NON-DISCRIMINATORY TAX OBSTACLES IN COMMUNITY LAW

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Abstract This article compares the approach of the Court of Justice in the area of taxation with its general case law on restrictions on free movement. It is argued that the Court, while sometimes referring to the same concepts as in the field of regulatory barriers, is in practice employing a narrower test. The possible reasons for the comparatively cautious approach are analysed and the issue of double taxation is examined, with reference also to the US case law. Finally, the connections to larger questions concerning the nature of the single market and the roles of the Community institutions are noted.

I. INTRODUCTION

One of the key developments in the single market law of the European Community has been the progressive abandonment of the requirement that a national measure be discriminatory to constitute a restriction on free movement of persons, services, or capital. In cases such as *Gebhard*, *Alpine Investments*, *Bosman, Carpenter*, and *Commission v United Kingdom* (Golden Shares) the European Court of Justice has found that even-handed measures may contravene free movement rules if they are 'liable to hinder or make less attractive the exercise of fundamental freedoms',[1] directly affect market access,[2] are detrimental to the conditions under which a fundamental freedom is exercised,[3] or are 'liable to deter investors from other Member States . . . and, consequently, affect access to the market'.[4] However, the same is not true for free movement of goods, where the requirement of discrimination still plays a decisive role as the result of the well-known decisions in *Keck*,[5] in which the Court found that rules concerning selling arrangements only breach Article 28 EC if they discriminate against products imported from other

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[1] Case C-55/94 *Gebhard* [1995] ECR I-4165, para 37.

[2] Case C-384/93 *Alpine Investments* [1995] ECR I-1141, para 38 and Case C-415/93 *Bosman* [1995] ECR I-4921, para 103.

[3] Case C-60/00 *Carpenter* [2002] ECR I-6279, para 39.

[4] Case C-98/01 *Commission v United Kingdom* [2003] ECR I-4641, para 47.

[5] Joined Cases C-267–268/91 *Keck* [1993] ECR I-6097. See on this judgment in particular R Joliet, 'The free circulation of goods: the *Keck and Mithouard* decision and the new directions in the case law' (1995) 1 Columbia J Eur L 435.

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Member States, and *Groenveld*,[6] where it held that non-discriminatory measures do not infringe Article 29 EC.[7]

In recent years, the irresistible force of free movement law, a core area of Community law, has been meeting the immovable object of national tax law, a core area of national sovereignty. In an ever-increasing number of cases the Court has been called to reconcile the conflicting requirements of the European internal market and the national tax autonomy. The purpose of the present article is to compare the Court's approach in the area of taxation with its general free movement case law. Have the principles developed to tackle regulatory barriers been transposed to the field of fiscal barriers, and should they be? The article will first examine indirect taxes and free movement of goods, and analogous situations in the area of capital and services, and then move to direct taxes. It will be argued that the Court, while sometimes referring to the same concepts as in the field of regulatory barriers, is in actual practice still employing a narrower test and focuses on discrimination.[8] The possible reasons for this will be analysed and the issue of double taxation explored, with reference to the rich jurisprudence on the Dormant Commerce Clause of the US Constitution. Finally, it will be argued that ultimately the issues are connected to larger questions concerning the nature of the single market and the roles of the Community institutions.

II. INDIRECT TAXES AND FREE MOVEMENT OF GOODS, SERVICES, AND CAPITAL

A. Goods

The treatment of pecuniary obstacles to free movement of goods is based on the elimination of measures having a disparate impact to the detriment of imports or exports when compared with domestic products or purely internal situations; it is not founded upon the abolition of all barriers to free movement. Articles 25 and 90 EC together set up a system which seeks to prohibit the imposition of a heavier burden on goods moving between Member States than on products that do not cross a frontier.

Article 25 EC bans '[c]ustoms duties on imports and exports and charges having equivalent effect'. The same applies to 'customs duties of a fiscal nature'. The Court has always interpreted this prohibition widely. In *Statistical*

[6] Case 15/79 *Groenveld* [1979] ECR 3409.

[7] See generally on these developments, eg P Oliver and W-H Roth, 'The internal market and the four freedoms' (2004) 41 CML Rev 407; J Snell, 'And then there were two: products and citizens in Community law' in T Tridimas and P Nebbia (eds), *European Union Law for the Twenty-first Century: Rethinking the New Legal Order. Vol II* (Hart Publishing, Oxford, 2004), and E Spaventa, 'From *Gebhard* to *Carpenter*: towards a (non-)economic European constitution' (2004) 41 CML Rev 743.

[8] This runs counter to the Court's traditional position, expressed in Case C-20/92 *Hubbard* [1993] ECR I-3777, para 19, that 'the effectiveness of Community law cannot vary according to the various branches of national law which it may affect'.

Levy the Court found that 'any pecuniary charge, however small and whatever its designation and mode of application, which is imposed unilaterally on domestic or foreign goods by reason of the fact that they cross a frontier'[9] was in principle forbidden. This is readily explicable on discrimination grounds as charges imposed for the reason that the goods cross a frontier can only ever affect imports or exports, and never concern domestic goods in circulation within the country.[10]

Further, the possible absence of competing domestic production does not alter this analysis.[11] First, if the criterion for a charge is the crossing of a border, the charge may be viewed as directly discriminatory against imports due to the employment of a prohibited distinguishing criterion,[12] and the fortuitous fact that substitutable products are not for the moment being produced within the Member State is simply irrelevant. Secondly, the charge may lead consumers to purchase domestic products that cannot properly be considered competing, in the same way as in the field of competition law the postulation of a hypothetical small but substantial non-transitory increase in price may result in an overly wide definition of the market if the prevailing price is supra-competitive.[13] Finally, the charge will in any event protect the *development* of domestic production.

In recent years the Court has extended the reach of Article 25 EC to charges imposed at the internal frontiers of Member States. In *Legros*[14] the Court was faced with dock dues levied in the French overseas departments. These dues were imposed both on goods coming from metropolitan France and on those imported from other Member States. Nevertheless, the Court held that the charging of dues on imports from other Member States was prohibited by Article 25 EC.

Although superficially in conflict with the disparate impact reading of Article 25 EC, on a closer examination *Legros* can be explained by the need to avoid the imposition of a heavier burden on imported goods than on domes-

[9] Case 24/68 *Commission v Italy* [1969] ECR 193, para 9.

[10] See also JHH Weiler, 'The Constitution of the Common Market Place: Text and Context in the Evolution of the Free Movement of Goods' in P Craig and G de Búrca, *The Evolution of EU Law* (OUP, Oxford, 1999) 394.

[11] Contra W Schön, 'Der freie Warenverkehr, die Steuerhoheit der Mitgliedstaaten und der Systemgedanke im europäischen Steuerrecht—Teil I: Die Grundlagen und das Verboot der Zölle und zollgleichen Abgaben' (2001) 36 EuR 216, 218.

[12] For a discussion of direct and indirect discrimination, see K Lenaerts, 'L'égalité de traitement en droit communautaire: un principe unique aux apparences multiples' (1991) 27 CDE 3, 12–17.

[13] Known as cellophane fallacy after *United States v EI du Pont de Nemours and Co* 351 US 377 (1956) where the US Supreme Court held, erroneously, that cellophane was in competition with other flexible packaging materials, despite the fact that the willingness of consumers to switch to inferior substitutes was the result of the already inflated price of cellophane. This is recognized in Commission Notice on the definition of relevant market for the purposes of Community competition law [1997] OJ C372/5, para 19, and discussed, eg, in R Whish, *Competition Law* (5th edn, LexisNexis, London, 2003) 30–2.

[14] Case C-163/90 *Legros* [1992] ECR I-4625.

tic products. It is true that goods coming from other Member States were on an equal footing with products originating from other parts of France. However, all imported products were treated less well than the goods of the region. Therefore, goods of other Member States were placed at a disadvantage when compared with the most favourably treated domestic products. It is no defence to a charge of disparate impact that some domestic products are hindered equally.[15]

The connection to disparate impact is also evident, albeit in a more tenuous form, in *Lancry*.[16] The case followed on from *Legros* with the national court asking this time whether the dock dues were illegal also in so far as they were levied on goods from metropolitan France. The Court, contrary to the Opinion of Advocate General Tesauro, decided that the charging of dock dues on products entering the region from other parts of France was prohibited. While the reasoning referred to a far-reaching notion of the 'unity of the Community customs territory',[17] the Court also more prosaically pointed to the impossibility, in practical terms, of distinguishing between goods of domestic origin and those originating in other Member States. In particular, a product coming from metropolitan France but containing parts from another Member State, or a product of another Member State entering via metropolitan France, could not be deemed a domestic one. Therefore, it would be necessary to verify the origin of every product shipped from metropolitan France, which in itself would give rise to delays and administrative procedures not borne by the products of the region.

