72 = € 30,116.28. The amount of tax payable that can be attributed to the profit realized out of the sale of the good that is attributable to branch a), i.e., € 8,000, equals to € 1,627.91.[39] Consequently, the amount of Dutch tax payable accordingly determined again entails an EATR in the Netherlands of 20.3% on the Dutch share of the tax pie, which is now calculated at € 148,000 (i.e., € 140,000 + € 8,000[40]). The same is true regarding the amount of DTR that is effectively provided with respect to the Belgian share of the tax pie. That amount also equals 20.3%.[41]

2.2.4 Intra-firm supplies of goods (capital asset transfers)

Suppose that, all other things being equal to the 'Base case' referred to in 2.2.1., in addition, a capital asset, for instance a plant breeder's right,[42] is transferred from Dutch branch a) to Belgian branch b) for the purpose of durably employing it for the benefit of Johnson's business operations carried on through its branch b). Suppose that the capital asset was acquired 5 years ago and that its acquisition price was € 600,000. Suppose that its economic life equals 20 years and that the yearly tax deductible in depreciation terms amounts to € 30,000. These are deducted from Johnson's worldwide operational profit of € 200,000 entailing a worldwide income of € 170,000. At the moment prior to the notional capital asset transfer, the asset was placed on branch a)'s balance sheet at an amount of € 450,000.[43] Suppose that at that time, its fair market value, for whatever commercial reason, equals €

[29] 12,000 – 5,000 = 7,000.
[30] 20,000 – 12,000 = 8,000.
[31] (60,000 + 8,000) / (200,000 + 15,000) * 43,750 = 13,837.21.
[32] (7,000 / 15,000) * (43,750 / 215,000) * 15,000 = 1,424.42.
[33] (1,424.42 / 7,000) * 100% = 20.3%.
[34] 29,912.79 / 147,000 * 100% = 20.3%.
[35] 13,837.21 / (60,000 + 8,000) * 100% = 20.3%.
[36] 20,000 – 12,000 = 8,000.
[37] 12,000 – 5,000 = 7,000.
[38] (60,000 + 7,000) / (200,000 + 15,000) * 43,750 = 13,633.72.
[39] (8,000 / 15,000) * (43,750 / 215,000) * 15,000 = 1,627.91.
[40] 1,627.91 / 8,000 * 100% = 20.3%.
[41] 13,633.72 / (60,000 + 7,000) * 100% = 20.3%.
[42] It is, or at least should be irrelevant for this purpose whether the respective capital asset is of a tangible or intangible nature.
[43] 600,000 – 5 * 30,000 = 450,000.

500,000 and that the remaining economic life remains the same. Accordingly, taxpayer Johnson faces a latent income tax claim on the hidden reserve of € 50,000.

Under the DTR methodology, Johnson's worldwide income does not alter upon the intra-firm capital asset transfer. The latent income tax claim on the hidden reserve does not become immediately due when the capital asset is transferred abroad. No "exit tax" is levied. Yet again, this is caused by the operation of the tax base reservation. And yet again, this makes sense as taxpayer Johnson has not in fact derived a profit, a capital gain of € 50,000 by just shipping the capital asset overseas to its foreign branch. Instead, substantially, the hidden reserve is added to the domestic taxable base in yearly installments, which vary in direct proportion to the annual depreciation terms during the remaining economic life of the transferred capital asset.[44]

Notably, again, if the Netherlands would have adopted a CLIN-promoting base exemption mechanism in this case, such an outbound intra-firm capital asset transfer would have led to a taxable event (i.e., the imposition of an "exit tax"), resulting in income tax due on the notional, fictitious item of income of € 50,000. The marginal tax due on this notional item of income would equal € 12,500, a marginal effective tax imposed at a rate of 25%.[45] Under a base exemption mechanism, the EATR in the Netherlands on the Dutch share of the tax pie calculated at € 143,333.33 (€ 140,000 + € 3,333.33; see for the latter amount the following paragraph hereunder) would equal 26.2% instead of 19.1% (see for the latter percentage the following paragraph).[46] This increase in the EATR can be explained as the combined effect of the recognized intra-firm transaction as a taxable event for tax purposes, on the one hand, and the income split effect, on the other. Despite the fact that the application of the base exemption mechanism moderates the progressivity effects in the employed tax rate structures, it does not help Johnson at the end of the day in terms of tax costs imposed by the Netherlands. The taxable notional capital gain element positively affecting the EATR now outweighs the first element, i.e., the income split effect, which affects the EATR numerically in a negative manner. The adoption of a base exemption mechanism would entail an EATR in this example, which even exceeds the marginal statutory tax rate of 25%! The imposition of such an "exit tax" would be conceptually unsound as Johnson does not actually derive an income by engaging in such an intra-firm transaction. A profit has not in fact been made upon the outbound transfer of the plant breeder's right to overseas. So why pay tax at that time? The increased tax burden upon the transfer of the plant breeder's right clearly makes it less attractive to invest abroad. Moreover, it neatly explains the reason why such market access restrictions caused by the imposition of "exit taxes" by EU MSs in relation to outward-bound movements of production factors are problematical from the perspective of the internal market without internal frontiers within which the fundamental freedoms should be respected by all EU MSs.[47] Obviously, it also makes apparent the rationale for taxpayers to challenge the imposition of such "exit taxes" on EU law grounds before the tax courts. They are plainly faced with an unfair increase in the imposed tax cost.

