Currency Exchange Results; What if EU MSs Subjected All Taxpayers to Unlimited Income Taxation Whilst Granting DTR under a Netherlands-style Tax Exemption?

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1   Introduction

On an earlier occasion, I plead in this journal for 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 that 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 inside or outside the territory of the taxing EU MS. To secure single taxation, I argued, each EU MS should subsequently grant juridical double tax relief ('DTR') in respect of the foreign-source income of these EU taxpayers under the juridical DTR method currently applied to active income in the Netherlands, i.e., the "credit for domestic tax attributable to foreign income" method. In other words, the application of juridical DTR under the methodology typically referred to in practice as "exemption with progression". I arrived at the, perhaps bold, 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. I illustrate things by means of numerical examples dealing with cross-border business losses. Hence, I argued, 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 (discriminations and restrictions). That is, an "obstacle-free" state international tax system simultaneously promoting both capital and labour import neutrality (CLIN) and capital and labour export neutrality (CLEN), independent of the taxpayer's place of tax residence. Both the 'internal market access principle' and the 'internal market equality principle' would be acknowledged to its full extent.[3] In cases where the Treaty on the Functioning of the European Union ('TFEU') applies, such an approach would provide the desired equilibrium between the tax sovereignty of the EU MSs and an internal market without internal frontiers.

This article further assesses 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 realize currency exchange results while carrying on their business activities in a cross-border, intra-EU, context?[4] The introduction of the European Monetary Union and the Euro currency to a great extent forced back currency exchange issues. However, they have not fully disappeared as the monetary union does not cover the entire geographical territories of the EU. Some EU MS have not (yet) embraced the Euro currency. Today, the United Kingdom adopts the Pound Sterling. Sweden and Denmark employ the Swedish and Danish Krone. As long as this is reality, distorting currency exchange differences remain present within the internal market. Hence, this reality may provide sufficient reasons to scrutinize the tax implications under the advocated approach, i.e., worldwide taxation of both resident and non-resident taxpayers while providing DTR under the Dutch-style tax exemption, in cases where taxpayers realize currency exchange results. Would primary EU law discriminations and restrictions also fade out in these cases? The answer is affirmative.

In the following sections, first, I illustrate the operation of the current Dutch juridical DTR mechanism in cases where taxpayers realize currency exchange differences (section 2). For that purpose, after posing some general remarks on the mechanism's operation in these cases, I return to the 'Base case', i.e., that of the hypothetical taxpayer 'Johnson', I also refer to in my earlier contribution to this journal. For the purpose of illustrating the tax effects where taxpayers realize currency exchange results, I introduce currency exchange effects in the

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[2] See Maarten F. de Wilde, *What if Member States Subjected Non-resident Taxpayers to Unlimited Income Taxation Whilst Granting DTR under a Netherlands-style Tax Exemption?*, Bulletin for International Taxation, 6/2011.
[3] On this principles, see further Maarten F. de Wilde, *Some Thoughts on a Fair Allocation of Corporate Tax in a Globalizing Economy*, 38 Intertax 281 (2010), section. 6.
[4] Administrative issues are not considered.

'Base case'.[5] In that respect, I address both the case where two currencies appear (Euro/Pound Sterling) and the case where three currencies (Euro/Pound Sterling/Danish Krone) come into play. Subsequently, second, I illustrate the overall effects in a cross-border, intra-EU, context, under the advocated approach (section 3). In doing so, it is assumed that both EU MSs involved adopt the same methodology on both sides of the tax border. The reason for this thought-experiment is to illustrate the advocated approach's non-discriminatory and tax neutral operation on the one hand, as well as, on the other hand, to exclude the distorting effects of tax disparities (i.e., mutual tax system divergences) from consideration. This article focuses on resolving impediments to the proper functioning of the internal market as caused by unilaterally imposed tax obstacles, rather than those caused by tax disparities. Tax disparities may only be resolved through the approximation of the EU MSs' direct tax systems (tax harmonization). Moreover, solutions for the distortions of the internal market as caused by mutual exchange rate differences, monetary disparities, should be sought through monetary harmonization, that is, a harmonized monetary policy, rather than by taking measures in the field of (direct) taxation. It can be considered true that the direct tax issues related to currency exchange results realized would cease to exist at the day that a monetary union, covering the entire territories of the EU, would come into existence.[6] However, until that day, currency exchange issues will necessarily uphold their implications also in the field of direct taxation.

2 The current Dutch DTR mechanism's operation regarding cross-border currency exchange results realized

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

2.1.1 General

The DTR mechanism for active income from foreign sources currently applied in the Netherlands, notwithstanding its common reference as "exemption-with-progression method", operates as a credit.[7] But contrary to typical tax credit mechanisms it is not the tax levied abroad that is credited against the domestic tax imposed on the foreign income, yet, rather, the Netherlands (individual or corporate) income tax attributable to the foreign-source income.[8] The Netherlands tax payable is determined by crediting the Netherlands tax attributable to the foreign-source income against the Netherlands tax calculated by reference to the taxpayer's worldwide income. In view of that, DTR is calculated without taking the foreign tax burden into account. The DTR mechanism applies in both intra-EU and third country scenarios.[9]

It should be mentioned that the Dutch State Secretary of Finance recently announced to consider replacing this DTR mechanism for a base exemption mechanism. At least, to the extent it concerns foreign source business income.[10] This would entail the impossibility of cross-border loss set-off, the imposition of 'exit taxes' upon intra-firm capital asset transfers (i.e., capital asset transfers from head office to permanent establishment ('PE') and vice versa), as well as, presumably, the exemption of currency exchange results realized from the Dutch tax base. Each of these implications can be labeled as unilaterally imposed restrictions impeding the proper functioning of the internal market. Therefore, the introduction of a base exemption for foreign business income necessarily entails a variety of primary EU law issues.

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[5] The implications of applying functional currency tax reporting rules are not considered.

[6] Obviously, this will remain untrue in a 'third country context' where the freedom of capital applies.

[7] See also De Wilde, supra note 2, at section 5.1.

[8] In its application, the methodology operates in a way akin to the second limitation commonly applied in regard to international taxation under an ordinary credit mechanism. However, the second limitation applies on a stand-alone basis, i.e., without referring to the foreign taxes levied, as is typically the case under the first limitation under the ordinary credit mechanisms.

[9] 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.

[10] See the letter of the State Secretary of Finance of April 14, 2011 ("Brief Staatssecretaris van Financiën van 14 april 2011"), No. AFP AFP/2011/248U, particularly the appendix, the 'Tax Agenda' ("Fiscale agenda; Naar een eenvoudiger, meer solide en fraudebestendig belastingstelsel"). At the time of preparing the manuscript draft legislative bills have not been proposed.

In my view, the introduction of a base exemption for foreign income, should therefore be considered undesirable.

Let us return to the Dutch-style DTR mechanism as applied today. The mechanism, which is exclusively available to resident taxpayers, entails a pro rate parte allocation of tax across-taxing jurisdictions in cases where resident taxpayers realize currency exchange results in the course of operating their cross-border business activities. In this respect, three scenarios may occur:

  (i)   Currency exchange results arise domestically, scenario (i);
  (ii)   Currency exchange results arise abroad, scenario (ii), and;
  (iii)   Currency exchange results arise both domestically and abroad, scenario (iii);

2.1.2   Scenario (i): currency exchange results arise domestically

Ad scenario (i). Currency exchange results that arise domestically are not included in the DTR mechanism's operation.[11] Such currency exchange results in effect remain part of the domestic part of the tax base and influence the Dutch tax burden imposed on domestic source income accordingly. Positive currency exchange results are taxable, negative currency exchange results are tax deductible.[12] Save for the exception of currency exchange risks being hedged, currency exchange results arise domestically according to Dutch standards in cases where resident taxpayers keep their tax books with respect to their foreign operations in local currencies (i.e., where they have their locally situated assets and liabilities accounted for in local currencies), while their worldwide income is being calculated in Euros. Accordingly, tax deductible/taxable currency exchange results are recognized for Dutch tax purposes in cases where such taxpayers carry on economic activities in foreign jurisdictions employing currencies other than the Euro, such as the United Kingdom, Denmark, the United States of America, or Japan.

Subsequently, no DTR is provided regarding such Dutch source currency exchange results. This is conceptually sound. According to Dutch standards, these results do not arise abroad as local tax reporting occurs in local currencies (just as Dutch tax reporting occurs in Euros). Accordingly, currency exchange results realized due to differences in values between the Euro and the respective local currencies do not arise in those foreign jurisdictions as these income items, by their nature, are not recognized in those jurisdictions for local tax calculation purposes. Accordingly, there is no need to take such currency exchange result into account for DTR purposes. DTR is only granted with respect to income that arises abroad and is taxed abroad according to Dutch standards. To illustrate the practical effects of applying this approach, this scenario is further explored by means of numerical examples in sections 2.2.2 (effects under current Dutch international tax law) and 3.2 (effects under the advocated approach) hereunder.