Article 90 EC supports Article 25 EC by outlawing internal taxes that discriminate against imports or afford indirect protection to competing products. The very language of this provision makes it clear that it is only concerned with discrimination or protectionism, and does not target neutral but burdensome obstacles, and this is how it has generally been applied in a long line of cases.[18]

Nevertheless, there have been some indications that the Court might also be prepared to tackle even-handed indirect tax rules. In *Commission v Denmark*[19]

[15] The same principle can be observed, eg, in Case C-353/89 *Commission v Netherlands* [1991] ECR I-4069 concerning regulatory barriers to free movement of services. The fact that the Dutch Mediawet gave preferential treatment to just one domestic company, at the expense of the other domestic and all foreign companies, did not remove it from the scope of Art 49 EC. See in the context of Art 28 EC Case C-21/88 *Du Pont de Nemours* [1990] ECR I-889.

[16] Joined Cases C-363 and 407–411/93 *Lancry* [1994] ECR I-3957. See also Case C-293/02 *Jersey Produce Marketing Organisation* [2005] ECR I-9543, paras 65–6 where the Court focused on the possibility of re-exportation.

[17] ibid para 27. For criticism, see AG Poiares Maduro in Case C-72/03 *Carbonati Apuani* [2004] ECR I-8027, paras 44–9.

[18] See generally on the application of Article 90 EC, eg, C Barnard, *The Substantive Law of the EU: The Four Freedoms* (OUP, Oxford, 2004) 45–62 or P Farmer and R Lyal, *EC Tax Law* (OUP, Oxford, 1994) 56–76. For an argument that the Court is engaged in a review of a protectionist motive, see A Easson, 'Fiscal discrimination: new perspectives on Art 95 of the EEC Treaty' (1981) 18 CMLRev 521, 546, and M Danusso and R Denton, 'Does the European Court of Justice look for a protectionist motive under Article 95?' [1990] LIEI 67.

[19] Case C-47/88 *Commission v Denmark* [1990] ECR I-4509.

the Court was faced with a challenge to the Danish car registration duty, which could almost treble the price of a new car. The Commission argued that, in the absence of domestic car production, the very high level of taxation breached Article 90 EC. The Court, following Advocate General Mischo, answered this argument by stating that Article 90 EC sought to 'guarantee the complete neutrality of internal taxation as regards competition between domestic products and imported products . . . [I]t does not provide a basis for censuring the excessiveness of the level of taxation . . . in the absence of any discriminatory or protective effect.'[20] However, referring to a statement in the early *Stier* judgment,[21] it added that if the amount of charges impeded the free movement of goods, they could be challenged under Article 28 EC. As the Commission's action was exclusively based on Article 90 EC, this matter did not need to be considered.

Commission v Denmark closed one door but potentially opened another. The Court clearly dismissed the possibility of challenging high tax rates under Article 90 EC, but hinted at the prospect of bringing an action under Article 28 EC,[22] which had previously been reserved for tackling non-pecuniary barriers. This issue was revisited in the more recent ruling in *De Danske Bilimportører*.[23] Once again the case concerned a challenge to the Danish car registration duty. De Danske Bilimportører, a professional association of car importers, argued that the excessive level of the duty impeded free movement of new cars contrary to Article 28 EC. The Full Court, following Advocate General Jacobs, rejected the challenge. It held that 'obstacles of a fiscal nature or having an effect equivalent to customs duties … do not fall within the prohibition laid down in Article 28 EC'.[24] It accepted that its earlier case law had referred to 'charges of such an amount that the free movement of goods within the common market would be impeded',[25] but stated that, in any event, this was not the case here. Accordingly, it ruled that the Danish registration duty had not ceased to be internal taxation and could not be classified as a barrier for the purposes of Article 28 EC.

In *De Danske Bilimportører* the Court and the Advocate General agreed that the Danish rules should be allowed to stand. However, there was a difference in their reasoning. While the Advocate General categorically refused the application of Article 28 EC to any fiscal charges, the Court did not entirely dismiss the possibility that a fiscal levy may cease to be only internal taxation

[20] ibid paras 9–10.
[21] Case 31/67 *Stier* [1968] ECR 235.
[22] The Court policing tax rates may sound outlandish, but it is not impossible to argue that such scrutiny could have merits, eg, if an exporting State that is the only producer of a type of raw material primarily shipped out of State imposes a heavy tax on it, seeking to exploit its market power. For a general discussion of tax rates and free movement, see A Cordewener, *Europäische Grundfreiheiten und nationales Steuerrecht* (Otto Schmidt, Cologne, 2002) 848–56.
[23] Case C-383/01 *De Danske Bilimportører* [2003] ECR I-6065.
[24] ibid para 32.
[25] ibid para 40.

and transform into a measure having an equivalent effect to a quantitative restriction.[26]

However, it may be argued that the difference between the Opinion and the Judgment is more apparent than real. It does not seem that the Court is in practice prepared to censure tax levels in the field of goods. First, the Danish registration duty that was allowed to stand under Article 28 EC was very high, 105 per cent of the purchase price up to a threshold determined each year and 180 per cent of the remainder.[27] If this level of taxation was tolerated, there would not be many cases where the Court would intervene, in particular as, in the absence of protectionism, revenue-maximizing governments are unlikely to impose tax burdens that destroy trade entirely.[28] Additionally, the Court was in this case prepared to entertain an argument that it normally rejects. It stated that figures given by the national court regarding the number of new vehicles registered in Denmark, all of which were imports, did not show any sign of the trade being impeded. According to the figures, from 1985 to 2000 the total number of vehicles rose from approximately 1.5 million to 1.9 million and the number of annual new registrations varied between 78,000 and 170,000.[29] Yet in previous Article 28 and Article 90 EC cases the Court has quite logically rejected this kind of argument, as the increase in imports could have been even higher in the absence of the national rules.[30] The Court simply seems to be doing its best to uphold the genuinely neutral Danish tax measure, whatever its approach in other cases may have been. It may well be that the reference to the possibility of applying Article 28 EC to high tax rates in the decisions is simply the Court acknowledging a remark in the 1968 *Stier* judgment, rather than an indication of a serious possibility of even-handed tax rates being condemned by the Court.[31]

[26] The issue also surfaced in Joined Cases C-34 and 38/01 *Enirisorse* [2003] ECR I-4243 concerning port charges. The Fifth Chamber of the Court held in para 58 that if the port charges fall within Art 25 or 90 EC, one of those provisions applies and not Art 28 EC. Further, the fact that the charges may be lawful under those provisions does not automatically bring them within Art 28 EC. However, the value of this case for the present purposes is small as the actual amounts levied were relatively low.

[27] *De Danske Bilimportører* (n 23) para 9. Further, the tax base already included 25 per cent VAT and flat-rate mark-up of 9 per cent.

[28] See para 12 of the Opinion of AG Mischo in *Commission v Denmark* (n 19). However, if the products taxed are harmful, eg, to the environment or public health, the tax rates can reach very high levels, as the governments may no longer be concerned with maximizing revenue but may quite rationally be internalizing the external costs created by the products.

[29] *De Danske Bilimportører* (n 23) paras 17 and 41.

[30] See Case 249/81 *Commission v Ireland* [1982] ECR 4005 (Buy Irish) in the context of Art 28 EC and Case 168/78 *Commission v France* [1980] ECR 347 (Whisky and Cognac) in the context of Art 90 EC.

[31] Interestingly, in Case C-387/01 *Weigel* [2004] ECR I-4981 in the field of workers, the Court applied a discrimination analysis to Austrian standard fuel consumption tax. It was argued that the tax, which was imposed on two German migrant workers when they registered their cars in Austria upon the transfer of their residence, contravened Art 39 EC. The Court dismissed the argument, holding in para 55 that 'the Treaty offers no guarantee to a worker that transferring his activities to a Member State other than the one in which he previously resided will be neutral as regards

B. Services and Capital

In contrast to goods, both regulatory and fiscal barriers to free movement of services and capital are in principle considered under the same Treaty provisions, Articles 49 and 56 EC.[32] The Court was thus placed in a dilemma. Should it extend the wide obstacle-oriented approach of regulatory cases also to cases concerning taxation, preserving the internal coherence of the case law on services and capital? Or should it opt for coherence between the different freedoms and follow the disparate impact route in line with Article 90 EC when dealing with analogous situations relating to services and capital? The number of decisions is still small, but very recently the Court seems to have opted for the latter course, despite some earlier indications to the contrary.