Let us return to the application of the Dutch-style DTR method. Technically, things work out as follows. Irrespective of the capital asset transfer, taxpayer Johnson's worldwide income still amounts to € 170,000. Accordingly, the Dutch tax on Johnson's worldwide income amounts to € 5,000 + € 10,000 + € 17,500[48] = € 32,500, which equals an EATR of 19.1%.[49] For the purpose of subsequently calculating the DTR, the intra-firm dealing, i.e., the notional capital asset transfer, is recognized for DTR purposes. The latent income tax claim needs to be allocated to the Netherlands as value has been added, i.e., income has accrued, in the Netherlands (at least, from an origin-based perspective that is). In terms of allocating business income under origin-based, supply-side, allocation factors, this makes sense. Viz., Johnson durably employs its capital asset, the plant breeder's right, for the purpose of its business in the Netherlands up until the time of the plant breeder's right's transfer overseas. Subsequent to its transfer, the capital asset is further durably employed for Johnson's activities in Belgium. Hence, this calls for a division of the tax base between the Netherlands and Belgium. In terms of allocating profits on an origin basis, the unrealized capital gain of € 50,000 should be allocated to the Netherlands as the production factor of capital, the plant breeder's right, had been employed in the Netherlands during the period of capital accrual. Mutations

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[44] See *Hoge Raad* (Dutch Supreme Court), February 12, 1964, BNB 1964/95 (*Hopperzuiger*).

[45] 25% * 50,000 = 12,500.

[46] The tax due in the Netherlands would amount to € 5,000 + € 10,000+ € 22,500 = € 37,500. The EATR would equal 37,500 / 143,333 * 100% = 26.2%.

[47] In cases falling within the scope of application of the TFEU, the levying of such an "exit tax" infringes upon the freedom of establishment. See *supra note* 25.

[48] 25% * 70,000 = 17,500.

[49] (32,500 / 170,000) * 100% = 19.1%

in the value of the plant breeder's right subsequent to its transfer to Belgium should be allocated to Belgium (that is, in terms of applying an origin-based income allocation method). In effect, due to a notional remuneration 'paid' in Belgium (i.e., in yearly installments) to the Netherlands of € 500,000 in return for the notional supply of goods from the Netherlands to Belgium, the capital asset transfer, this entails a transfer of Johnson's worldwide tax base from Belgium to the Netherlands corresponding to a notional 'capital gain' (i.e., in yearly installments) of € 50,000 (500,000 – 450,000). To ensure this, the asset is placed on Belgium branch b)'s balance sheets at fair market value, i.e., € 500,000, rather than the (lower) fiscal bookkeeping value of € 450,000. Accordingly, for the purpose of calculating the DTR, the (tax deductible) yearly depreciation terms are taken into consideration against that fair market value, i.e., € 33,333.33,[50] instead of the fiscal bookkeeping value, i.e., € 30,000. The latter, notably, remains the depreciation term to be taken into consideration for the purpose of determining Johnson's worldwide income. Consequently, under the DTR mechanism, the numerator in the fraction is calculated at € 60,000 – € 33,333.33, while the contribution of branch b) to Johnson's worldwide income in the denominator of the fraction is calculated a € 60,000 – € 30,000. The increased amount of € 3,333.33 (i.e., 33,333.33 - 30,000) equals the difference between the capital asset's fiscal bookkeeping value and its fair market value as divided by the number of years corresponding with its remaining economic life (i.e., € 50,000 / 15 depreciation terms). The application of the fraction entails an amount of DTR of € 5,098.04.[51] The Dutch tax payable is accordingly set at € 32,500 - € 5,098.04 = € 27,401.96. The Dutch tax due equals an EATR in the Netherlands of 19.1% on the Dutch share of the tax pie, calculated at € 143,333.33 (i.e., € 140,000 + € 3,333.33).[52] The same is true regarding the amount of DTR that is effectively provided with respect to the Belgian share of the tax pie. That amount also equals 19.1%.[53]

Hence, the DTR methodology entails an annual reduction of the amount of DTR for a period that corresponds with the remaining economic life of the respective transferred capital asset. And this leads to *a pro rata parte* increase in the income tax annually payable in the Netherlands during that same period. In this case, the hidden reserve is taxed in 15 annual terms of € 3,333.33. Should all things remain equal during the remaining economic life of the transferred capital asset the increased amount of tax yearly due equals € 637.25,[54] an amount corresponding to an EATR of 19.1%.[55] On an overall basis, the hidden reserve of € 50,000 would be taxed in the Netherlands at an amount of € 9,558.82 (i.e., 15 terms * 637.25). This equals an EATR of 19.1% on the hidden reserve (i.e., 9,558.82 / 50,000) – inflation and the time value of money not being taken into consideration.