Notably, in practice, this is a typical scenario. A similar issue was at hand in *Deutsche Shell*, i.e., the case in which the Court of Justice, notably thereby ruling the German tax rules applied incompatible with the EU fundamental freedoms, adopted the same approach as set out in the above. *Deutsche Shell* is further discussed hereunder.

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[11] See Dutch Supreme Court ("Hoge Raad", hereinafter: 'HR') May 4, 1960, published in the unofficial tax reporter *"Beslissingen in Belastingzaken Nederlandse Belastingrechtspraak"* ('BNB') 1960/163 and HR April 29, 1959, BNB 1960/164 (*Rupiah*) confirmed by HR March 10,1993, BNB 1993/209, as well as HR December 5, 2003, BNB 2004/139 (*Cruzeiro*). Furthermore, see HR March 31, 1954, BNB1954/180. See for a brief description of currency exchange effects in Dutch international tax law, Geert T.W. Janssen & Maarten F. de Wilde, *Key practical issues to eliminate the double taxation of business income; The Netherlands*, to be presented at the 2011 Paris Congress of the International Fiscal Association (not yet published), at section 2.7. Notably, the Dutch tax legislator has adopted functional currency tax reporting rules for administrative convenience reasons (Article 7, fifth indent, Dutch CITA). These are not further discussed. Worth mentioning is that the Court of Justice takes a similar stand as the Dutch Supreme Court in case C-293/06 (*Deutsche Shell*).

[12] An alternative to recognize currency exchange results for tax purposes would be to exempt them from the worldwide taxable base altogether. In Dutch corporate taxation, this is currently the case with currency exchange results realized on proceeds from corporate shareholder interests that are tax accounted for in foreign currencies, in regard to which the participation exemption regime, a base exemption mechanism, applies. Such an approach would be conceptually unsound. Currency exchange risks are actual commercial risks. These risks – in the event that they have not been hedged – may lead to actual mutations in the taxpayer's equity capital. In my view, this economic reality should be acknowledged for tax purposes, irrespective of the technical difficulties that may emerge from this when calculating the tax liability. Hedge accounting could be applied for tax purposes in scenarios where the currency exchange risks have been hedged. The aforementioned issues with regard to the tax implications of currency exchange results would then not (at least to some extent) arise as currency risks would not occur.

2.1.3 Scenario (ii): currency exchange results arise abroad

Ad scenario (ii). In the second, opposite, scenario, i.e., in cases where currency exchange results do arise abroad according to Dutch standards, these results are included in the DTR mechanism and do not influence the Dutch tax burden imposed on Dutch source income accordingly. Such currency exchange results in effect are considered part of the foreign part of the worldwide tax base. Save for the exception of currency exchange risks being hedged, currency exchange results arise locally according to Dutch standards in cases where Dutch resident taxpayers keep their tax books with respect to their foreign operations in Euros (i.e., where they have locally situated assets and liabilities accounted for in Euros), while their worldwide income is calculated in Euros. Accordingly, according to Dutch standards, tax deductible/taxable currency exchange results are recognized locally in cases where such taxpayers carry on economic activities in foreign jurisdictions employing currencies other than the Euro. Such currency exchange results are considered not to arise domestically as Dutch tax reporting occurs in Euros and, therefore, necessarily cannot be taken into account for Dutch income tax purposes.

Subsequently, DTR is provided regarding such foreign source currency exchange results realized. This is conceptually sound. According to Dutch standards, these results arise abroad since the tax burden imposed overseas is calculated in local currencies. Consequently, currency exchange results realized due to differences in values between the Euro and the respective domestic currencies arise in these jurisdictions. Accordingly, such currency exchange results are taken into account for Dutch DTR purposes. This scenario is further explored by means of numerical examples in sections 2.2.3 and 3.3.

2.1.4 Scenario (iii): currency exchange results arise both domestically and abroad

Ad scenario (iii). In the third scenario, i.e., the scenario in which currency exchange results arise both domestically and abroad according to Dutch standards, these results are partially included in the DTR mechanism and partially influence the Dutch tax burden imposed on Dutch source income accordingly. Save for the exception of currency exchange risks being hedged, this occurs in cases where Dutch resident taxpayers keep their tax books with respect to their foreign operations in a third country currency (that is, where they have locally situated assets and liabilities accounted for in third country currencies), i.e., another currency than the local currency or the Euro, while their worldwide income is being calculated in Euros.

Under the application of the Dutch-style tax exemption mechanism, the effects in such a scenario are as follows. According to Dutch standards, tax deductible/taxable currency exchange results arise locally in cases where Dutch resident taxpayers carry on economic activities in foreign jurisdictions employing currencies other than the Euro. Local currency exchange results occur to the extent that the third country currency and the local currency mutually fluctuate in value. In addition, according to Dutch standards, tax deductible/taxable currency exchange results arise in the Netherlands as well. Dutch source currency exchange results occur to the extent that the third country currency and Euro mutually fluctuate in value.

Subsequently, DTR is provided regarding the currency exchange results 'third country currency / local currency'. This makes sense. According to Dutch standards, such currency exchange results arise abroad. These foreign source income items are taken into account for Dutch DTR purposes. On the contrary, no DTR is provided regarding the currency exchange results 'third country currency / Euro'. This makes sense also. According to Dutch standards, such currency exchange results arise in the Netherlands. Domestic source income items are not taken into account for Dutch DTR purposes. Hence, at the end of the day, in terms of tax burdens imposed regarding Dutch source income, the Netherlands acknowledges the currency exchange results 'third country currency / Euro'. And, according to Dutch standards, the state in which the Dutch resident taxpayer carries on its business operations recognizes the local/third country currency exchange result, for which the Netherlands provides DTR by means of the Dutch-style tax exemption method. This scenario is further explored by means of numerical examples in sections 2.2.4 and 3.4.

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

2.2.1 General

The functioning of the Dutch-style DTR methodology can be best explained through numerical examples. Let us return to the 'Base case', which I also referred to in my earlier contribution. Please allow me to repeat things a little. The business income of a Dutch resident taxpayer 'Ben Johnson (Horticultural Retail 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[13] + € 10,000[14] + € 25,000[15] = € 40,000. Second, the DTR is calculated by making reference to the Dutch tax that is attributable to Johnson's foreign income – thereby appreciating the functionally separate entity approach as found in the respectively applicable DTC's equivalent of the current Article 7 OECD Model Tax Convention. For the purpose of calculating the DTR, the following fraction is applied: *(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.[16] The Dutch tax payable is accordingly set at € 40,000 – € 12,000 = € 28,000, an effective average tax rate in the Netherlands of 20% on the Dutch share of the international tax pie (i.e., € 140,000). The amount of double tax relief effectively granted with respect to Johnson's foreign income of € 60,000 equals a 20% rate also.[17] The amount of Belgian tax payable (€ 10,800[18]) is ignored for the purpose of calculating the DTR in the Netherlands.

2.2.2   Scenario (i) – British branch b)'s tax books are kept in British Pounds

Now let us introduce a currency exchange result into our 'Base case'. Suppose that State X now is the United Kingdom (instead of Belgium). The United Kingdom adopts the Pound sterling (£) as its currency for income tax calculation purposes. Johnson's worldwide income is calculated in Euros for Dutch tax purposes. Suppose that, contrary to the 'Base case', Johnson's branch b)'s tax books are kept in the British Pound currency and the books of branch a) are kept in the Euro currency. Accordingly, branch b)'s assets, liabilities and equity, as well as its expenses and receipts are booked in British Pounds. Branch a)'s equivalents are kept in Euros.

Case a); British Pound increases in value

Suppose that £ 1 is worth € 1 at the start of the tax bookkeeping period. And suppose that the the British Pound increases in value during the tax bookkeeping period: at the end of this period £ 1 is worth € 1.25. Obviously, the Euro rate concurrently decreases in value during

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[13] 10% * 50,000.
[14] 20% * 50,000.
[15] 25% * 100,000.
[16] 60,000 / 200,000 * 40,000.
[17] 12,000 / 60,000 * 100% = 20%.
[18] 18% * 60,000.

this period. At the end of the tax bookkeeping period, € 1 is worth £ 0.80.[19] Notably, it is assumed that the global currency exchange rate markets clear.[20]

Under the Dutch DTR methodology, Johnson's worldwide income increases as the value of British Pounds increases. The currency exchange result is not recognized for DTR purposes as the income arises in The Netherlands according to Dutch standards.