In *Sandoz*[33] the Sixth Chamber of the Court considered an Austrian rule that applied a stamp duty of 0.8 per cent to loans obtained by residents. The same stamp duty was applicable irrespective of where the lender was established. The Court, following Advocate General Léger, found that the imposition of the stamp duty on loans contracted abroad amounted to a restriction on free movement of capital, as it 'deprives residents of a Member State of the possibility of benefiting from the absence of taxation which may be associated with loans obtained outside the national territory. Accordingly, such a measure is likely to deter such residents from obtaining loans from persons established in other Member States'.[34] The Court then examined the justification of the measure and found that it stopped Austrian residents from evading domestic taxes and was therefore essential to prevent the infringement of national tax law within the meaning of Article 58 EC, thus ultimately upholding it.

The Court in *Sandoz* adopted an entirely different approach to indirect taxes in the context of capital than the one used under Article 90 EC in the context of goods, at least at the level of language. The mere imposition of a tax on 'imported' loans amounted to a restriction on free movement of capital, despite the absence of discrimination. This meshes well with the obstacle-oriented general case law on Article 56 EC, but runs counter to the general case law on indirect taxes where the aim has been the achievement of fiscal neutrality between domestic goods and imports, not the preservation of any possible tax advantages of foreign products. However, it is important to note

taxation. Given the disparities in the legislation of the Member States in this area, such a transfer may be to the worker's advantage in terms of indirect taxation or not, according to circumstance. It follows that, in principle, any disadvantage, by comparison with the situation in which the worker pursued his activities prior to the transfer, is not contrary to Article 39 EC if that legislation does not place that worker at a disadvantage as compared with those who were already subject to it'. This formula has been repeated a number of times since. However, *Weigel* is not fully comparable with the cases discussed above, as the restrictive effect was more remote. The tax was not imposed on the migrating worker as such, but simply applied to any first time car registration in Austria.

[32] Art 90 EC does not apply to services. See Case 267/86 *Van Eycke* [1988] ECR 4769.
[33] Case C-439/97 *Sandoz* [1999] ECR I-7041.
[34] ibid para 19.

that the Court's treatment of justifications was extremely generous and would seem to permit essentially all equally applicable national tax rules. Accordingly, the case should be treated with some caution.

In *De Coster*[35] the Court was faced with a Belgian municipal tax on satellite dishes, which was introduced to prevent their 'uncontrolled proliferation'. In a view almost diametrically opposite to the one more recently adopted by Advocate General Jacobs in *De Danske Bilimportører*, Advocate General Ruiz-Jarabo Colomer argued that, regardless of whether the tax on satellite dishes was discriminatory, it was in any event caught by Article 49 EC as a barrier to the freedom to provide services. According to him, the tax reduced opportunities for cross-border broadcasting by making the reception of television programmes by satellite less appealing.[36] This analysis corresponded fully to the method normally adopted by the Court for regulatory barriers to the free movement of services. The Advocate General was clearly prepared to examine the legality of even-handed taxes in the field of services, no matter what the approach was in the field of goods. The Fifth Chamber of the Court was more cautious. Its approach focused on the disparate impact of the tax. It noted that the tax only applied to satellite dishes, and did not affect transmissions by cable. Domestic broadcasters enjoyed an unlimited access to cable distribution, while for many broadcasters established in other Member States satellite transmission was the only option. Accordingly, it held that the tax was liable to impede the activities of foreign service-providers while giving an advantage to Belgian broadcasters.[37]

In *De Coster* the Court did not need to follow the obstacle-based analysis of the Advocate General, as it was able to deal with the case already on differential effect grounds. Accordingly, the decision committed the Court to neither the disparate impact nor the obstacle-oriented approach but left its options open. In *Viacom Outdoor* it seemed to opt for the latter.[38]

Viacom Outdoor concerned an Italian municipal advertising tax. Viacom Outdoor had carried out bill-posting advertising on behalf of a French

[35] Case C-17/00 *De Coster* [2001] ECR I-9445.

[36] ibid para 134 of the Opinion.

[37] See D Chalmers, C Hadjiemmanuilm G Monti, and A Tomkins, *European Union Law: Text and Materials* (CUP, Cambridge, 2006) 771–2 for a criticism of the approach.

[38] Case C-134/03 *Viacom Outdoor* [2005] ECR I-1167. Another judgment that might be cited as support for the obstacle-based approach is Joined Cases C-430-431/99 *Sea-Land Service and Nedlloyd Lijnen* [2002] ECR I-5235. The case concerned a Dutch tariff on sea-going vessels longer than 41 metres which was payable for navigation in certain areas. The Sixth Chamber of the Court found that although there was no direct or indirect discrimination on grounds of nationality, the rules did constitute a restriction as they were liable to impede or render less attractive the provision of services. However, as is apparent in particular from para 92 of the Opinion of AG Alber, the vessels bearing the charge were exclusively providing cross-border services and the charge was payable when they actually engaged in this activity. Therefore, the tariff was more akin to a charge of equivalent effect to a customs duty than an internal tax. It should also be noted that the case was decided under Council Regulation (EEC) 4055/86 applying the principle of freedom to provide services to maritime transport between Member States and between Member States and third countries [1986] OJ L378/1.

company. This activity resulted in a tax charge of a little over €200. Viacom Outdoor sought to reclaim the charge from the French company, which refused to pay arguing that the tax was contrary to Article 49 EC. The Third Chamber of the Court, following Advocate General Kokott, found that the free movement of services was not infringed. It noted first that the tax applied without distinction to any provision of outdoor advertising services. It then stated that the

> tax is applied only to outdoor advertising activities involving the use of public space administered by the municipal authorities and its amount is fixed at a level which may be considered modest in relation to the value of the services provided which are subject to it. In those circumstances, the levying of such a tax is not on any view liable to prohibit, impede or otherwise make less attractive the provision of advertising services.[39]

Accordingly, the national rules were allowed to stand.

Viacom Outdoor can be read as suggesting that even-handed indirect tax rules can infringe free movement of services. The Court assessed the origin-neutral tax against its general Article 49 EC test of whether the tax was 'liable to prohibit, impede or otherwise make less attractive' the provision of services. It explicitly drew attention to the 'modest' level of the tax, which would have been unnecessary, had the Court been prepared to dispose of the case on the grounds that the impact of the tax was the same for all service-providers and services, regardless of their origin. Accordingly, the Court seemed to contemplate extending Article 49 EC to those even-handed rules that impose substantial barriers to free movement.[40]

Despite the willingness of the Third Chamber of the Court to discuss the level of taxation, a few months later the Second Chamber opted for a narrower, disparate impact reading of Article 49 EC in the case of *Mobistar*.[41] The case concerned actions by two Belgian mobile telephony operators for the annulment of Belgian communal taxes on GSM antennae. The referring national court asked whether such taxes on communications infrastructure used in service provision were in accordance with Article 49 EC.[42]

The Court began its judgment by referring to its general case law on free movement of services and by stating that the Treaty 'requires not only the elimination of all discrimination on grounds of nationality . . . but also the abolition of any restriction . . . which is liable to prohibit or further impede the activities of a provider of services'.[43] Despite this wide formula of words that

[39] *Viacom Outdoor* (n 38) para 38.

[40] Similarly, AG Ruiz-Jarabo Colomer in *De Coster* (n 35) footnote 166 drew attention to the 'significant' amount of the tax.

[41] Joined Cases C-544 and 545/03 *Mobistar* [2005] ECR I-7723. AG Léger would have disposed of the case on the basis of a directive, and did not consider Art 49 EC.

[42] Although the tax was not imposed on the service as such, it was comparable to taxes falling under Art 90 EC, such as the tax on carriage of goods by road in Case 20/76 *Schöttle* [1977] ECR 247.

[43] *Mobistar* (n 41) para 29.

seemed capable of condemning all taxes as 'impediments', the Court next stated that nevertheless 'measures, the only effect of which is to create additional costs in respect of the service in question and which affect in the same way the provision of services between Member States and that within one Member State, do not fall within the scope of Article [49]'.[44] It then turned to the facts of the case, noting that the taxes applied without distinction and had the same effect, in law and fact, on foreign and national operators. Further, they did not hinder cross-border services more than domestic ones, and there was nothing to suggest that the cumulative effect of the local taxes compromised the free movement of services. Accordingly, the Court ruled that the taxes did not contravene Article 49 EC.