Notably, if the capital asset would have been disposed of against its fair market value immediately following its transfer overseas, Dutch income tax would become due on the, at that time, realized capital gain of € 50,000. No DTR would be available as the capital gain would not be attributed to the operations carried on through branch b). That is, the capital gain attributable to branch b) would amount to nil (i.e., 500,000 – 500,000) as the capital asset is placed on branch b)'s balance sheets at fair market value. And, to that extent, the numerator in the fraction would accordingly amount to nil. Furthermore, if the capital asset would have been disposed of later that tax year at an amount of, say, € 540,000, the capital gain attributable to branch b) would amount to € 40,000 (i.e., 540,000 – 500,000). That amount would be included in the numerator in the fraction, having the effect that, to that extent, DTR is granted to our taxpayer Johnson. If the capital asset would have been sold at a loss, that capital loss would reduce Johnson's worldwide income and in conjunction with that simultaneously reduce the amount of foreign income included in the numerator of the fraction.

Now imagine the *mirror case* and suppose that the capital asset is transferred from branch b) to branch a). Again, Johnson's worldwide income does not alter upon the intra-firm capital asset transfer. It still amounts to € 170,000. At the moment prior to the notional capital asset transfer, the asset was placed on branch b)'s balance sheet at an amount of € 450,000.[56] Accordingly, taxpayer Johnson has a latent DTR entitlement on the foreign source hidden reserve of € 50,000. Under the DTR methodology, Johnson's worldwide income does not alter upon the intra-firm capital asset transfer. The latent DTR entitlement on the hidden reserve does not, or at least should not, become available at the time of transferring the capital asset from abroad. Viz., the capital asset transfer does

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[50] 500,000 / 15 terms = 33,333.33.
[51] (60,000 – 33,333.33) / (200,000 – 30,000) * 32,500 = 5,098.04.
[52] 27,401.96 / 143,333.33 * 100% = 19.1%.
[53] 5,098.04 / (60,000 – 33,333.33) * 100% = 19.1%.
[54] 3,333.33 / 170,000 * 32,500 = 637.25.
[55] 637.25 / 3,333.33 * 100% = 19.1%.
[56] 600,000 – 5 * 30,000 = 450,000.

not affect taxpayer Johnson's worldwide income. Yet again, this is caused by the operation of the tax base reservation. And yet again, this makes sense as taxpayer Johnson has not in fact derived a capital gain of € 50,000 by just shipping the capital asset from overseas to its domestic branch with respect of which DTR should be made available. Instead, substantially, the latent DTR entitlement becomes available in yearly terms, which vary directly in proportion to the annual depreciation terms during the remaining economic life of the transferred capital asset. These terms increase the amount of foreign source income and, accordingly, the amounts of DTR provided. This reduces the income tax annually payable. Notably, should the intra-firm capital asset transfer from branch b) to branch a) be recognized as a taxable event at this time in Belgium, resulting in income tax due (i.e., the imposition of an "exit tax" as would be the case under a CLIN-promoting base exemption system), which, if I am not mistaken actually occurs in Belgium in a scenario as described here, this would be conceptually unsound as the taxpayer, at that time, has not actually derived an income. A profit has not in fact been made. So why pay tax? Moreover, Belgium, by imposing such an "exit tax", would impede the proper functioning of the internal market.[57]

Let us return to the application of the Dutch-style DTR method. Technically, things should work out as follows.[58] Irrespective of the capital asset transfer, taxpayer Johnson's worldwide income still amounts to € 170,000 (i.e., € 200,000 - € 30,000). Accordingly, the Dutch tax on Johnson's worldwide income amounts to € 32,500, which, again, equals an EATR of 19.1%.[59] For the purpose of subsequently calculating the DTR, the intra-firm dealing, i.e., the notional capital asset transfer, is recognized for DTR purposes. The latent income tax claim on the hidden reserve needs to be allocated to Belgium as value has been added, i.e., income has accrued, in Belgium (at least, from an origin-based perspective that is). In terms of allocating business income under origin-based, supply-side, allocation factors, this makes sense. Viz., Johnson durably employs its capital asset, the plant breeder's right, for the purpose of its business operations in Belgium up until the time of the right's transfer to the Netherlands. Subsequent to its transfer, the capital asset is further durably employed for Johnson's business activities in the Netherlands. Hence, this calls for a division of the tax base between Belgium and the Netherlands. In terms of allocating business income on an origin basis, the unrealized capital gain of € 50,000 should be allocated to Belgium as the production factor capital, the plant breeder's right, had been employed in Belgium during the period of capital accrual. Mutations in the value of the plant breeder's right subsequent to its transfer to the Netherlands should be allocated to the Netherlands (that is, again, in terms of applying an origin-based income allocation method such as the transfer pricing methodology). In effect, due to a notional remuneration 'paid' in the Netherlands (i.e., in yearly installments) to Belgium of € 500,000 in return for the notional supply of goods from Belgium to the Netherlands, i.e., the capital asset transfer, this entails a transfer of Johnson's worldwide tax base from the Netherlands to Belgium corresponding to a notional 'capital gain' (i.e., in yearly installments) of € 50,000 (500,000 – 450,000). Under the DTR mechanism, the numerator is calculated at € 60,000 + € 3,333.33.[60] The latter amount equals the *pro rata parte* capital gain recognized upon the notional capital asset transfer at the level of branch b) for DTR purposes. That amount equals the difference between the capital asset's fiscal bookkeeping value and its fair market value as divided by the number of years corresponding with its remaining economic life (i.e., € 50,000 / 15 depreciation terms). Consequently, the application of the fraction entails an amount of DTR of € 12,107.84.[61] The Dutch tax payable is accordingly set at € 32,500 – € 12,107.84 = € 20,392.16. The Dutch tax due equals an EATR in the Netherlands of 19.1% on the Dutch share of the tax pie, calculated at € 106,666.67.[62] Notably, that latter amount, i.e., the Dutch share of the tax pie, can be understood when the following is appreciated. Upon its inward-bound transfer from overseas, the capital asset should be considered to be placed on branch a)'s balance sheets at its fair market value of € 500,000 rather than its fiscal bookkeeping value of € 450,000. Viz., the hidden reserve has a foreign source. That amount of € 500,000 subsequently constitutes the basis on which the annual deprecation terms, i.e., € 33,333.33,[63] are calculated. Accordingly, the contribution of branch a) to