Notably, before proceeding to the technical overview, the following side note should be made. For simplicity reasons, I calculate the currency exchange effects by taking the overall influence of the currency exchange rate on the branch b)'s equity mutation. In practice, the currency exchange results are calculated by making reference to the value of the taxpayer's individual assets and liabilities. Furthermore, under the Dutch approach adopted for the purpose of allocating business proceeds to tax years, the so-called principle of sound business practice ("goed koopmansgebruik"),[21] a further distinction is made between the taxpayer's individual long-term and short-term (in)tangible assets and liabilities. Subsequently, the currency exchange results realized, where appropriate, distinguish between profits / losses and capital gains / capital losses, to be calculated, dependant on facts and circumstances, by making reference to historical rates, the (average) monthly rates or daily rates. This makes things technically somewhat more complex in practice. Conceptually, however, things do not materially alter for DTR calculation purposes. Hence, I assume that all mutations in currency exchange rates entail the realization of a current taxable profit or tax-deductible loss for Dutch income tax purposes. Moreover, I assume that the currency exchange result may be calculated by making reference to the mutation in the respective currency's value over the tax bookkeeping period. This enables me to simply determine the currency exchange result in the examples by calculating the mutations in the currency exchange rate against Johnson's overall equity mutation.

This being said, technically, things work out as follows. Johnson's worldwide income amounts at € 215,000 (i.e., 200,000 + 15,000). The latter amount, i.e., the profit of € 15,000 equals the value increase recognized upon the conversion of the branch b) profit of £ 60,000 into Euros (i.e., 60,000 * 1,25 – 60,000 * 1). The Dutch tax on Johnson's worldwide income amounts to € 5,000 + € 10,000 + € 28,750[22] = € 43,750, which equals an average effective tax rate of 20.3%.[23] For the purpose of subsequently calculating the DTR, the currency exchange result is not recognized for DTR purposes as no currency exchange result appears in the United Kingdom according to Dutch standards. Consequently, under the DTR mechanism, the numerator in the fraction is calculated at € 60,000. The fraction subsequently applied under the DTR mechanism equals to € 12,209.30.[24] The Dutch tax payable is accordingly set at € 43,750 – € 12,209.30 = € 31,540.70. The Dutch tax due equals an average effective tax rate in the Netherlands of 20.3% on the Dutch share of the tax pie, calculated at € 155,000 (i.e., € 140,000 + € 15,000).[25] The same is true regarding the amount of DTR that is effectively granted with respect to the British share of the tax pie. That amount equals 20.3% as well.[26]

What if currency exchange results would have been exempt from the tax base?

Notably, would the Netherlands have adopted CLIN-promoting base exemption system, the currency exchange result that occurs as a consequence of the tax bookkeeping of Johnson's income derived through its British branch b) in British Pounds would, at least very likely, not be taken into account for Dutch tax purposes. In such a case, Johnson's branch b) income, including the currency exchange result Euro/British Pound, would have

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[19] 1 / 1.25 = 0.80.

[20] In practice, short-term imbalances occur. These may be commercially exploited. This may be illustrated by pointing at the possibilities in practice to derive income from currency carry trading, i.e. the (short-term) borrowing of money in a low-interest rate currency (typically of a weaker economy) for the purpose of using the funds to invest in an asset (e.g. a long-term bond) in a different currency (i.e. typically of a stronger economy) yielding a higher rate of return. This may enable a currency carry trader to make money by capturing the difference between the rates. Substantial profits (or losses) may be derived through carry trade when leverage is taken into consideration.

[21] The principle of sound business practice to a large extent operates in line with common business economics and accounting principles (e.g. the reality, matching, realization and prudence principles).

[22] 25% * 115,000 = 28,750.

[23] (43,750 / 215,000) * 100% = 20.3%.

[24] 60,000 / (200,000 + 15,000) * 43,750 = 12,209.30.

[25] 31,540.70 / 155,000 * 100% = 20.3%

[26] 12,209.30 / 60,000 * 100% = 20.3%. Notably, the sum of 12,209.30 and 31,540.70 equals 43,750.

been exempt from the tax base. Only the Dutch source income, i.e., the branch a) income of € 140,000, would have been taxable in the Netherlands. Consequently, the payable Dutch tax would have amounted to € 5,000[27] + € 10,000[28] + € 10,000[29] = € 25,000. Please note that the Dutch tax burden imposed in such a case would not equal 17,9%.[30] As Johnson actually realizes a currency exchange result on its British branch b) income, this should be taken into account for effective tax burden calculation purposes. The application of another DTR method than the Dutch-style tax exemption method, i.e., the CLIN-promoting base exemption, would not entail that currency exchange results, all of a sudden, would not arise in the Netherlands any more. The only thing changed is the application of another DTR method. The Dutch tax payable under a base exemption method of € 25,000 substantially entails the imposition of an effective tax imposed at a rate of 16.1%,[31] instead of the above mentioned 20.3%.

What does this say? This says that the application of such a base exemption mechanism would arbitrarily affect the tax burden imposed as it disregards economically substantive income items for tax calculation purposes. Despite the fact that macro-economic currency exchange effects cannot be influenced on a micro-economic level, i.e., at the level of individual taxpayers, currency exchange results actually impose commercial risks and currency exchange results actually affect income levels. In the example, taxpayer Johnson would have been better of. The tax burden imposed would equal 16.1% rather than 20.3%. However, in the end, this is just a matter of chance. The relaxed burden is the consequence of the fact that the British Pound increased in value, whilst this is not taken into account for tax calculation purposes. Moreover, the application of the base exemption mechanism moderates the internationally commonplace progressivity effects in the employed tax rate structures. Johnson would have benefited from the income split effect. Yet, tomorrow, reality may be a different one. The British Pound may decrease in value, or Johnson may have suffered a loss from its foreign operations. That would cancel out the advantages. The dices easily could have rolled against Johnson. At the end of the day, exempting currency exchange results from the tax base entails a market distortion. Currency exchange results cannot be influenced individually. The question of whether the tax burden imposed ends up in a more relaxed or heavier burden is just a matter of chance. This clearly distorts the decision of taking business across the tax border as one cannot oversee, in advance, the outcome of things in terms of tax burdens imposed at the end of the day.

Worth mentioning is that, in cases where the TFEU applies, notably, the Court of Justice ruled in a matter akin to the aforementioned reasoning in the *Deutsche Shell* case.[32] The *Deutsche Shell* case dealt with the (in)compatibility with the EU fundamental freedoms of the German tax treatment of currency exchange losses suffered in the course of business operations carried on abroad. Until the Court of Justice's ruling in this case, Germany, under its CLIN-promoting exemption system, exempted resident taxpayer's currency exchange losses realized from their foreign business operations from the German tax base. *Deutsche Shell* involved a German resident taxpayer that operated a business in Italy. The tax reporting of the German taxpayer's Italian activities occurred in Liras (it involved a tax year prior to the introduction of the Euro). As the Italian Lira decreased in value relative to the German Mark, the German taxpayer suffered a currency loss. This loss was not tax-deductible in Germany as Germany exempted such losses from the tax base. The consequence of applying such a base exemption is that the German international tax system made it less attractive for German resident taxpayers to get involved in intra-EU cross-border economic activities. Viz., these taxpayers did not have any upfront knowledge as to the German tax burden imposed in respect of their income realized at the end of the day. As said, currency exchange rates cannot be influenced individually, yet impose real economic risks. By not taking into account actual currency exchange losses for German income tax purposes, i.e., by means of exempting these income items from the tax base, the Court of Justice fairly considered the German tax rules to infringe upon the 'market access principle' and accordingly decided these rules to be a market access restriction, an obstacle, incompatible with the EU fundamental freedoms.

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[27] 10% * 50,000 = 5,000.
[28] 20% * 50,000 = 10,000.
[29] 25% * 40,000 = 10,000.
[30] 25.000 / 140.000 * 100% = 17.9%.
[31] 25,000 / (140,000 + 15,000) * 100% = 16.1%.
[32] *Deutsche Shell*, *supra note* 11.

Case b); British Pound drops in value

Let us return to the operation of the Dutch-style DTR mechanism. Imagine the *mirroring case* in which the British Pound drops in value during the tax bookkeeping period. At the end of this period £ 1 is worth € 0.80. The Euro rate concurrently increases: at the end of the tax bookkeeping period, € 1 is worth £ 1.25.