The ruling in *Mobistar* sits uncomfortably with the general services case law of the Court,[45] and leaves little room for the examination of origin-neutral tax levels, which was contemplated in *Viacom Outdoor*.[46] What the Court is concerned with is simply whether there is a differential impact to the detriment of operators or services from other Member States. In the absence of such an effect, Article 49 EC does not enter into play. The Court seems willing to examine realistically whether a disparate impact exists. It looks at discrimination in fact, as well as in law, not accepting every tax that is formally even-handed. In a language reminiscent of *Keck*,[47] it makes clear that if the impact of a tax is truly non-discriminatory, the tax does not infringe Article 49 EC.

Accordingly, the Court seems to have largely unified its approach to indirect taxes in the fields of goods and services. In both contexts it is examining whether national fiscal rules have a disparate impact, and is not seeking to strike down burdensome but even-handed measures. It has occasionally, in particular in *Commission v Denmark* and *Viacom Outdoor*, hinted at a willingness to examine origin-neutral tax levels against free movement rules, but in practice it does not seem to be prepared to disapply national tax rules on this ground. The approach has similarities with the one used in Article 28 EC case law on regulatory barriers to free movement of goods.[48] It does not sit well with the Court's general jurisprudence on free movement of services or with the language, if not the result, in *Sandoz* on free movement of capital. Coherence between goods and services has been furthered, but the internal consistency of Article 49 EC and the coherence vis-à-vis capital has been cast in doubt.

[44] *Mobistar* (n 41) para 31.

[45] Alternatively, it may of course represent a more general reining in of the case law. See V Hatzopoulos and TU Do, 'The case law of the ECJ concerning the free provision of services 2000–2005' (2006) 43 CMLRev 923, 957–61, and also J Meulman and H de Waele, 'A retreat from *Säger*? Servicing or fine-tuning the application of Article 49 EC' (2006) 33 LIEI 207, 226–8.

[46] It could be argued that the taxes in *Viacom Outdoor* and *Mobistar* were different, as in the former they affected the service more directly. However, it is submitted that nothing should hinge on this arbitrary and formalistic distinction.

[47] *Keck* (n 5).

[48] See however on the treatment of double burden, below, section V.

III. DIRECT TAXATION

The picture in the field of direct taxation is not fundamentally dissimilar to that examined above. The Court has started to use language that is reminiscent of its terminology in the field of regulatory barriers to free movement of persons, services, and capital, albeit several years later than in its non-tax case law. Despite the similar terminology, it is not clear that the Court has gone as far in the fiscal context as it has in the regulatory one when it comes to the actual results of the cases. It still from time to time disposes of cases on discrimination grounds without examining them from an obstacle-perspective at all, often also finding that a differential treatment of residents and non-residents does not constitute discrimination, its approach to bilateral treaties may be different, it has accepted the principle of territoriality in the field of tax obstacles while rejecting it in the field of intellectual property, and it tolerates the use of nationality criterion when Member States allocate tax powers. Altogether, it seems that the Court is employing the same language as in the obstacle-oriented jurisprudence developed in the regulatory context, but in reality continues with a more restrained discrimination-based approach.[49]

The Court abandoned the language of discrimination in its direct taxation case law relatively late, in 1997. This took place in *Futura Participations*,[50] a judgment of the Full Court. The case concerned a Luxembourg law which only allowed a non-resident taxpayer to deduct previous losses if they were economically related to local income and could be established on the basis of accounts complying with national rules. It was argued that the law breached Article 43 EC on the right of establishment. While in its previous case law the Court had always examined whether national tax provisions *discriminated* on grounds of nationality, it now adopted a different terminology. It stated that the Luxembourg rule on accounts might constitute a 'restriction'[51] and held that it was in principle prohibited in the absence of justification, as it 'specifically affects companies or firms having their seat in another Member State'.[52] This did not go unnoticed by the commentators,[53] and was indeed the start of a new trend in the field of direct taxation.[54] However, in the area of regulatory

[49] In an interesting Opinion in Case C-374/04 *ACT Group Litigation* [2006] ECR I-0000 AG Geelhoed argues that the Court needs to distinguish between 'true restrictions', which in practice also qualify as directly or indirectly discriminatory measures, and 'quasi-restrictions', which inevitably arise out of the co-existence of national tax systems and do not infringe the right of establishment or the free movement of capital. See also his Opinion in Case C-524/04 *Thin Cap Group Litigation* nyr in particular para 48.

[50] Case C-250/95 *Futura Participations* [1997] ECR I-2471.

[51] ibid para 24. However, it should be noted that the Court was not examining a substantive tax rule, but a tax accounting obligation.

[52] ibid para 26.

[53] See, eg, V Hatzopoulos, 'Casenote on *Futura Participations*' (1998) 35 CMLRev 493, 500–5.

[54] See, eg, Case C-118/96 *Safir* [1998] ECR I-1897, in respect of services, and Case C-35/98 *Verkooijen* [2000] ECR I-4071, in respect of capital.

barriers a similar terminological shift had taken place already a few years earlier, in cases such as *Säger*[55] and *Kraus*.[56]

Despite the terminological shift from 'discrimination' to 'restrictions' or 'obstacles', it is not clear that the Court is in actual practice prepared to scrutinize national direct tax measures that are truly even-handed. To my knowledge, every direct tax measure that has so far been categorized as a restriction has entailed a disparate impact to the disadvantage of foreign nationals or cross-border situations.[57] Further, there have been cases where the Court has allowed national tax rules to stand in the absence of discrimination, without examining whether they might constitute a barrier.

Illustrations of this focus on equality of treatment include the judgment of the Full Court in *Gschwind*[58] and the decision of the Grand Chamber in *D*.[59] The first case was decided under the rules on free movement of workers and concerned German income tax law, which refused the application of a splitting procedure for married couples to non-residents, unless 90 per cent or more of the total income of the couple arose in Germany or the income that was not subject to German taxation was 24,000 DM or less. As a result of these conditions, Mr Gschwind, a Dutch national who lived with his wife in the Netherlands but worked in Germany, was denied tax relief that a German resident would have been granted. In *D* the issue was the compliance of the Dutch wealth tax rules with free movement of capital. D, a German resident in Germany, was not granted the same tax allowance to the tax levied on his Dutch property as a Netherlands resident would have been.[60]

In neither case did the Court consider whether the tax rules created barriers,[61] like it does in most cases concerning regulatory obstacles. Instead it simply examined whether the rules discriminated against nationals of other Member States. On the facts, the rules treated residents more favourably than non-residents, but the Court held that residents and non-residents were not in

[55] Case C-76/90 *Säger* [1991] ECR I-4221.

[56] Case C-19/92 *Kraus* [1993] ECR I-1663.

[57] Similarly P Farmer, 'The Court's case law on taxation: a castle built on shifting sands' [2003] EC Tax Rev 75, 81 and R Lyal, 'Non-discrimination and direct tax in Community law' [2003] EC Tax Rev 68, 74. The 'restriction' in *Futura Participations* could be characterized as discriminatory, as is apparent from the Opinion of AG Lenz in the case. See also MJ Graetz and AC Warren, 'Income tax discrimination and the political and economic integration of Europe' (2006) 115 The Yale LJ 1186 in particular 1199, who point out that the concept of discrimination employed has been much more robust than that found in international trade and tax law.

[58] Case C-391/97 *Gschwind* [1999] ECR I-5451. The Court followed AG Ruiz-Jarabo Colomer.

[59] Case C-376/03 *D* [2005] ECR I-5821.

[60] Again, the allowances would have been granted, had 90 per cent of D's property been situated in the Netherlands.

[61] See S van Thiel, *Free Movement of Persons and Income Tax Law: the European Court in Search of Principles* (IBFD, Amsterdam, 2002) 247 for an argument that the refusal of the splitting tariff in *Gschwind* should have been deemed a restriction. For an analysis of *D* from a restriction perspective, see T O'Shea, 'The ECJ, the "D" case, double tax conventions and most-favoured nations: comparability and reciprocity' [2005] EC Tax Rev 190, 196–200.

comparable positions,[62] and accordingly the difference in treatments did not amount to discrimination. As a result, the Court held that free movement provisions of the Treaty did not preclude the national tax measures.