[57] In cases falling within the scope of application of the TFEU, the levying of such an "exit tax" infringes upon the freedom of establishment. See *supra note* 25.
[58] Logic requires the approach to apply as set forth hereunder. However, at this time, there is no case law available in the Netherlands to verify this.
[59] (32,500 / 170,000) * 100% = 19.1%.
[60] 33,333.33 - 30,000. The increased amount of € 3,333.33 again equals the difference between the capital asset's fiscal bookkeeping value and its fair market value as divided by the number of years corresponding with its remaining economic life.
[61] (60,000 + 3,333.33) / (200,000 – 30,000) * 32,500 = 12,107.84.
[62] 20,392.16 / 106,666.67 * 100% = 19.1%.
[63] 500,000 / 15 year terms = 33,333.33.

taxpayer Johnson's worldwide income upon the notional capital asset transfer amounts at € 140,000 – € 33,333.33 = € 106,666.67. The amount of DTR granted with respect to the Belgian share of the tax pie effectively equals 19.1% as well.[64]

Hence, the DTR methodology entails an annual increase in the amount of DTR provided in the Netherlands for a period that corresponds with the remaining economic life of the respective transferred capital asset. And this leads to a *pro rata parte* reduction of the income tax annually payable in the Netherlands during that same period. In this case, the DTR entitlement regarding the foreign source hidden reserve is granted in 15 annual terms of € 3,333.33. Should all things remain the same during the remaining economic life of the transferred capital asset, the reduction of income tax due yearly equals € 637.25,[65] an amount corresponding to an EATR reduction of 19.1%.[66] On an overall basis, the reduction of Dutch tax payable would amount to € 9,558.82 (i.e., 15 terms * 637.25). This equals an effective tax reduction of 19.1% on the hidden reserve (i.e., 9,558.82 / 50,000) – inflation and the time value of money not being taken into consideration.

Notably, if the capital asset would have been disposed of against its fair market value immediately following its transfer overseas, DTR would be granted on the, at that time, realized capital gain of € 50,000. DTR would be available as the capital gain would be attributed to the operations carried on through branch b). The numerator in the fraction would increase by € 50,000. Notably, the capital gain attributable to branch a) would amount to nil (i.e., 500,000 – 500,000) as the capital asset is placed on branch a)'s balance sheets at fair market value. Furthermore, would the capital asset have been disposed of later that tax year at an amount of, again, say € 540,000, the capital gain attributable to branch a) would amount to € 40,000 (i.e., 540,000 – 500,000). That amount would not be included in the numerator in the fraction, having the effect that, to that extent, no DTR is granted to our taxpayer Johnson. The capital gain attributable to branch b) would still amount to € 50,000. And only to that extent would DTR be provided.

3 The operation of the advocated system

3.1 The advocated approach resolves unjustified unequal tax treatment

What would the effect be if all taxpayers of the EU MSs were made subject to the aforementioned tax treatment, just like the Netherlands currently applies to its resident taxpayers? What if Johnson would have been entitled to this tax treatment if it had resided in an EU MS other than the Netherlands?

Today, this is not the case. Under Dutch tax law, taxpayers, both individuals and companies, are only eligible for the tax treatment, referred to in the previous section, in the Netherlands if they reside within Dutch territories for tax purposes.[67] The foreign income of non-resident taxpayers is excluded, or is "exempt", from the Dutch tax base. If Johnson had resided, for example, in Paris, France, for Dutch tax purposes, it would have been taxed in the Netherlands exclusively on its domestic sources of income, i.e., the business income as derived through its Dutch branch a). Johnson's business income derived through its Belgian branch b) would be kept entirely outside Dutch taxation.[68] Accordingly, the Netherlands applies a CLIN-promoting, territorial taxing system to its non-resident taxpayers. Furthermore, the proceeds from foreign sources of taxable income, both proceeds from actual third-party transactions and proceeds from intra-firm, notional transactions, as described in the above, would be "exempt" from Dutch taxation as well. As a consequence of this, taxpayer Johnson, for the sake of argument now residing for Dutch tax purposes in Paris, France, would be subject to tax upon the recognition of outbound intra-firm transactions. In the aforementioned scenarios, Johnson would respectively be subject to EATRs of 18.5%, 18.2% and 26.2% upon the respective outbound intra-firm service provided, the outbound intra-firm supply of goods (the horticultural plants) and the outbound intra-firm transfer of the capital asset (the plant breeder's right), instead of 20%, 20.3% and 19.1%. That is, a divergent tax treatment which is the sole consequence of Johnson's place of tax residence in Paris rather than, say Leiden, the Netherlands. This outcome under current Dutch tax law holds true whilst nothing has changed but Johnson's transfer of tax residence within the internal market without internal frontiers to another EU MS, in this case France. The underlying cause of this divergent tax treatment is essentially the fact