Under the DTR methodology, Johnson's worldwide income decreases as the value of the British Pound decreases. The currency exchange result is not recognized for DTR purposes. Technically, things work out as follows. Taxpayer Johnson's worldwide income amounts at € 188,000 (i.e., 200,000 – 12,000). The latter amount, i.e., the loss of € 12,000 equals the value decrease recognized upon the conversion of the branch b) profit of £ 60,000 into Euros (i.e., 60,000 * 0.80 – 60,000 * 1). The Dutch tax on Johnson's worldwide income amounts to € 5,000 + € 10,000 + € 22,000[33] = € 37,000, which equals an average effective tax rate of 19.7%.[34] For the purpose of subsequently calculating the DTR, the currency exchange result is not recognized for DTR purposes as no currency exchange result appears in the United Kingdom according to Dutch standards. Consequently, under the DTR mechanism, the numerator in the fraction is calculated at € 60,000. The fraction subsequently applied under the DTR mechanism equals to € 11,808.51.[35] The Dutch tax payable is accordingly set at € 37,000 – € 11,808.51 = € 25,191.49. The Dutch tax due equals an average effective tax rate in the Netherlands of 19.7% on the Dutch share of the tax pie, calculated at € 128,000 (i.e., € 140,000 – € 12,000.[36] The same is true regarding the amount of DTR that is effectively granted with respect to the United Kingdom's share of the tax pie. It also equals 19.7%[37]

Notably, would the Netherlands have adopted a CLIN-promoting base exemption system, the currency exchange result that occurs as a consequence of the tax bookkeeping of Johnson's income derived through its British branch b) in British Pounds would not be taken into account for Dutch tax purposes. Again, Johnson's branch b) income, including the currency exchange result Euro/British Pound, would have been exempt from the tax base. Only the income derived from the activities carried on through branch a) of € 140,000 would have been taxable in the Netherlands. As said, the payable Dutch tax would have amounted to € 25,000. That would substantially entail the imposition of an effective tax imposed at a rate of 19.5%,[38] instead of the above mentioned 19.7%. Johnson would have been lucky. The dices rolled in its favour. He would be better of in terms of tax burdens imposed. The disadvantage imposed as a consequence of the non-recognition of the currency exchange loss on the British Pound would have been compensated by the benefits derived from the progressivity moderating income split alongside Dutch and Britain's tax borders.

2.2.3 Scenario (ii) – British branch b)'s tax books are kept in Euros

Now suppose that, contrary to the two cases referred to in the above section 2.2.2, both the tax books of branch b) and branch a) are kept in Euros. Accordingly, both branch a)'s and branch b)'s assets, liabilities and equity, as well as its expenses and receipts are booked in Euros.

Case c); British Pound increases in value

And suppose that, again, the British Pound conversion rate increases from € 1 to € 1.25 during the tax bookkeeping period.

Under the DTR methodology, Johnson's worldwide income does not alter. It remains to amount at € 200,000. This is conceptually sound as taxpayer Johnson keeps its books for Dutch tax purposes in Euros and, accordingly, no currency exchange result arises in the Netherlands according to Dutch standards. The Dutch tax on Johnson's worldwide income accordingly amounts to € 5,000 + € 10,000 + € 25,000[39] = € 40,000, an average effective tax

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[33] 25% * 88,000 = 22,000.

[34] (37,000 / 188,000) * 100% = 19.7%.

[35] 60,000 / (200,000 – 12,000) * 37,000 = 11,808.51.

[36] 25,191.49 / 128,000 * 100% = 19.7%

[37] 11,808.51 / 60,000 * 100% = 19.7%. Notably, the sum of 11,808.51 and 25,191.49 equals 37,000.

[38] 25,000 / (140,000 – 12,000) * 100% = 19.5%.

[39] 25% * 100,000 = 25,000.

rate in the Netherlands of 20%. Subsequently, the DTR is calculated. The amount of relief alters in comparison with the 'Base case' scenario since a currency loss of £ 12,000 (60,000 * 0.80 – 60,000 * 1) arises in the United Kingdom according to Dutch standards. The amount of £ 12,000 equals the value decrease recognized upon the conversion of the branch b) profit of € 60,000 into £ 48,000. This effect is recognized for DTR purposes. The application of the fraction entails DTR amounting to € 9,600.[40] The Dutch tax payable is accordingly set at € 40,000 – € 9,600 = € 30,400, an average effective tax rate in the Netherlands of 20% on the Dutch share of the tax pie, calculated at € 152,000 (i.e., € 140,000 + € 12,000). The same is true regarding the DTR that is effectively granted with respect to the British share of the tax pie. The amount of relief effectively equals 20% also.[41]

Notably, would the Netherlands have adopted a CLIN-promoting base exemption system, the payable Dutch tax would, again, have amounted to € 25,000. That would substantially entail the imposition of an effective tax imposed at a rate of 16,4%[42] instead of the above mentioned 20%. Again, Johnson would have been lucky. The British Pound increased in value, whilst this fact, indeed arbitrarily, would not have been taken into account for Dutch tax calculation purposes. Moreover, Johnson would have benefited from the income split.

Case d); British Pound drops in value

Now imagine the *mirroring case* in which the British Pound drops in value during the tax bookkeeping period. Again, £ 1 is worth € 0.80 at the end of this period. And the Euro rate concurrently increases from € 1 to £ 1.25.

Under the DTR methodology, again, Johnson's worldwide income does not alter. It remains to amount at € 200,000. And again, this is conceptually sound as taxpayer Johnson keeps its books for Dutch tax purposes in Euros and, accordingly, no currency exchange result appears in the Netherlands according to Dutch standards. The Dutch tax on Johnson's worldwide income accordingly amounts to € 40,000. Again, the amount of relief alters in comparison with the default scenario as a currency gain of £ 15,000 appears in the United Kingdom according to Dutch standards. The amount of £ 15,000 equals the value increase recognized upon the conversion of the branch b) profit of € 60,000 into £ 75,000 (i.e., 60,000 * 1.25 – 60,000 * 1). As this effect is recognized for DTR purposes, the application of the fraction entails DTR amounting to € 15,000.[43] The Dutch tax payable is accordingly set at € 40,000 – € 15,000 = € 25,000, an average effective tax rate in the Netherlands of 20% on the Dutch share of the tax pie, calculated at € 125,000 (i.e., € 140,000 – € 15,000). The same is true regarding the DTR that is effectively granted with respect to the United Kingdom's share of the tax pie. The amount of relief effectively equals 20% as well. [44]

Notably, would the Netherlands have adopted a CLIN-promoting base exemption system, the payable Dutch tax would, yet again, have amounted to € 25,000. That would substantially entail the imposition of an effective tax imposed at a rate of 20%.[45] The tax burden would equal to the tax burden as imposed under the Dutch-style tax exemption method as referred to in the above paragraph. A tied game! The British Pound decreased in value, whilst this fact would not have been taken into account for Dutch tax calculation purposes. The fact of Johnson's income being split alongside the Dutch and British tax border would have compensated for this. Barely. Chances are.

2.2.4   Scenario (iii) – British branch b)'s tax books are kept in Danish Krones

Let us suppose that, contrary to the four cases referred to in the above two sections, the tax books of the British branch b) are kept in the Danish Krone currency and the books of branch a) are kept in the Euro currency. Accordingly, branch b)'s assets, liabilities and equity, as well as its expenses and receipts are booked in Danish Krones. Branch a)'s equivalents in Euros.

Case e); British Pound increases in value

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[40] (60,000 – 12,000) / 200,000 * 40,000 = 9,600.
[41] 9,600 / 48,000 * 100% = 20%. Notably, the sum of 9,600 and 30,400 equals 40,000.
[42] 25,000 / (140,000 + 12,000) * 100% = 16,4%.
[43] (60,000 + 15,000) / 200,000 * 40,000 = 15,000.
[44] 15,000 / 75,000 * 100% = 20%. Notably, the sum of 15,000 and 25,000 equals 40,000.
[45] 25.000,00 / (140.000 – 15.000) * 100% = 20%.

In addition, suppose that £ 1 is worth € 1 and kr 1 at the start of the tax bookkeeping period. And suppose that the exchange rate of the British Pound increases during the tax bookkeeping period in respect of both the Euro and the Danish Krone: at the end of this period £ 1 is worth € 1.25 and kr 1.50. The Euro and Danish Krone exchange rates concurrently decrease during this period. Accordingly, at the end of the tax bookkeeping period, kr 1 is worth € 0.83[46] and £ 0.67.[47] € 1 is worth £ 0.80.[48] And € 1 is worth kr 1.20.[49] In a table:

Table 2. Exchange rates at the end of the bookkeeping period

Exchange rates (£ : € : kr)			
	£	€	kr
£ 1	1	1.25	1.50
€ 1	0.80	1	1.20
kr 1	0.67	0.83	1

Under the DTR methodology, Johnson's worldwide income alters as a tax deductible currency exchange result is recognized for Dutch tax purposes with respect to the value fluctuation between the Danish Krone and the Euro. Taxpayer Johnson's worldwide income amounts at € 190,000 (i.e., 200,000 – € 10,000). The latter amount, i.e., the loss of € 10,000 equals the value decrease recognized upon the conversion of the branch b) profit of kr 60,000 into Euros (i.e., 60,000 * 0.83 – 60,000 * 1). The Dutch tax on Johnson's worldwide income amounts to € 5,000 + € 10,000 + € 22,500[50] = € 37,500, which equals an average effective tax rate of 19.7%.[51] No DTR is granted with respect to this currency exchange result. This makes sense as this currency exchange result arises in the Netherlands according to Dutch standards.