Gschwind and *D* are examples of the Court's actual approach in the field of taxation. Despite the terminological shift in *Futura Participations*, the Court does not necessarily examine whether the effect of the rules is to hinder free movement. Instead it often concentrates on discrimination. Further, the Court shows leniency even in this respect. It does not automatically assume that a higher tax burden for a non-resident than a resident constitutes a prima facie violation of free movement rules, like it would do in the case of a regulatory burden. Instead, it carefully examines whether the situation of a resident and a non-resident is comparable or not,[63] and in the latter case allows for a differential treatment.[64]

In *D* the Court also proved more receptive to reciprocity arguments than it has previously been. The Dutch rules extended the tax allowance also to residents of Belgium by virtue of a bilateral tax convention. It was argued that the resulting difference in treatment between residents of Germany and Belgium amounted to prohibited discrimination. The Court rejected this argument and upheld the rules, refusing to follow the Opinion of Advocate General Ruiz-Jarabo Colomer. It stated that the fact that the 'reciprocal rights and obligations apply only to persons resident in one of the two Contracting Member States is an inherent consequence of bilateral double taxation conventions'[65] and continued that the allowance in question contributed to the overall balance of the convention.

The treatment of reciprocity in *D* can be contrasted with earlier judgments such as *Matteucci*,[66] which did not concern a tax treaty but a bilateral cultural agreement between Belgium and Germany. According to this agreement, each country would grant scholarships to nationals of the other country. Miss

[62] This line of argument can be traced back to Case C-279/93 *Schumacker* [1995] ECR I-225. See also in the context of free movement of capital Art 58(1)(a) EC.

[63] It is interesting to note that in *Gschwind* the Belgian Government and the Commission argued that the German law did discriminate against non-residents. See *Gschwind* (n 58) paras 17–19. In *D* AG Ruiz-Jarabo Colomer found discrimination.

[64] It has to be noted that Case C-152/03 *Ritter-Coulais* [2006] ECR I-1711 could be seen to be casting some doubt on the approach. Since *Schumacker* (n 62) para 31, the Court has taken as its starting point in respect of subjective tax elements that '[i]n relation to direct taxes, the situations of residents and of non-residents are not, as a rule, comparable.' However, in *Ritter-Coulais*, a case concerning German income tax rules, the Grand Chamber stated in para 38 that a law treating non-residents less favourably than residents was 'as a rule, contrary to Article [39] EC.' This might be seen as a reversal of the basic assumption. However the *Schumacker* formula has been repeated post *Ritter-Coulais*, eg, in Case C-346/04 *Conijn* [2006] ECR I-6137, para 16 and in Case C-520/04 *Turpeinen* [2006] ECR I-00000, para 26, and there were differences in factual situations, namely between the availability of personal allowances and the recognition, for tax rate purposes, of rental income losses resulting from the own use of a dwelling.

[65] *D* (n 59) para 61.

[66] Case 235/87 *Matteucci* [1988] ECR 5589. See also Case C-55/00 *Gottardo* [2002] ECR I-413 and, in the tax context, Case C-307/97 *Saint-Gobain ZN* [1999] ECR I-6161.

Matteucci, an Italian national resident in Belgium, wished to study in Germany, but Belgium refused to put her forward for a scholarship on the ground of her nationality. It was argued that this was contrary to the rules on free movement of workers. However, as a counter-argument it was submitted that bilateral cultural agreements aim at developing cultural exchanges between the two contracting parties, and this legitimate bilateral cooperation should not be frustrated by Community law. This reciprocity argument was not accepted by the Court, which simply stated that a bilateral agreement cannot preclude the application of Community rules on equal treatment.

One should not jump too readily to the conclusion that *D* represents a total departure from the previous case law on reciprocity. The fact configuration in *D* was not the same as in *Matteucci*. In the latter judgment one Member State, Belgium, was treating its own nationals and other residents differently. In *D* the Netherlands was treating two categories of non-residents differently.[67] Perhaps this distinguishes the cases and fully explains the results, but it may also be argued that the ready rejection of reciprocity in *Matteucci* and its ready acceptance in *D* represent a shift in emphasis towards a more favourable treatment of reciprocity in bilateral tax conventions.[68]

Another example of the Court's leniency towards fiscal rules is the express approval of the principle of territoriality in the tax context after the rejection of the same principle in the regulatory context.[69] *Futura Participations*[70] is again the relevant case. According to the Luxembourg tax law non-resident companies were taxed only for locally received income, but could also deduct for tax purposes only those previous losses that were economically related to this local income. By contrast, all the income of a resident company was in principle taxable, and there was no similar condition of 'economic relation' on the deductibility of previous losses. Despite the fact that the Luxembourg rule expressly subjected resident and non-resident companies to differential treatment the Court, following Advocate General Lenz, did not find this element of the law a restriction in need of justification. The only reason the Court gave was that the system was in conformity with the fiscal principle of territorial-

[67] A further difference between *Matteucci* and *D* was that the former involved direct discrimination on grounds of nationality, while in the latter residence was the distinguishing criterion. However, this difference was not present in *Saint-Gobain*, ibid.

[68] See S van Thiel, 'A slip of the European Court in the D case (C-376/03): denial of the most-favoured-nation treatment because of absence of similarity?' (2005) 33 Intertax 454, 455–7 for a forceful critique of this aspect of the ruling. See also A Cordewener and E Reimer, 'The future of most-favoured-nation treatment in EC tax law—Did the ECJ pull the emergency break without real need?—Part 2' (2006) 46 European Taxation 291 for a sophisticated analysis of the issues. The ruling in *ACT Group Litigation* (n 49) has confirmed the judgment.

[69] However, see BJM Terra and PJ Wattel, *European Tax Law* (4th edn, Kluwer Law International, The Hague, 2005) 132–3 for an argument that cases concerning the 'correct territorial matching of social security costs and benefits' such as Case C-224/98 *D'Hoop* [2002] ECR I-6191 also represent an acceptance of territoriality.

[70] *Futura Participations* (n 50). See for recent discussion and application the Opinion of AG Léger in Case C-345/04 *CELG* nyr paras 32–8.

ity.[71] *Futura Participations* can therefore be read as an authority for the proposition that national measures which comply with the territoriality principle do not constitute restrictions.

However, there are also instances where the Court has ignored the territoriality principle when applying free movement rules. This can be clearly seen in the area of intellectual property. As Bently and Sherman write: 'One of the defining characteristics of intellectual property rights is that they are national or territorial in nature. That is, they do not ordinarily operate outside of the national territory where they are granted.'[72] Because of the territoriality principle, States have needed to negotiate treaties granting reciprocal recognition of intellectual property rights for their citizens, just like various tax conventions have sought to reconcile conflicting tax claims. Yet in this area the Court has not been prepared to allow the territoriality principle to get in the way of market integration. For example, in *Musik-Vertrieb Membran*[73] the German copyright owners argued that they were entitled to additional royalties in respect of records first sold in the UK and later imported into Germany; more specifically they wished to claim the difference between the lower royalties paid in the UK and the higher German royalties. The importers countered with an argument that the national copyright law providing for the right to additional royalties contravened Community rules on free movement of goods. The Court agreed with the importers and held that the rights of the copyright owners had been exhausted by the first consensual sale within the Community. In doing so, it expressly rejected the argument of the Belgian and Italian Governments that the principle of territoriality of copyright laws always prevailed over the principle of free movement of goods. The Court pointed out that the essential purpose of the EC Treaty, the unification of national markets, could not be attained if the various legal systems of the Member States were able to partition the market.[74] Here, in the intellectual property context, the Court was not prepared to accept that the conformity of the national rules with the territoriality principle rendered them single market compliant, like it did in *Futura Participations* in the taxation context.