[64] 12,107.84 / (60,000 + 3,333.33) * 100% = 19.1%.
[65] 3,333.33 / 170,000 * 32,500 = 637.25.
[66] 637.25 / 3,333.33 * 100% = 19.1%.
[67] This is true save for the exception as laid down in Article 2.5 Dutch IITA 2001 on the basis of which non-resident taxpayers / individuals may opt to be treated as equal to resident taxpayers for income tax purposes.
[68] The 'tax base reservation' exclusively applies for the benefit of Dutch resident taxpayers.

that the Dutch international tax system is entirely based on the differential treatment of resident taxpayers (unlimited tax liability) and non-resident taxpayers (limited tax liability).[69] Yet, Johnson's Dutch-French tax-border crossing is of no material relevance under the EU equality principle.[70] By refraining from acknowledging this, the Netherlands international tax system, in its essence, is founded on an unjustified unequal tax treatment in materially equal circumstances. This is clearly indirectly discriminatory as the Court of Justice, fairly acknowledged for instance in the *Renneberg* case.[71]

And the Netherlands does not stand alone in this respect. This difference in tax treatment on the basis of the taxpayer's place of residence is in full compliance with the concepts typically applied in international taxation. Moreover, to my knowledge, all EU MSs subject non-resident taxpayers to this differential tax treatment, having the consequence that proceeds from foreign source actual and notional transactions are "exempt" from the domestic tax base. This, however, does not provide sufficient grounds, save for legal positivistic ones, to conclude on the intrinsic fairness of such a differential tax treatment on the sole basis of a different place of tax residence.

It should be noted that the resemblance with the distorting effects under a CLIN-promoting, territorial system, as touched upon in the previous section 2.2, is not a coincidence. The application of a base exemption mechanism regarding resident taxpayers' foreign income items as described in the above section has the exact same effects as the tax treatment of non-resident taxpayers described in the above paragraphs. By subjecting non-resident taxpayers to limited tax liability, i.e., to tax them on their income from domestic sources only, the Netherlands, as well as any other EU MS, applies a territorial taxing system to its non-resident taxpayers. By doing that, as said, such an approach discriminates between non-resident taxpayers and resident taxpayers. This unequal tax treatment cannot be simply resolved by introducing a base exemption mechanism for resident taxpayers deriving income from foreign sources. As the Court of Justice acknowledges, for instance in the "exit tax cases" of *N.* and *Lasteyrie*,[72] and the "cross-border costs / losses cases" of *Bosal* and *Marks & Spencer II* – the latter two, notably, at least to some extent –,[73] EU MSs cannot resolve all EU law impediments by extending the territorial tax treatment of non-resident taxpayers to their resident taxpayers, i.e., by applying a base exemption to all their taxpayers' foreign source income, irrespective of their place of residence. Indeed, such an approach would cancel out the discriminations in their tax systems. However, this is untrue as regards the market access restrictions unilaterally imposed by the EU MSs in respect of outbound investments. Concurrently, the replacement of the current Dutch-style DTR mechanism for a base exemption mechanism in the Netherlands, a tax measure that is currently considered by the Dutch State Secretary for Finance, would simply entail the transformation of one EU law impediment, the discriminatory tax treatment of non-resident taxpayers, for the other, the restrictive tax treatment of cross-border, intra-EU business operations.

From the perspective of attaining market access neutrality and market equality within the internal market, such arbitrary, unilaterally imposed differences in tax burdens imposed in relation to intra-firm transactions realized should not occur. The internal market requires direct tax effects as imposed on taxpayers by EU MSs to be equal regardless of how and where these taxpayers employ

[69] See the Dutch Ministry of Finance's '2011 Tax Policy Notes' (*"Notitie Fiscaal Verdragsbeleid 2011*"), V-N 2011/12.
[70] See Commission Staff Working Paper, *Company Taxation in the Internal Market*, {COM(2001)582 final} Brussels. 23 October 2001, SEC(2001) 1681, p. 309-310.
[71] See Court of Justice, case C-527/06 (*Renneberg*).
[72] See Court of Justice, cases C-9/02 (*De Lasteyrie du Saillant*) and C-470/04 (*N.*) in which the Court of Justice ruled that the imposition of an "exit tax" upon the transfer of property to another EU MS alongside the emigration of the respective taxpayer, an individual, to another EU MS constitutes a market access restriction incompatible with the fundamental freedoms. Contra, Court of Justice, case 81/87 (*Daily Mail*) in which the Court of Justice considered the clearance requirement under UK law for allowing corporate emigration, to settle the corporate tax position, i.e., the imposition of an "exit tax" upon the transfer of property to overseas together with the corporate taxpayer's emigration to be a disparity rather than a unilaterally imposed obstacle impeding the functioning of the internal market as ruled in *N.* and *Lasteyrie*. Accordingly, *Daily Mail* is quite difficult, if not impossible, to reconcile with *N.* and *Lasteyrie*.
[73] See Court of Justice, cases C-168/01 (*Bosal*) and C-446/03 (*Marks & Spencer II*). In *Bosal* and *Marks & Spencer II*, the Court of Justice required respectively the Netherlands and the United Kingdom – though in a mutually inconsistent fashion – to enable taxpayers to set-off foreign source negative income items (i.e., it involved foreign source costs in *Bosal* and foreign source losses in *Marks & Spencer II*) against domestic source positive income items. Moreover, it should be noted that the Court of Justice has not adopted a consistent line of argumentation in this matter altogether and ruled otherwise, for instance, in cases C-250/95 (*Futura*), C-414/06 (*Lidl*) and C-337/08 (X *Holding*). In these cases, the Court of Justice rigorously allowed the EU MSs involved, without making an exception, to maintain the impossibility to set-off foreign source negative income items against domestic source positive income items in their tax systems. These cases are difficult, if not impossible, to reconcile with each other. See on this matter, De Wilde, *supra note* 25.