Subsequently, the DTR is calculated. For DTR purposes, a currency exchange result is recognized with respect to the value fluctuation between the Danish Krone and the British Pound. This is conceptually sound as a currency loss of £ 20,000 (60,000 * 0.67 – 60,000 * 1) arises in the United Kingdom according to Dutch standards. The amount of £ 20,000 equals the value decrease recognized upon the conversion of the branch b) profit of kr 60,000 into £ 40,000. The application of the fraction entails DTR amounting to € 7,894.74.[52] The Dutch tax payable is accordingly set at € 37,500 – € 7,894.74 = € 29,605.26, an average effective tax rate in the Netherlands of 19.7% on the Dutch share of the tax pie, calculated at € 150,000 (i.e., € 140,000 + € 10,000). The latter amount, i.e., the increase of € 10,000 equals the difference in the value fluctuations between the Danish Krone and the Euro on the one hand and the Danish Krone and the British Pound on the other (i.e., 60,000 * 0.83 – 60,000 * 0.67). In addition, the amount of DTR granted with respect to the United Kingdom's share of the tax pie equals an effective relief of 19.7% as well.[53] Accordingly, in effect, the Netherlands recognizes a tax deductible Euro/Danish Krone currency exchange result of € 10,000 for tax purposes as branch b)'s profits of kr 60,000 convert into € 50,000 (i.e., 60,000 * 0.83). In addition, in effect, according to Dutch standards, the United Kingdom recognizes a tax deductible British Pound/Danish Krone currency exchange result of £ 20,000 as branch b)'s profits of kr 60,000 convert into £ 40,000 (i.e., 60,000.00 * 0.67).

Notably, would the Netherlands have adopted a CLIN-promoting base exemption system, the payable Dutch tax would, again, have amounted to € 25,000. That would substantially entail the imposition of an effective tax imposed at a rate of 16.7%,[54] instead of the above mentioned 19.7%. Johnson would have been lucky. The British Pound increased in value, whilst this fact, indeed again on an arbitrary basis, would not have been taken into account for Dutch tax calculation purposes. Moreover, Johnson would have benefited from the income split alongside Dutch and Britain's tax borders.

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[46] 1.25 / 1.50 = 0.83.

[47] 1 / 1.50 = 0.67.

[48] 1 / 1.25 = 0.80.

[49] 1 / (1.25 / 1.50) = 1.20.

[50] 25% * 90,000 = 22,500.

[51] (37,500 / 190,000) * 100% = 19.7%.

[52] (60,000 – 20,000) / (200,000 – 10,000) * 37,500 = 7,894.74.

[53] 7,894.74 / 40,000 * 100% = 19.7%. Notably, the sum of 7,894.74 and 29,605.26 equals 37,500.

[54] 25,000 / (140,000 + 10,000) * 100% = 16.7%

Case f); British Pound drops in value

Now imagine the *mirroring case*. The British Pound drops in value during the tax bookkeeping period in respect of both the Euro and the Danish Krone. At the end of this period £ 1 is worth € 0.80[55] and kr 0.67.[56] The Euro and Danish Krone exchange rates concurrently increase in value during this period. Accordingly, at the end of the tax bookkeeping period, the Euro rate increases in value to £ 1.25.[57] The Danish Krone rate concurrently increases in value, i.e., to £ 1.50[58] and € 1.20.[59] At that time, € 1 is worth kr 0.83.[60] In a table:

Table 3. Exchange rates at the end of the bookkeeping period

Exchange rates (£ : € : kr)			
	£	€	kr
£ 1	1	0.80	0.67
€ 1	1.25	1	0.83
kr 1	1.50	1.20	1

Under the DTR methodology, Johnson's worldwide income, again, alters as a taxable currency exchange result is recognized for Dutch tax purposes with respect to the value fluctuation between the Danish Krone and the Euro according to Dutch standards. Taxpayer Johnson's worldwide income amounts at € 212,000 (i.e., 200,000 + 12,000). The latter amount, i.e., the profit of € 12,000 equals the value increase recognized upon the conversion of the branch b) profit of kr 60,000 into Euros (i.e., 60,000 * 1.20 – 60,000 * 1). The Dutch tax on Johnson's worldwide income amounts to € 5,000 + € 10,000 + € 28,000[61] = € 43,000, which equals an average effective tax rate of 20.3%.[62] Again, no DTR is granted with respect to this currency exchange result. Again, this makes sense as this currency exchange result arises in the Netherlands.

Subsequently, the DTR is calculated. For DTR purposes, a currency exchange result is recognized with respect to the value fluctuation between the Danish Krone and the British Pound. This is conceptually sound as a currency exchange result of £ 30,000 (60,000 * 1.50 – 60,000 * 1) arises in the United Kingdom according to Dutch standards. The amount of £ 30,000 equals the value increase recognized upon the conversion of the branch b) profit of kr 60,000 into £ 90,000. The application of the fraction entails DTR amounting to € 18,254.72.[63] The Dutch tax payable is accordingly set at € 43,000 – € 18,254.72 = € 24,745.28, an average effective tax rate in the Netherlands of 20.3% on the Dutch share of the tax pie, calculated at € 122,000 (i.e., € 140,000 – € 18,000). The latter amount, i.e., € 18,000 equals the difference in the value fluctuations between the Danish Krone and the Euro on the one hand and the Danish Krone and the British Pound on the other (i.e., 60,000 * 1.20 – 60,000 * 1.50). In addition, the amount of DTR granted with respect to the British share of the tax pie equals an effective average relief of 20.3% as well.[64] Accordingly, in effect, the Netherlands recognizes a taxable Euro/Danish Krone currency exchange result of € 12,000 for tax purposes as branch b)'s profits of kr 60,000 convert into € 72,000 (i.e., 60,000 * 1.20). In addition, in effect, according to Dutch standards, the United Kingdom recognizes a taxable British Pound/Danish Krone currency exchange result of £ 30,000 as branch b)'s profits of kr 60,000 convert into £ 90,000.

Notably, would the Netherlands have adopted a CLIN-promoting base exemption system, the payable Dutch tax would, again, have amounted to € 25,000. That would substantially entail the imposition of an effective tax imposed at a rate of 20.5%,[65] instead of the above mentioned 20.3%. Johnson would have run out of luck. The British Pound decreased in value, whilst this fact, indeed again on an arbitrary basis, would not have been

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[55] 1 / 1.25 = 0.80.

[56] 1 / 1.50 = 0.67.

[57] 1 / (1 / 1.25) = 1.25.

[58] 1 / (1 / 1.50) = 1.50.

[59] 1 / (1.25 / 1.50) 1.20.

[60] 1.25 / 1.50 = 0.83.

[61] 25% * 112,000 = 28,000.

[62] (43,000 / 212,000) * 100% = 20.3%.

[63] (60,000 + 30,000) / (200,000 + 12,000) * 43,000 = 18,254.72.

[64] 18,254.72 / 90,000 * 100% = 20.3%. Notably, the sum of 18,254.72 and 24,745.28 equals 43,000.

[65] 25,000 / (140,000 – 18,000) * 100% = 20.5%.

taken into account for Dutch tax calculation purposes. The progressivity moderating fact of Johnson's income being split alongside the Dutch and United Kingdom tax border would not have compensated for this. Things would even be worse if the British branch b) activities would have been loss-rendering.

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 in question in the Netherlands if they reside within Dutch territories for tax purposes.[66] The foreign income of non-resident taxpayers is excluded, or "exempt", from the Netherlands tax base. If Johnson had resided, for example, in Cologne, Germany, for Netherlands 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 U.K. branch b) would entirely be kept outside Dutch taxation.[67] Accordingly, the currency exchange results realized, as set forth in the above, would be "exempt" from Dutch taxation as well. This would be the sole consequence of Johnson's place of tax residence in Germany. 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 accordance with the concepts typically applied in international taxation. Also Dutch international tax policy is essentially based on the differential treatment of resident taxpayers (unlimited tax liability) and non-resident taxpayers (limited tax liability).[68] Moreover, to my knowledge, all EU MSs subject non-resident taxpayers to this differential tax treatment, having the consequence that foreign currency exchange results are "exempt" from domestic tax. This, however, does not provide sufficient grounds, save for legal positivistic ones (which I fail to appreciate), to conclude on the fairness of such a differential tax treatment on the sole basis of a different place of tax residence.