A final example of leniency can be found in *Gilly*[75] where the Court drew a distinction between the allocation and exercise of fiscal competence, and ruled that in the former instance the use of nationality criterion did not amount to unlawful discrimination on the grounds of nationality. By contrast in the regulatory context, differentiation on the basis of nationality is almost invariably condemned. The far-reaching implications of the logic of *Gilly* can be

[71] It should be noted that nowadays the Court seems to treat the principle as a ground of justification, as evidenced, eg, by Case C-471/04 *Keller Holding* [2006] ECR I-2107, para 44.
[72] L Bently and B Sherman, *Intellectual Property Law* (2nd edn, OUP, Oxford, 2004) 5.
[73] Joined Cases 55 and 57/80 *Musik-Vertrieb Membran* [1981] ECR 147.
[74] ibid para 14.
[75] Case C-336/96 *Gilly* [1998] ECR I-2793.

seen in *Van Hilten*[76] which concerned a Dutch rule extending the domestic inheritance tax to all nationals even if they did not reside in the Netherlands at the time of death, provided they had been resident within the previous 10 years. The Third Chamber of the Court, following Advocate General Léger, ruled that despite the reliance on the nationality criterion, the measure did not restrict the free movement of capital, basing its reasoning in part on the power of a Member State to allocate its tax jurisdiction.[77] This raises the disturbing question whether a Member State is given a permanent entitlement to extend the full force of its taxation to its own nationals, regardless of their country of residence, by claiming that it is simply allocating its tax competence? Hopefully the fact that *Van Hilten* involved a person who had moved to Switzerland rather than within the Community, and was therefore solely concerned with Article 56 EC, allows the Court to avoid such a conclusion. Otherwise the result could be the proliferation of double taxation, directly contrary to the rider in *Gilly* that the Member States have the power to allocate fiscal jurisdiction 'with a view to eliminating double taxation'.[78]

Altogether it seems that the Court is hesitant in its approach to direct taxation.[79] On the one hand, it has shifted its terminology and started to talk about restrictions or obstacles, not only about discrimination. On the other hand, the new language was adopted only a few years after a similar change in the context of regulatory barriers, and is by no means used in every case. The actual decisions in tax cases can still be explained on discrimination grounds and even differential tax treatment on grounds of residency is not always seen as a restriction in need of a justification. Further, bilateral tax treaties may be treated more favourably than other bilateral treaties, the Court has accepted the principle of territoriality in the fiscal area, while expressly rejecting it in the intellectual property context, and it tolerates the use of the nationality criterion when tax powers are allocated. Just like with indirect taxes, the Court seems reluctant to extend the full force of the obstacle-analysis to the realm of fiscal rules.

In this respect, the Court can be criticized for creating an unacceptable level of unpredictability,[80] in particular as the concept of restriction is not the only

[76] Case C-513/03 *Van Hilten-van der Heijden* [2006] ECR I-1957.

[77] For a trenchant criticism, see D Weber, 'Community report' in XL Xenopoulos (ed), *Direct Tax Rules and the EU Fundamental Freedoms: Origin and Scope of the Problem; National and Community Responses and Solutions* (FIDE, Nicosia 2006) 482–4.

[78] *Gilly* (n 75) para 24. In *Van Hilten* the Netherlands did award a tax credit corresponding to the foreign inheritance tax, thereby removing double taxation, and this was specifically mentioned by the Court in its actual answer to the referring national court.

[79] See also van Thiel (n 61) 290–305. See FC Hosson, 'On the controversial role of the European Court in corporate tax cases' (2006) 34 Intertax 294, 302–3 for an argument that the Court's treatment of grounds of justification demonstrates its 'awareness of the special position occupied by taxation'.

[80] See P Farmer and A Zalasinski, 'General Report' in XL Xenopoulos (ed) (n 77) and Terra and Wattel (n 69) 65–6 and 162. See also Farmer (n 57) 81, who argues that the 'analytical untidiness' of the case law may create difficulties for national courts and accordingly compromise the

source of uncertainty. Confusion seems to extend to the issue of justification[81] where the Court accepted the fiscal cohesion justification in the case of *Bachmann*[82] but made it to a large extent redundant in later cases such as *Baars*[83] and *Verkooijien*,[84] with the result that Advocates General have started to argue for its rehabilitation.[85] Yet, as stated by Advocate General Geelhoed, 'predictability and legal certainty are crucially important' for this area of law, as Member States need to be able to plan their budgets and design their 'tax systems on the basis of relatively reliable revenue predictions.'[86]

IV. THE REASONS FOR HESITATION

There are a number of possible reasons for the reluctance of the Court to extend the full force of its obstacle-oriented case law on regulatory barriers to the tax field. The first, and most obvious one, is the political sensitivity of

uniform application of Community law. The Court accepted in Case C-446/04 *FII Group Litigation* [2006] ECR I-00000, para 215 that 'in a field such as direct taxation, the consequences arising from the freedoms of movement guaranteed by the Treaty have been only gradually made clear' and advised the referring national court to take this into account when deciding upon the seriousness of a breach of Art 43 EC for State liability purposes. The Commission Communication on 'Co-ordinating Member States' direct tax systems in the Internal Market' COM (2006) 823 final highlights the uncertainty at 5.

[81] An additional, more general, source of confusion relates to the availability of justifications in case of discrimination. Compare eg the Opinion of AG Jacobs in Case C-136/00 *Danner* [2002] ECR I-8147, paras 32–41 where he argues that overriding requirements can be invoked even in cases of direct discrimination with the Opinion of AG Tizzano in Case C-433/04 *Commission v Belgium* [2006] ECR I-00000, para 36 where he argues that the Belgian law which appears indistinctly applicable can only be saved by express Treaty derogations as it in reality discriminates. See also AG Léger in Case C-196/04 *Cadbury Schweppes* [2006] ECR I-00000, para 64. For recent academic discussion in the tax context, see M Dahlberg, *Direct Taxation in Relation to the Freedom of Establishment and the Free Movement of Capital* (Kluwer Law International, The Hague, 2005) 119–24. It may be added that the concept of discrimination is itself unclear. See, eg, AG Stix-Hackl in Case C-150/04 *Commission v Denmark* nyr, paras 42–6.

[82] Case C-204/90 *Bachmann* [1992] ECR I-249.

[83] Case C-251/98 *Baars* [2000] ECR I-2787.

[84] *Verkooijien* (n 54).

[85] See AGs Kokott in Case C-319/02 *Manninen* [2004] ECR I-7477 and Poiares Maduro in Case C-446/03 *Marks & Spencer* [2005] ECR I-10837. AG Stix-Hackl describes the case law as confusing in *Commission v Denmark* (n 81) paras 72 and 77. See generally F Vanistendael, 'Cohesion: the phoenix rises from his ashes' [2005] EC Tax Rev 208.

[86] *ACT Group Litigation* (n 49) para 3. See also the Opinion of AG Geelhoed in *Thin Cap Group Litigation* (n 49) where he states in para 68 in the context of an analysis of anti-abuse justification: 'I find it extremely regrettable that the lack of clarity … has led to a situation where Member States, unclear of the extent to which they may enact *prima facie* "discriminatory" antiabuse laws, have felt obliged to "play safe" by extending the scope of their rules to purely domestic situations where no possible risk of abuse exists … Such an extension of legislation to situations falling wholly outwith its rationale, for purely formalistic ends and causing considerable extra administrative burden for domestic companies and tax authorities, is quite pointless and indeed counterproductive for economic efficiency. As such, it is anathema to the internal market.'

fiscal issues.[87] Power to tax, ie the power of a State to coercively raise revenue, is a fundamental part of State sovereignty. To an adherent of the brutalist school of Statecraft, a State needs at all times to be prepared to deal with external and internal threats to its existence. For this purpose, it must have access to effective armed forces and other instruments of violence, and this can only be guaranteed if the State has a ready and reliable access to treasure.[88] To a less extreme observer, the power to tax is a central instrument of economic and social policy,[89] and accordingly may need to be guarded against outside interference. Indeed, governments have often stressed the importance of tax matters for national sovereignty. For example, a UK Government spokesman recently identified taxation as one of the three pillars of national identity.[90]

The sensitive nature of taxation is reflected in the EC Treaty. The governments have been reluctant to transfer sovereignty in this area to the Community. This can be seen for example in Article 95(2) EC, which removes fiscal provisions from the sphere of internal market harmonization by qualified majority voting, thereby maintaining the national veto, while Article 58(1)(a) EC exempts from the free movement of capital those provisions of tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or the place where their capital is invested.[91] By inserting these provisions into the Treaty, the Member States have sought to grant their tax laws certain immunity from the demands of integration.[92]

However, the mere invocation of political sensitivity is not a very good reason. It is not a legal reason. In itself, it essentially amounts to an argument that one of the parties, the State, will be upset if it loses a case. Clearly a State

[87] See, eg, J Wouters, 'The case-law of the European Court of Justice on direct taxes: variations upon a theme' (1994) 1 MJ 179, 183.

[88] See P Bobbitt, *The Shield of Achilles: War, Peace and the Course of History* (Penguin, London, 2002) eg at 96 for a discussion of the relationship between the development of a modern state and the need to finance war.

[89] M Wathelet, 'The Influence of Free Movement of Persons, Services and Capital on National Direct Taxation: Trends in the Case Law of the Court of Justice' (2001) 20 YEL 1.