their production factors within the EU territories. This holds true irrespective of the taxpayer's place of tax residence. I hope that I have demonstrated that this is currently not the case when it comes to the taxation of notional proceeds from notional intra-firm transactions undertaken in the course of carrying on business activities in a cross-border, intra-EU environment.

Let us return to the query as forwarded at the beginning of this section. What would the outcome be under the approach advocated, in terms of the tax burden imposed, when applied consistently by both EU MSs involved, thereby with regard to all EU residents having domestic (and foreign) sources of income? Let us exercise the, I imagine now familiar, thought-experiment.[74] Suppose that both the Netherlands and Belgium applied the approach advocated. The result would be that the tax burden imposed by both the Netherlands and Belgium would be exactly the same in both domestic and cross-border scenarios, i.e., regarding all proceeds derived from intra-EU economic activities. It would be immaterial in which EU MS Johnson resides. All (in)direct forms of discrimination would be cancelled out. It would also be immaterial whether or not Johnson operates its commercial activities in an intra-EU cross-border context. All market access restrictions would be canceled out. The tax burden imposed would consistently be the same. The crossing of tax borders within the EU's internal market would, therefore, not be hindered.

3.2 Interconnected tanks: intra-firm provision of services, intra-firm supplies of goods

3.2.1 General

Things are best illustrated by referring to the tax position of Johnson in the 'Base case' and its variations as put forward in section 2. That is, under the additional assumption that the identical approach is adopted on both sides of the Dutch–Belgian tax border. Then, it becomes evident that the mutual operation of the advocated approach, worldwide taxation and DTR under the Dutch-style DTR mechanism, entails the same *pro rata parte* effects as is currently the case for Dutch resident taxpayers. Where one EU MS recognizes the notional profit for DTR purposes, the other EU MS recognizes a notional loss; and vice versa. Accordingly, in their mutual operation, the DTR mechanisms as applicable on both sides of the tax borders operate as interconnected tanks. This holds true in respect of both intra-firm provisions of services as well as intra-firm supplies of goods.

3.2.2 Intra-firm provisions of services

First, let us return to the scenario referred to in section 2.2.2. As mentioned, one of taxpayer Johnson's workers in branch a) renders an intra-firm service for the benefit of the business activities carried on through branch b). The fair market value of the service rendered equals € 15,000. The effects are best demonstrated by tables:

- *Table 2. 'Domestic scenario – intra-firm provisions of services'* deals with the purely domestic scenario in which both branches are situated within Dutch or Belgian territory;
- *Table 3. 'Cross-border scenario – intra-firm provisions of services'* deals with a cross-border scenario, i.e., where branch a) is situated within Dutch territory and branch b) in Belgian territory.

Table 2. 'Domestic scenario – intra-firm provisions of services'

Taxpayer Johnson	**Year X**
Income branch a) in NL/Be	140,000
'Added': notional service fee received by branch a)	15,000
Income branch b) in NL/Be	60,000
'Deducted': notional service fee paid by branch b)	<15,000>
On balance	**200,000**
Tax due in NL/Be (under brackets as in 2.2.1)	**40,000**
Tax burden imposed by NL/Be	**20%**

Table 3. 'Cross-border scenario – intra-firm provisions of services'

[74] Disparities are assumed to be absent. All EU MSs involved are assumed to adopt the same approach towards the taxable unit, the tax base, the tax rate, as well as the adopted international tax principles.

Taxpayer Johnson (Year X)	Domestic income	Worldwide income	Tax before DTR	DTR	Tax after DTR	Tax burden after DTR
Tax position in NL	**155,000**[75]	200,000	40,000	9,000[76]	**31,000**[77] *(tax due in NL)*	**20%**[78] *(tax burden imposed by NL)*
Tax position in Belgium	**45,000**[79]	200,000	40,000	31,000[80]	**9,000**[81] *(tax due in Belgium)*	**20%**[82] *(tax burden imposed by Belgium)*
On balance	**200,000**	200,000	40,000	n/a	**40,000** *(overall tax due)*	**20%**[83] *(overall tax burden imposed)*

Under the advocated approach, the tax burdens imposed by the Netherlands and Belgium would be the same in both domestic and cross-border scenarios. The EATR imposed on Johnson in both the Netherlands and Belgium, both pre-DTR and post-DTR, would equal 20%. The overall amount of income tax payable would be the same as well. In both cases Johnson would pay € 40,000 in income tax, an amount equal to an EATR of 20%. Hence, it would be irrelevant where Johnson has its place of residence for tax purposes. It would also be irrelevant whether taxpayer Johnson performs its business activities solely in the Netherlands / Belgium, or spread across EU MSs, in this example the Netherlands and Belgium. Johnson itself as well as its horticultural activities could move unhindered across tax borders within the internal market, while the Netherlands and Belgium would receive their fair share of the tax pie.