In the aforementioned scenarios (i), (ii) and (iii), taxpayer Johnson, for argument's sake now residing for Dutch tax purposes in Cologne, Germany, would consistently be subject to Dutch income tax on its € 140.000 business income derived from its Dutch branch a) amounting to € 5.000[69] + € 10.000[70] + € 10.000[71] = € 25.000. However, please do not be tempted to race to the conclusion that the average effective tax rate in these cases would consistently be the same as well, for instance 17.9%.[72] You would, notably just like the Dutch tax legislator, mistakenly fail to consider the currency exchange results realized. There is no reason not to take them into consideration. Johnson's transfer of tax residence to Cologne does not entail that these currency exchange differences all of a sudden disappear. Nothing has changed but Johnson's transfer of tax residence within the internal market without internal frontiers to another EU MS, in this case Germany. And Johnson's Dutch-German tax-border crossing is of no material relevance whatsoever under the EU equality principle.[73] The

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[66] 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 equal to resident taxpayers.

[67] The 'tax base reservation' as consistently found in the DTR article in the Netherlands double tax conventions – on the basis of which the Netherlands reserves the right to include foreign source income items in the tax base – exclusively applies for the benefit of Dutch resident taxpayers.

[68] See the Dutch Ministry of Finance's '2011 Tax Policy Notes' (*"Notitie Fiscaal Verdragsbeleid 2011"*), published in the unofficial tax reporter *"Vakstudie Nieuws"* 2011/12.

[69] 10% * 50,000 = 5,000.

[70] 20% * 50,000 = 10,000.

[71] 25% * 40,000 = 10,000.

[72] 25,000 / 140,000 = 17.9%.

[73] See for a comparison Commission Staff Working Paper, *Company Taxation in the Internal Market*, {COM(2001)582 final} Brussels. 23 October 2001, SEC(2001) 1681, p. 309-310, which accurately sets forth that: "In general, discrimination can be defined as treating similar situations differently, or different situations alike. This definition is used in both Community law and international tax law but the notion of discrimination in Community law differs from that of international tax law. Under Community law it is sufficient that situations are materially similar, whereas

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amount of Dutch tax payable would be consistently the same; yet, the average effective tax rate imposed by the Netherlands on Johnson's actual Dutch source income would arbitrarily alter to a great extent. Under current Dutch international tax law, the € 25,000 tax payable would entail effective average Dutch tax rates respectively of:

   a) 16.1% as regards to non-resident taxpayer Johnson in scenario (i), 'Case a)',[74] instead of 20.3 as regards to resident taxpayer Johnson in the same scenario;[75]
   b) 19,5% as regards to non-resident taxpayer Johnson in scenario (i), 'Case b)',[76] instead of 19,7% as regards to resident taxpayer Johnson in the same scenario;[77]
   c) 16,4% as regards to non-resident taxpayer Johnson in scenario (ii), 'Case c)',[78] instead of 20% as regards to resident taxpayer Johnson in the same scenario;[79]
   d) 20% as regards to non-resident taxpayer Johnson in scenario (ii), 'Case d)',[80] which is in accordance with 20% as regards to resident taxpayer Johnson in the same scenario;[81]
   e) 16.7% as regards to non-resident taxpayer Johnson in scenario (iii), 'Case e)',[82] instead of 19.7% as regards to resident taxpayer Johnson in the same scenario,[83] and;
   f) 20.5% as regards to non-resident taxpayer Johnson in scenario (iii), 'Case f)',[84] instead of 20.3% as regards to resident taxpayer Johnson in the same scenario.[85]

These figures illustrate that the entire Dutch (inter)national direct tax system, by distinguishing between the tax treatment of resident taxpayers and non-resident taxpayers in the manner as just described, in its essence is founded on an unjustified unequal tax treatment in materially equal circumstances. Viz., the mere reason of the differential tax treatment of non-resident taxpayer Johnson is its place of tax residence in Germany. This is clearly indirectly discriminatory.[86] Individual taxpayers who find themselves in equal economic circumstances, would, dependant on their place of tax residence, be worse or better off in terms of tax burdens imposed. As the occurrence of currency exchange differences is arbitrarily (dis)regarded for domestic tax calculation purposes the domestic tax burden imposed proves arbitrary as well. The question of whether an individual taxpayer ends up in a favourable or unfavourable fashion (in terms of tax costs) is just a matter of chance. Our non-resident taxpayer Johnson would be better or equally well off in comparison with our resident taxpayer Johnson in 'Case a)' through 'Case e)', while in 'Case f)', our non-resident taxpayer Johnson would be worse-off. Obviously, this discriminatory tax treatment distorts the decision of taking business across the tax border as one cannot oversee, upfront, the outcome of things in terms of tax burdens imposed.

The perceptive reader may have already recognized the resemblance with the effects under a CLIN-promoting, territorial system. This is no coincidence. The application of a base exemption mechanism regarding resident taxpayer's foreign income items has the exact same effects as the tax treatment of non-resident taxpayers described in the above paragraphs. By subjecting non-residents to a limited tax liability, i.e., to tax them on their domestic income only, the Netherlands, as well as any other EU MS, applies a territorial taxing system to its non-resident taxpayers. By doing that, such an approach discriminates non-resident taxpayers against resident taxpayers. Please note that this problematic tax treatment cannot be simply resolved by introducing a base exemption mechanism for resident

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international tax law rules are based on the assumption that residents and non-residents are in a different situation and can therefore legitimately be subject to different treatment. The difference between these two approaches results from the difference between the principal objectives of the relevant Community law provisions and international tax law, respectively. While the four freedoms provisions aim at removing the borders between the Member States, in as much as possible, for intra-Community economic activities, the very starting point of international tax law is the existence of these borders."

[74] 25,000.00 / (140,000 + 15,000) * 100% = 16.1%.
[75] 31,540.70 / (140,000 + 15,000) * 100% = 20.3%
[76] 25,000.00 / (140,000 – 12,000) * 100% = 19.5%
[77] 25,191.49 / (140,000 – 12,000) * 100% = 19.7%.
[78] 25,000.00 / (140,000 + 12,000) * 100% = 16.4%.
[79] 30,400.00 / (140,000 + 12,000) * 100% = 20.0%.
[80] 25,000.00 / (140,000 – 15,000) * 100% = 20.0%.
[81] 25,000.00 / (140,000 – 15,000) * 100% = 20.0%.
[82] 25,000.00 / (140,000 + 10,000) * 100% = 16.7%
[83] 29,605.26 / (140,000 + 10,000) * 100% = 19.7%.
[84] 25,000.00 / (140,000 – 18,000) * 100% = 20.5%.
[85] 24,745.28 / (140,000 – 18,000) * 100% = 20.3%.
[86] See for a comparison, Court of Justice, case C-527/06 (*Renneberg*).

taxpayers deriving income from foreign source. As *Deutsche Shell* illustrates, 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 income, irrespective of their place of residence. Indeed, that would cancel out the discriminations in their tax systems. However, this is untrue as regards to the market access restrictions unilaterally imposed.[87] 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 of 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 foreign, intra-EU, business operations.

From the perspective of attaining market access neutrality and market equality within the internal market without internal frontiers, such arbitrary, unilaterally imposed differences in tax burdens imposed in relation to currency exchange results realized should not occur. The internal market without internal frontiers requires direct tax effects as imposed to taxpayers by EU MSs to be equal regardless of how and where these taxpayers employ their production factors within the EU territories. Direct taxation should not distort business decisions (or at least as little as possible). This holds true irrespective of the taxpayer's place of tax residence. I hope to have demonstrated that this is currently not the case when it comes to the taxation of currency exchange results realized in the course of carrying on business activities in a cross-border, intra-EU, context.

Let us go back to the query as forwarded at the front 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 in regard to all EU residents having domestic (and foreign) sources of income? Let us exercise the thought-experiment described in section 1. In this regard, suppose that disparities were absent and that all EU MSs involved were to adopt the same approaches towards the taxable unit, the tax base and the tax rate. Further, assume international tax principles were also consistently adopted. Suppose again that both the United Kingdom and the Netherlands applied the approach advocated. The result would be that the tax burden imposed by both the United Kingdom and the Netherlands 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 utterly immaterial in which EU MSs Johnson resides. All indirect discriminations would be cancelled out from the EU MSs' (inter)national direct tax systems. 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 consistently be canceled out from the EU MSs' (inter)national direct tax systems. The tax burden imposed would be the same. The crossing of tax borders within the EU's internal market would, therefore, not be hindered.