[90] K Guha, C Newman, and G Parker, 'Hain referendum slip puts Downing Street in a spin', *Financial Times* (London, 28 May 2003) 1. The other pillars were foreign and defence policy. See also KS Tikka, 'Tuloverosuvereniteetin kaventuminen lainsäätäjän haasteena' (2003) 101 Lakimies 1184 who calls parliaments' tax powers one of the cornerstones of democracy.

[91] It should also be noted that according to Declaration on Art 73d of the Treaty establishing the European Community Art 58(1)(a) EC applies 'only with respect to the relevant provisions which exist at the end of 1993' in the case of intra-Community capital movements and payments.

[92] The Court invariably recognizes that direct taxation falls within the competence of the Member States, but adds a rider that this competence must be exercised in accordance with Community law. See, eg, Case C-80/94 *Wielockx* [1995] ECR I-2493, para 16. However, it does the same in other fields. Already in *Cassis de Dijon* or Case 120/78 *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein* [1979] ECR 649, para 8 the Court accepted that in the absence of common rules it was for the Member States to regulate the production and marketing of alcohol, but continued that if disparities between national laws create an obstacle, the law must be disapplied unless a justification can be demonstrated.

should not escape normal legal scrutiny merely because of this; otherwise judicial supervision of matters such as treatment of refugees or minority groups could be called into question. Further, the Court is routinely forced to step into areas that are marked by political sensitivity, such as healthcare or immigration, and has not, as a general rule, shied away from the full application of Community law.[93]

Secondly, and perhaps more convincingly, it can be argued that regulation and taxation pursue fundamentally different objectives and are therefore legitimized in different ways.[94] Regulation is, or at least should be, largely about economic efficiency.[95] The aim is to create rules and other devices that effectively rectify market failures but do not go further than is necessary. Examples include various polluter-pays schemes to internalize the external costs of pollution and consumer protection laws dealing with information asymmetries between the producer and the consumer. Essentially, the legitimacy of efficiency-oriented policies is output-bound, it depends on their results, and here courts may have a role in holding the decision-makers to account. By contrast, tax rules are essential elements in redistribution. They are a part of a system of taxes and benefits which channels resources from one societal group to another. The legitimacy of redistributive policies does not depend on the outputs but on the inputs. Accordingly, the only way to confer legitimacy to redistributive policies is through majoritarian democratic means, and the role courts can play is limited.

Thirdly, extending obstacle-based jurisprudence to fiscal rules would encounter formidable practical problems. Under the principles developed for regulatory barriers to free movement of persons, services and capital, almost every element of national tax laws would prima facie seem to violate the EC Treaty.[96] Indeed, the mere fact that an activity or an economic operator is taxed in the first place seems 'liable' to make the activity 'less attractive' or to 'dissuade' economic operators. In the regulatory context the Court has sought

[93] In the context of healthcare, the Court stated in Case C-372/04 *Watts* [2006] ECR I-4325, para 121 that 'although Community law does not detract from the power of the Member States to organise their social security systems and decide the level of resources to be allocated to their operation, the achievement of the fundamental freedoms guaranteed by the Treaty nevertheless inevitably requires Member States to make adjustments to those systems. It does not follow that this undermines their sovereign powers in the field'. The same formula of words might well be used also in the fiscal context.

[94] This is an application of an argument advanced in G Majone, 'Europe's "democratic deficit": the question of standards' (1998) 4 ELJ 5, 28 and in G Majone, *Dilemmas of European Integration: The Ambiguities and Pitfalls of Integration by Stealth* (OUP, Oxford, 2005) in particular 189–91.

[95] It is an axiom of law and economics that legal rules should focus on efficiency and redistribution should be a matter for the system of taxes and benefits. See, eg, L Kaplow and S Shavell, 'Why the legal system is less efficient than the income tax in distributing income' (1994) 23 Journal of Legal Studies 667.

[96] See, however, I Roxan, 'Assuring real freedom of movement in EU direct taxation' (2000) 63 MLR 831 for an attempt to distinguish lawful 'disincentives to migration' from unlawful 'costs of migration'.

to rein in the concept by arguing that the impact of certain national rules on free movement is 'too uncertain and indirect' to amount to a restriction,[97] but this strategy seems ill suited for the tax context, as the dissuasive character of taxation is normally very clear and certain.[98] Further, the justification of prima facie violations would be difficult. Purely economic grounds, such as combating the loss of revenue and the erosion of the tax base do not constitute general interest grounds capable of saving national measures.[99] Yet, the primary reason for taxation is normally the raising of funds.[100] Accordingly, the extension of the general case law to the field of fiscal rules would logically lead to the disapplication of many if not most national tax laws, a result giving pause for thought.[101]

V. THE QUESTION OF DOUBLE TAXATION

For a long time, the biggest open question relating to the interplay between free movement rules and national direct tax laws concerned international double taxation.[102] The issue was whether the Court could and should examine the justification of national tax rules in circumstances where two or more Member States impose comparable taxes on the same taxpayer for the same subject-matter and period.[103] The Court has now answered the question in the groundbreaking judgment in *Kerckhaert*,[104] also clarifying its general

[97] See, eg, Case C-190/98 *Graf* [2000] ECR I-493, para 25.

[98] See also generally JC Moitinho de Almeida, 'Le droit fiscal national, la libre circulation des travailleurs, le droit d'établissement et la libre prestation de services' in M Dony and A De Walsche (eds), *Mélanges en Homage à Michel Waelbroeck: Volume II* (Bruylant, Brussels, 1999) 1347 and van Thiel (n 61) 305.

[99] As established, eg, in Case C-264/96 *ICI v Colmer* [1998] ECR I-4695 and Case C-168/01 *Bosal Holding* [2003] ECR I-9409. For discussion, see the Opinion of AG Poiares Maduro in Case C-347/04 *Rewe Zentralfinanz* nyr, paras 52–9 and J Snell, 'Economic aims as justification for restrictions on free movement' in A Schrauwen, *Rule of Reason: Rethinking another Classic of European Legal Doctrine* (Europa Law Publishing, Groningen, 2005) 37–47.

[100] As noted in W Schön, 'Der freie Warenverkehr, die Steuerhoheit der Mitgliedstaaten und der Systemgedanke im europäischen Steuerrecht—Teil II: Das Verbot diskriminierenden und protektionistischer Abgaben und das Problem der Belastung "exotischer" Waren' (2001) 36 EuR 341, 359, the same problem is not encountered with those taxes that are imposed on eg environmental or health grounds.

[101] A comparison can be made with the treatment of national price controls under Art 28 EC, where the Court showed leniency even prior to *Keck* (n 5). One reason may have been the difficulty of finding non-economic justifications. See J Snell, 'Free movement of pharmaceutical products: an overdose of cheap drugs?' (2003) 14 EBLR 507, 509–10.

[102] See Cordewener (n 22) 857–88 for an insightful discussion. See F Vanistendael, 'The ECJ at the crossroads: balancing tax sovereignty against the imperatives of the single market' [2006] European Taxation 413, 418–19 and Van Thiel (n 61) 310–15 for the view that double taxation contravenes the Treaty. Farmer and Zalasinski (n 80) argue at 403 that both Member States involved 'should bear collective and several responsibility' for eliminating double taxation.

[103] See on the difficulties facing the Court T Georgopoulos, 'Le rôle creatif du juge communautaire en matière de fiscalité directe' (2005) 41 RTD 61, 73–9.

[104] Case C-513/04 *Kerckhaert and Morris* [2006] ECR I-00000.

approach to fiscal barriers. While the reasoning of the Court is open to criticism, the result can also be defended.

Kerckhaert concerned a Belgian tax of 25 per cent imposed on all dividends, whatever their source. Mr and Mrs Kerckhaert-Morres, two residents of Belgium, had received dividends from a French company. The dividends had already been subject to a 15 per cent withholding levy in France. Now the Belgian tax was applied as well. Mr and Mrs Kerckhaert-Morres objected, arguing that the tax violated Article 56 EC on free movement of capital, as it did not provide for the possibility of setting off the French tax, with the result that the dividends from the French company were taxed twice, while dividends from a Belgian company would only have been subject to the single tax of 25 per cent.