3.2.3 Intra-firm supplies of goods (stock transfers)

Second, let us return to the scenario referred to in section 2.2.3. As mentioned, goods, horticultural plants, are produced through branch a), subsequently transferred to branch b), from which they are sold on the market. As said, the manufacturing costs equal € 5,000, the wholesale value equals € 12,000 and the resale price equals € 20,000.

- *Table 4. 'Domestic scenario – intra-firm supplies of goods*' deals with the purely domestic scenario in which both branches are situated within Dutch or Belgian territory;
- *Table 5. 'Cross-border scenario – intra-firm supplies of goods*' deals with the cross-border scenario, i.e., where branch a) is situated within Dutch territory and branch b) on Belgian territory.

Table 4. 'Domestic scenario – intra-firm supplies of goods'

Taxpayer Johnson	**Year X**
Income branch a) in NL/Be	140,000
'Added': notional consideration received by branch a) upon intra-firm goods supply	12,000
'Deducted': manufacturing costs.	<5,000>
Income branch b) in NL/Be	60,000
'Deducted': notional consideration paid by branch b) upon intra-firm goods supply	<7,000>
Added: resale price upon	15,000

[75] 140,000 + 15,000 = 155,000.
[76] (60,000 – 15,000) / 200,000 * 40,000 = 9,000.
[77] 40,000 – 9,000 = 31,000.
[78] 31,000 / 155,000 * 100% = 20%.
[79] 60,000 – 15,000 = 45,000.
[80] (140,000 + 15,000) / 200,000 * 40,000 = 31,000.
[81] 40,000 – 31,000 = 9,000.
[82] 9,000 / 45,000 * 100% = 20%.
[83] 40,000 / 200,000 * 100% = 20%.

sale of goods on market **On balance**	**215,000**
Tax due in NL/Be (under brackets as in 2.2.1)	**43,750**
Tax burden imposed by NL/Be	**20.3%**

Table 5. 'Cross-border scenario – intra-firm supplies of goods'

Taxpayer Johnson (Year X)	**Domestic income**	**Worldwide income**	**Tax before DTR**	**DTR**	**Tax after DTR**	**Tax burden after DTR**
Tax position in NL	**147,000**[84]	215,000	43,750	13,837.21[85]	**29,912.79**[86] *(tax due in NL)*	**20.3%**[87] *(tax burden imposed by NL)*
Tax position in Belgium	**68,000**[88]	215,000	43,750	29,912.79[89]	**13,837.21**[90] *(tax due in Belgium)*	**20.3%**[91] *(tax burden imposed by Belgium)*
On balance	**215,000**	215,000	43,750	n/a	**43,750** *(overall tax due)*	**20.3%**[92] *(overall tax burden imposed)*

The tax burdens imposed by the Netherlands and Belgium would be the same in both domestic and cross-border scenarios. The EATR imposed on Johnson in both the Netherlands and Belgium, both pre-DTR and post-DTR, would equal 20.3%. The overall amount of income tax payable would be the same as well. In both cases Johnson would pay € 47,500 income tax, an amount equal to an EATR of 20.3%. Hence, it would be irrelevant where Johnson has its place of residence for tax purposes. It would also be irrelevant whether taxpayer Johnson performs its business activities solely in the Netherlands / Belgium, or spread across EU MSs, in this example the Netherlands and Belgium. Accordingly, Johnson would be able to operate its horticultural business within the internal market without being hindered by the Dutch or Belgian tax systems, while the Netherlands and Belgium would receive their fair share of the tax pie.

3.2.4 Intra-firm supplies of goods (capital asset transfers)

Third and finally, let us return to the scenario referred to in section 2.2.4. As mentioned, a capital asset, the plant breeder's right, is transferred from branch a) to branch b) for the purpose of durably employing it for the benefit of Johnson's business operations carried on through its branch b). The capital asset was acquired 5 years ago. Its acquisition price was € 600,000; its economic life equals 20 years and the yearly tax-deductible depreciation terms amount to € 30,000. In addition, at the moment prior to the notional capital asset transfer, the asset was placed on branch a)'s balance sheet at an amount of € 450,000, while at that time, its fair market value equalled € 500,000.

- *Table 6. 'Domestic scenario – intra-firm capital asset transfers*', again, deals with a purely domestic scenario in which both branches are situated within Dutch or Belgian territory;
- *Table 7. 'Domestic scenario – intra-firm capital asset transfers*', again, deals with the cross-border scenario, i.e., where branch a) is situated within Dutch territory and branch b) on Belgian territory.