3.2 Scenario (i) – British branch b)'s tax books are kept in British Pounds

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 Netherlands–United Kingdom 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 with Dutch resident taxpayers. Where one EU MS recognizes a currency gain, the other EU MS recognizes a currency loss. And vice versa. In their mutual operation, the mechanisms as applicable on both sides of the tax-borders operate as interconnected tanks.

Let us go back to the scenario referred to in 2.2.2, i.e., scenario (i), 'Case a)'. Taxpayer Johnson (the place of residence is now irrelevant for tax purposes), now subject to unlimited tax liability, still operates its flower trading activities through branches a) and b). Johnson's branch a) tax books are kept in the Euro currency. The books of branch b) are kept in the British Pound currency. The Netherlands employs the Euro for tax calculation purposes. State

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[87] It should be noted that the Court of Justice has not adopted a consistent line of argumentation in this matter and rigorously 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 allowed the EU MSs involved to maintain the unilaterally imposed distortive features, i.e., "No Cross-Border Loss Set-Off" in their tax systems. See on this matter, De Wilde, *supra note* 3 and Maarten F. de Wilde, *On X Holding and the ECJ's Ambiguous Approach towards the Proportionality Test*, 19 EC Tax Review 170 (2010).

X, The United Kingdom, employs the British Pound for this purpose. The British Pound increases in value during the tax booking period in a manner as referred to in 2.2.2. The effects are best demonstrated by tables:

- *Table 4. 'Domestic scenario – NL – British Pound rate increases – currency exchange results realized'* deals with the purely domestic scenario in which both branches are situated within Dutch territory;
- *Table 5. 'Domestic scenario – U.K. – British Pound rate increases – currency exchange results realized'* deals with the purely domestic scenario in which the branches are situated within U.K. territory, and;
- *Table 6. 'Cross-border scenario – NL and U.K. – British Pound rate increases – currency exchange results realized'* deals with the cross-border scenario, i.e., where branch a) is situated within Dutch territory and branch b) in United Kingdom ' territory.

Table 4. 'Domestic scenario – NL – British Pound rate increases – currency exchange results realized'

Taxpayer Johnson	Year X
Income branch a) in NL	€ 140,000
Income branch b) in NL	£ 60,000
Added: currency exchange result realized	€15,000
On balance	**€ 215,000**
Tax due in NL (under brackets as in 2.2.1)	**€ 43,750**
Tax burden imposed by NL	**20.3%**

Table 5. 'Domestic scenario – U.K. – British Pound rate increases – currency exchange results realized'

Taxpayer Johnson	Year X
Income branch a) in U.K.	€ 140,000
Deducted: currency exchange result realized	<£28,000>
Income branch b) in U.K.	£ 60,000
On balance	**£ 172,000**
Tax due in U.K. (under brackets as in 2.2.1)	**£ 33,000**
Tax burden imposed by U.K.	**19.2%**

Table 6. 'Cross-border scenario – NL and U.K. – British Pound rate increases – currency exchange results realized'

Taxpayer Johnson (Year X)	Domestic income	Worldwide income	Tax before DTR	Average effective tax rate before DTR	Credit for domestic tax attributable to foreign income	Tax after DTR	Tax burden after DTR
Tax position in NL	€ 155,000[88]	€ 215,000[89]	€ 43,750[90]	20.3%[91]	€ 12,209.30[92]	€ 31,540,70[93] *(i.e., tax due in NL)*	**20.3%[94]** *(i.e., tax burden imposed by NL)*
Tax position in U.K.	£ 32,000[95]	£ 172,000[96]	£ 33,000[97]	19.2%[98]	£ 26,860.46[99]	£ 6,139.54[100] *(i.e., tax due in U.K.)*	**19.2%** [101]

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[88] 140,000 + 15,0000 = 155,000.

[89] 140,000 + 60,000 + 15,000 = 215,000

[90] 5,000 + 10,000 + 0.25 * 115,000 = 43,750.

[91] 43,750 / 215,000 * 100% = 20.3%.

[92] 60,000 / (200,000 + 15,000) * 43,750 = 12,209.30.

[93] 43,750 – 12,209.30 = 31,540.70.

[94] 31,540.70 / 155,000 * 100% = 20.3%.

							(i.e., tax burden imposed by U.K.)

Under the advocated approach, the tax burdens imposed by The Netherlands and the United Kingdom would be the same in both domestic and cross-border scenarios. The tax burden imposed to Johnson in The Netherlands, both pre-DTR and post-DTR, would equal 20.3% as a positive currency exchange result of € 15,000 would have been realized. The United Kingdom would impose a 19.2 % effective tax, both pre-DTR and post-DTR, as a consequence of the currency loss of £ 28,000. Both The Netherlands and The United Kingdom would receive their fair share of the tax pie.

Notably, overall calculations are of no argumentative value as the currency exchange results are calculated on diverging bases, i.e., the mutually diverging branch a) and b) profits. Currency risks cannot be influenced by taxpayers individually. The distortive effects of fluctuating currency exchange rates due to the presence of varying currencies in the global marketplace (monetary disparities) may only be resolved by means of monetary harmonization, i.e., a monetary union such as the European Monetary Union.

In the *mirroring case* in which the British Pound drops in value, referred to in the above as scenario (i), 'Case b)', things would work out in the exact opposite manner. Again, the tax burden imposed by The Netherlands and The United Kingdom is the same in both domestic and cross-border scenarios, both pre-DTR and post-DTR. In tables:

Table 7. 'Domestic scenario – NL – British Pound rate decreases – currency exchange results realized'

Taxpayer Johnson	Year X
Income branch a) in NL	€ 140,000
Income branch b) in NL	£ 60,000
Deducted: currency exchange result realized	<€ 12,000>
On balance	**€ 188,000**
Tax due in NL (under brackets as in 2.2.1)	**€ 37,000**
Tax burden imposed by NL	**19.7%**

Table 8. 'Domestic scenario – U.K. – British Pound rate decreases – currency exchange results realized'

Taxpayer Johnson	Year X
Income branch a) in U.K.	€ 140,000
Added: currency exchange result realized	<£35,000>
Income branch b) in U.K.	£ 60,000
On balance	**£ 235,000**
Tax due in U.K. (under brackets as in 2.2.1)	**£ 48,750**
Tax burden imposed by U.K.	**20.7%**

Table 9. 'Cross-border scenario – NL and U.K. – British Pound rate decreases – currency exchange results realized'

Taxpayer Johnson (Year X)	Domestic income	Worldwide income	Tax before DTR	Average effective tax rate before DTR	Credit for domestic tax attributable to foreign income	Tax after DTR	Tax burden after DTR

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[95] 60,0o0 – 28,000 = 32,000.

[96] 140,000 – 28,000 + 60,000 = 172,000.

[97] 5,000 + 10,000 + 0.25 * 72,000 = 33,000.

[98] 33,000 / 172,000 * 100% = 19.2%.

[99] 140,000 / (200,000 – 28,000) * 33,000 = 26,860.46.

[100] 33,000 – 26,860.46 = 6,139.54.

[101] 6,139.53 / 32,000 * 100% = 19.2%.

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Tax position in NL	€ 128,000[102]	€ 188,000[103]	€ 37,000[104]	19.7%[105]	€ 11,808.51[106]	€ 25,191.49[107] *(i.e., tax due in NL)*	**19.7%** [108] *(i.e., tax burden imposed by NL)*
Tax position in U.K.	£95,000[109]	£235,000[110]	£48,750[111]	20.8%[112]	£29,042.55[113]	£ 19,707.44[114] *(i.e., tax due in U.K.)*	**20.7**% [115] *(i.e., tax burden imposed by U.K.)*

3.3 Scenario (ii) – British branch b)'s tax books are kept in Euros

If both the tax books of the Dutch branch a) and the British branch b) would be kept in Euros while the British Pound increases in value in a manner comparable to the case referred to in 2.2.3, scenario (ii), 'Case c)', the effects would be as follows:

Table 10. 'Domestic scenario – NL – British Pound rate increases – no currency exchange results realized'

Taxpayer Johnson	Year X
Income branch a) in NL	€ 140,000
Income branch b) in NL	€ 60,000
On balance	**€ 200,000**
Tax due in NL (under brackets as in 2.2.1)	**€ 40,000**
Tax burden imposed by NL	**20.0%**

Table 11. 'Domestic scenario – U.K. – British Pound rate increases – currency exchange results realized'

Taxpayer Johnson	Year X
Income branch a) in U.K.	€ 140,000
Deducted: currency exchange result realized	<£28,000>
Income branch b) in U.K.	£ 60,000
Deducted: currency exchange result realized	<£ 12,000>
On balance	**£ 160,000**
Tax due in U.K. (under brackets as in 2.2.1)	**£ 30,000**
Tax burden imposed by U.K.	**18.8%**

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[102] 140,000 – 12,000 = 128,000.
[103] 140,000 + 60,000 – 12,000 = 188,000.
[104] 5,000 + 10,000 + 0,25 * 88,000 = 37,000
[105] 37,000 / 188,000 * 100% = 19.7%.
[106] 60,000 / (200,000 – 12,000) * 37,000 = 11,808.51.
[107] 37.000 – 11,808.51 = 25,191.49.
[108] 25,191.48 / 128,000 * 100% = 19.7%.
[109] 60,000 + 35,000 = 95,000.
[110] 140,000 + 35,000 + 60,000 = 235,000.
[111] 5,000 + 10,000 + 0,25 * 135,000 = 48,750.
[112] 48,750 / 235,000 * 100% = 20.7%.
[113] 140,000 / (200,000 + 35,000) * 48,750 = 29,042.55.
[114] 48,750 – 29,042.55 = 19,707.44.
[115] 19,707.44 / 95,000 * 100% = 20.7%.