Table 6. 'Domestic scenario – intra-firm capital asset transfers'

Taxpayer Johnson	**Year X**

[84] 140,000 + 7,000 = 147,000.
[85] (60,000 + 8,000) / 215,000 * 43,750 = 13,837.21.
[86] 43,750 – 13,837.21= 29,912.79.
[87] 29,912.79 / 147,000 * 100% = 20.3%.
[88] 60,000 + 8,000 = 68,000.
[89] (140,000 + 7,000) / 215,000 * 43,750 = 29,912.79.
[90] 43,750 – 29,912.79 = 13,837.21.
[91] 13,837.21/ 68,000 * 100% = 20.3%.
[92] 43,750 / 215,000 * 100% = 20.3%.

Income branch a) in NL/Be	140,000
‘Added’: notional consideration received by branch a) upon intra-firm asset transfer	500,000
Income branch b) in NL/Be	60,000
‘Deducted’: notional consideration paid by branch b) upon intra-firm capital asset transfer	<500,000>
Deducted: depreciation term capital asset upon capital asset transfer	<30,000>
On balance	**170,000**
Tax due in NL/Be (under brackets as in 2.2.1)	**32,500**
Tax burden imposed by NL/Be	**19.1%**

Table 7. ‘Domestic scenario – intra-firm capital asset transfers’

Taxpayer Johnson (Year X)	**Domestic income**	**Worldwide income**	**Tax before DTR**	**DTR**	**Tax after DTR**	**Tax burden after DTR**
Tax position in NL	**143,333.33**[93]	170,000	32,500	5,098.04[94]	**27,401.96**[95] *(tax due in NL)*	**19.1%**[96] *(tax burden imposed by NL)*
Tax position in Belgium	**26,666.67**[97]	170,000	32,500	27,401.96[98]	**5,098.04**[99] *(tax due in Belgium)*	**19.1**%[100] *(tax burden imposed by Belgium)*
On balance	**170,000**	170,000	32,500	n/a	**32,500** *(overall tax due)*	**19.1%**[101] *(overall tax burden imposed)*

The tax burdens imposed by the Netherlands and Belgium would be the same in both domestic and cross-border scenarios. The EATR imposed on Johnson in both the Netherlands and Belgium, both pre-DTR and post-DTR, would equal 19.1%. The overall amount of income tax payable would be the same as well. In both cases Johnson would pay € 32,500 in income tax, an amount equal to an EATR of 19.1%. Neither Johnson’s place of residence nor the question of whether it performs its business activities in a cross-border setting would be relevant for income tax purposes. Johnson would be able to operate its horticultural business within the internal market unhindered, while the Netherlands and Belgium would receive their fair share of the tax pie.[102]

4 Concluding remarks

This article assesses the effects, in terms of unilateral tax burdens effectively imposed, of adopting a direct taxation approach where each EU MS subjects all taxpayers, corporations and individuals, residing for tax purposes in the EU that derive income from sources situated within its domestic territory to unlimited taxation, whilst granting DTR under a Netherlands-style tax exemption. That is, to the extent that taxpayers perform intra-firm transactions. By means of numerical examples, I

[93] 140,000 + 3,333.33 = 143,333.33.
[94] (60,000 – 33,333.33) / (200,000 – 30,000) * 32,500 = 5,098.04.
[95] 32,500 – 5,098.04 = 27,401.96.
[96] 27,401.96 / 143,333.33 * 100% = 19.1%.
[97] 60,000 – 33,333.33 = 26,666.67.
[98] (140,000 + 3,333.33) / (200,000 – 30,000) * 32,500 = 27,401.96.
[99] 32,500 – 27,401.96 = 5,098.04.
[100] 5,098.04 / 26,666.67 * 100% = 19.1%.
[101] 32,500 / 170,000 * 100% = 19.1%.
[102] Notably, if a taxpayer completely leaves a taxing jurisdiction, that taxing jurisdiction could adopt a tax measure to ensure the taxation of any subsequent commercial benefits derived from its domestic sources, for example, the realization of a hidden reserve. This issue is not further discussed.

demonstrate that the outcome of the assessment is that the tax burden imposed by each EU MS involved would be exactly the same in both domestic and cross-border scenarios, i.e., regarding all proceeds derived from intra-EU economic activities. Neither the taxpayer's place of residence nor the question of whether its business operations are carried on in an intra-EU cross-border context would influence the unilaterally imposed tax burden. Accordingly, all (in)direct forms of discrimination and market access restrictions would be cancelled out from the EU MSs' (inter)national direct tax systems. The crossing of tax borders within the internal market would therefore not be hindered. The desired equilibrium between the autonomy of the EU MSs in the area of direct taxation and the internal market without internal frontiers would be attained. This now holds true not only regarding cross-border business losses and currency exchange results, as demonstrated in my earlier contributions to this journal, but also in respect of EU taxpayers who carry out cross-border intra-firm transactions. The advocated approach would therefore resolve the "exit taxation" issues within the internal market. Moreover, it would also resolve the imbalances created by the Court of Justice as regards to the application of the fundamental freedoms in the area of direct tax allowances for personally related expenses, a matter dealt with, for instance in the *Schumacker*, *Gilly*, *Gschwind*, and *De Groot* cases.[103]

[103] See Court of Justice, cases C-279/93 (*Schumacker*), C-336/96 (*Gilly*), C-391/97 (*Gschwind*) and C-385/00 (*De Groot*). See for an analysis of this case law, Peter J. Wattel, *Red Herrings in Direct Tax Cases before the ECJ*, 31 Legal Issus of Economic Integration 81 (2004), at pp. 81-95.