Table 12. 'Cross-border scenario – NL and U.K. – British Pound rate increases – currency exchange results realized'

Taxpayer Johnson (Year X)	Domestic income	Worldwide income	Tax before DTR	Average effective tax rate before DTR	Credit for domestic tax attributable to foreign income	Tax after DTR	Tax burden after DTR
Tax position in NL	€ 152,000[116]	€ 200,000[117]	€ 40,000[118]	20.0%[119]	€ 9,600[120]	€ 30,400[121] *(i.e., tax due in NL)*	**20.0%**[122] *(i.e., tax burden imposed by NL)*
Tax position in U.K.	£ 20,000[123]	£ 160,000[124]	£ 30,000[125]	18.8%[126]	£ 26,250[127]	£ 3,750[128] *(i.e., tax due in U.K.)*	**18.8%**[129] *(i.e., tax burden imposed by U.K.)*

Again, the tax burdens imposed by the Netherlands and the United Kingdom would be the same in both domestic and cross-border scenarios, both pre-DTR and post-DTR. The Netherlands would consistently impose a tax at an effective average rate of 20.0%. The United Kingdom would subject Johnson to an effective average tax of 18.8%. Both the Netherlands and the United Kingdom would receive their fair share of the tax pie.

In the *mirroring case* in which the British Pound drops in value, referred to in the above as scenario (ii), 'Case d)', things would work out in the exact opposite manner. Again, the tax burden imposed by the Netherlands and the United Kingdom is the same in both domestic and cross-border scenarios, again, both pre-DTR and post-DTR. I do not forward the non-discriminatory and neutral effects by means of a schedule. I respectfully dare the reader to determine these effects himself.

3.4 Scenario (iii) – British branch b)'s tax books are kept in Danish Krones

In the case in which the books of Dutch branch a) are kept in Euros and those of British branch b) in Danish Krones, while the British Pound increases in value in respect of both the Euro and the Danish Krone in the same manner as referred to in 2.2.4, scenario (iii), 'Case e)', things would turn out as follows:

Table 13. 'Domestic scenario – NL – British Pound rate increases – currency exchange results realized'

Taxpayer Johnson	Year X
Income branch a) in NL	€ 140,000
Income branch b) in NL	kr 60,000
Deducted: currency exchange result realized	<€ 10,000>
On balance	**€ 190,000**

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[116] 140,000 + 12,000 = 152,000.
[117] 140,000 + 60,000 = 200,000.
[118] 5,000 + 10,000 + 0.25 * 100,000 = 40,000
[119] 40,000 / 200,000 * 100% = 20.0%.
[120] (60,000 – 12,000) / 200,000 * 40,000 = 9,600.
[121] 40,000 – 9,600 = 30,400.
[122] 30,400 / 152,000 * 100% = 20.0%.
[123] 60,000 – 28,000 – 12,000 = 20,000.
[124] 140,000 + 60,000 – 28,000 – 12,000 = 160,000.
[125] 5,000 + 10,000 + 0.25 * 60,000 = 30,000.
[126] 30,000 / 160,000 * 100% = 18.8%.
[127] 140,000 / 160,000 * 30,000 = 26,250.
[128] 30,000 – 26,250 = 3,750.
[129] 37,500 / 20,000 * 100% = 18.8%.

Tax due in NL (under brackets as in 2.2.1)	**€ 37,500**
Tax burden imposed by NL	**19.7%**

Table 14. 'Domestic scenario – U.K. – British Pound rate increases – currency exchange results realized'

Taxpayer Johnson	**Year X**
Income branch a) in U.K. Deducted: currency exchange result realized	€ 140,000 <£28,000>
Income branch b) in U.K. Deducted: currency exchange result realized	kr 60,000 <£ 20,000>
On balance	**£ 152,000**
Tax due in U.K. (under brackets as in 6.1)	**£ 28,000**
Tax burden imposed by U.K.	**18.4%**

Table 15. "Cross-border scenario – NL and U.K. – British Pound rate increases – currency exchange results realized"

Taxpayer Johnson (Year X)	**Domestic income**	**Worldwide income**	**Tax before DTR**	**Average effective tax rate before DTR**	**Credit for domestic tax attributable to foreign income**	**Tax after DTR**	**Tax burden after DTR**
Tax position in NL	€ 150,000[130]	€ 190,000[131]	€ 37,500[132]	19.7%[133]	€ 7,894.74[134]	€ 29,605.26[135] *(i.e., tax due in NL)*	**19.7%** [136] *(i.e., tax burden imposed by NL)*
Tax position in U.K.	£ 12,000[137]	£ 152,000[138]	£28,000[139]	18.4%[140]	£25,789.47[141]	£ 2,210.53[142] *(i.e., tax due in U.K.)*	**18.4%** [143] *(i.e., tax burden imposed by U.K.)*

Yet again, the tax burdens imposed by the Netherlands and the United Kingdom would not alter in the cross-border scenario when compared with the purely domestic scenario. Again, the tax burden imposed, both pre-DTR and post-DTR, would not be affected as a consequence of taxpayer Johnson's place of residence or the geographical locations of its sources of income. The Netherlands would maintain to tax taxpayer Johnson at an

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[130] 140,000 + 10,000 = 150,000.
[131] 140,000 + 60,000 – 10,000 = 190,000.
[132] 5,000 + 10,000 + 0.25 * 90,000 = 37,500
[133] 37,500 / 190,000 * 100% = 19.7%.
[134] (60,000 – 20,000) / (200,000 – 10,000) * 37,500 = 7,894.74.
[135] 37,500 – 7,894.74 = 29,605.26.
[136] 29,605.26 / 150,000 * 100% = 19.7%.
[137] 60,000 – 28,000 – 20,000 = 12,000.
[138] 140,000 + 60,000 – 28,000 – 20,000 = 152,000.
[139] 5,000 + 10,000 + 0.25 * 52,000 = 28,000.
[140] 30,000 / 160,000 * 100% = 18.8%.
[141] 140,000 / (200,000 – 28,000 – 20,000) * 28,000 = 25,789.47.
[142] 28,000 – 25,789.47 = 2,210.53.
[143] 2,210.53 / 12,000 * 100% = 18.4%.

effective rate of 19.7%. The United Kingdom would tax Johnson at a rate of 18.4%. Moreover, both the Netherlands and the United Kingdom would receive their fair share of the tax pie. Equity and neutrality within the Netherlands' and the United Kingdom's (inter)national tax systems would be achieved, even in the case of taxpayers keeping their tax books in a third country currency.

In the *mirroring case* in which the British Pound drops in value, referred to in the above as scenario (iii), 'Case f)', things, again, would work out in the exact opposite manner. Yes, again, the tax burden imposed by the Netherlands and the United Kingdom is the same in both domestic and cross-border scenarios. This holds true, again in terms of both pre-DTR and post-DTR tax burdens. I did not forward the non-discriminatory and neutral effects by means of a schedule. Also on this occasion, I respectfully dare the reader to determine these effects himself.

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 realize currency exchange results while carrying on their business activities in a cross-border, intra-EU, context. By means of numerical examples, I 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 indirect discriminations and market access restrictions would be cancelled out from the (inter)national direct tax system. The crossing of tax borders within the EU's internal market would, therefore, not be hindered. The desired equilibrium between the tax sovereignty of the EU MSs and the internal market without internal frontiers would be attained. This holds true, now, not only regarding cross-border business losses as argued in my earlier contribution to this journal, but also in respect of EU taxpayers who derive currency exchange results in the course of operating their cross-border businesses. As a final remark, I would like to forward the hypothesis that the neutral and equitable operation of the advocated approach can also be demonstrated by assessing the effects regarding intra-firm transactions. It may therefore also resolve the exit taxation issues which are currently pending before the Court of Justice. This, however, perhaps is a topic for another day.