The Grand Chamber of the Court followed Advocate General Geelhoed[105] and found that Article 56 EC had not been breached. The Court proceeded in three stages. First it distinguished cases such as *Manninen*,[106] where it had held that a Member State granting a tax benefit to domestic dividends had to grant the same advantage to foreign source dividends. The Court reasoned that in these cases the national law had made a distinction between national and foreign dividends, while the Belgian tax at issue in the present case treated all dividends in the same manner. Secondly, it dealt with the argument that this similar treatment of all dividends was discriminatory as the situation of the shareholders whose dividends had already been taxed was dissimilar to those whose dividends had not been taxed. The Court accepted that in principle the application of the same rule to different circumstances could amount to a prohibited discrimination, but then stated that

> in respect of the tax legislation of his State of residence, the position of a shareholder receiving dividends is not necessarily altered, in terms of [earlier] case-law, merely by the fact that he receives those dividends from a company established in another Member State, which, in exercising its fiscal sovereignty, makes those dividends subject to a deduction at source by way of income tax.[107]

Finally, it pointed out that any adverse consequences to the taxpayers were the result of the parallel exercise of fiscal sovereignty by two Member States. The Treaty envisaged that the negative effects of the coexistence of national tax systems be dealt with by conventions under Article 293 EC, but apart from some isolated measures such Community legislation had not been adopted. Consequently, the matter of apportioning fiscal sovereignty was left entirely to the Member States and the Court ruled that the Belgian tax did not violate Article 56 EC.

[105] To be more precise, AG Geelhoed had argued in paras 25–6 of his Opinion that the tax should stand as on the facts, taking into account the French imputation tax credit, there was no less favourable treatment. However, in his additional remarks in paras 27–36 he argued that in principle international double taxation was not contrary to the Treaty. The Court followed these additional remarks.

[106] *Manninen* (n 85).

[107] *Kerckhaert and Morris* (n 104) para 19.

The judgment in *Kerckhaert* is a clear statement of principle. International double taxation is not contrary to the Treaty free movement rules. A country can apply an even-handed tax to all income, regardless of the fact that the same income has already been taxed in another Member State. In this, the Court departs totally from its case law on double regulation, where in a consistent line of rulings stemming from the late 1970s, the Court has held that an attempt by a Member State to regulate subject-matter that has already complied with the rules of another Member State amounts to a restriction of free movement rights.[108] There is a widespread approval of this case law and it is considered that the single market could not become a reality without such a legal stance.[109] Yet, in the field of tax barriers a different approach now prevails.[110]

The Court also adopts a narrower view than the US case law. The US Supreme Court has interpreted the free movement rule of the US Constitution, the Dormant Commerce Clause,[111] as prohibiting cumulative tax burdens that would expose businesses active in interstate trade to a higher tax burden than those operating in a single state. This was established in the case of *Western Live Stock* where Justice Stone wrote for the Court that state taxes are invalidated when they place

> on the commerce burdens of such a nature as to be capable in point of substance, of being imposed . . . or added to . . . with equal right by every state which the commerce touches, merely because interstate commerce is being done, so that without the protection of commerce clause it would bear cumulative burdens not imposed on local commerce.[112]

He feared that the multiplication of state taxes burdening the same activity 'would spell the destruction of interstate commerce'.[113] This doctrine has survived the clearing up exercise that the Supreme Court undertook in *Complete Auto Transit*[114] to 'adopt a consistent and rational method of inquiry'.[115] In this case the Supreme Court set up a four-pronged test according to which a state tax is only valid if it is applied to an activity having a

[108] The best-known example is *Cassis de Dijon* (n 92). The same applies inter alia to social security contributions. See, eg, Joined Cases 62 and 63/81 *Seco* [1982] ECR 223.

[109] For discussion, see S Weatherill, 'Pre-emption, harmonisation and the distribution of competence to regulate the internal market' in C Barnard and J Scott, *The Law of the Single European Market* (Hart Publishing, Oxford, 2002) 42–51.

[110] The spokesman for Commissioner László Kovács is reported as saying that in *Kerckhaert* the Court fails to 'take into account the internal market issue' in V Houlder and G Parker, 'Investors hit as court backs Belgian double taxation' *Financial Times* (London, 15 Nov 2006) 8. The Commission has in its Communication on 'Co-ordinating Member States' direct tax systems in the Internal Market' (n 80) 8 promised that it will come forward with a general initiative designed to eliminate international double taxation within the EU.

[111] Art I, s 8.

[112] *Western Live Stock v Bureau of Revenue* 303 US 250 (1938) 255–6.

[113] ibid 256.

[114] *Complete Auto Transit, Inc v Brady* 430 US 274 (1977).

[115] *Mobil Oil Corporation v Commissioner of Taxes of Vermont* 445 US 425 (1980) 443.

substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to services provided by the state. The second prong, the requirement of fair apportionment, has in particular been used to tackle double taxation,[116] but sometimes cumulative tax burdens have also been viewed as discriminatory.[117]

The reasoning of the European Court of Justice in *Kerckhaert* is open to criticism. First, the distinction it drew between the present case and earlier decisions is not entirely convincing. It can be argued that the rulings the Court cites, and also for example the decision of the Grand Chamber in *Marks & Spencer*,[118] require that a Member State recognize the tax system of another Member State, something that *Kerckhaert* emphatically denies.

Marks & Spencer concerned British rules that stopped the plaintiff from deducting the losses incurred by its Belgian, French, and German subsidiaries from its UK profits. Under the national system of group relief such a deduction would have been possible had the subsidiaries been resident in the UK. However, since the profits of foreign subsidiaries were not subject to UK taxation, their losses were not taken into account either. The Court held, following Advocate General Poiares Maduro, that the rules did restrict freedom of establishment but could benefit from a justification. However, the denial of deduction in circumstances where it was impossible to have the losses taken into account in the subsidiaries' State of residence was disproportionate.[119] In essence, the Court required the home State to consider the deductions available in the host State when deciding whether to accept a deduction under the domestic law.[120] Logically, there is no giant leap from this to requiring one State to consider the taxation in another State when deciding on the imposition of a tax under the domestic law. Additionally, the Court has in a number of cases, most notably in the Grand Chamber ruling in *Manninen*,[121] held that a country granting shareholders receiving dividends a tax credit which corresponds to the national corporate tax paid on the profits must extend that tax credit to dividends received from abroad. In effect, this entails the mutual

[116] See, eg, W Hellerstein, 'State Taxation and the Supreme Court' [1989]. The Supreme Court Rev 223, 234 and LH Tribe, *American Constitutional Law, Vol 1* (3rd edn, Foundation Press, New York, 2000) 1132–3.

[117] See, eg, *American Trucking Associations, Inc v Scheiner* 483 US 266 (1987).

[118] *Marks & Spencer* (n 85). For criticism, see AG Geelhoed in *ACT Group Litigation* (n 49) para 65. His Opinion was followed by the Grand Chamber of the Court. For annotation, see A Cordewener and I Dörr, 'Casenote on *Marks & Spencer*' (2006) 43 CMLRev 855.

[119] Conversely, in Case C-403/03 *Schempp* [2005] ECR I-6421 the Court upheld a German rule which made the availability of a deduction dependant on taxability, whether in Germany *or* in another Member State.

[120] The same issue, but from the perspective of the host State, arises in *Schumacker* (n 62) , where the host State needs to take into account the non-availability of personal allowances in the home State. See generally van Thiel (n 61) 300–2.

[121] *Manninen* (n 85). Conversely, the interaction between two national systems, as organized by double taxation treaties, could conceivably rescue a national tax rule that in isolation looked restrictive. See, eg, AG Geelhoed in Case C-170/05 *Denkavit International and Denkavit France* [2006] ECR I-0000, para 44.

recognition of a foreign tax for the purpose of granting a tax credit.[122] It is not clear from the reasoning of the Court why, as a matter of policy,[123] mutual recognition applies when a Member State grants a tax advantage but does not apply when it imposes a tax.

The second criticism of the Court's reasoning in *Kerckhaert* concerns the treatment of the concept of discrimination.[124] It was argued that it is discriminatory to impose the same tax both on income that has not been taxed and on income that has already been subject to a withholding levy. The argument was entirely credible, as the Court has repeatedly held that the application of the same rule to different situations can be discriminatory.[125] The imposition of double taxation obviously has a disparate impact to the detriment of cross-border situations, and was condemned as discriminatory by the European Court of Justice in the context of the common system of VAT in *Gaston Schul*[126] and by the US Supreme Court in the context of the Dormant Commerce Clause.[127] It may be said that there is a sin of omission, namely a failure by one State to take into account the distinct situation of a product or person that is also subject to a tax in another Member State.[128] Yet in its reasoning the Court simply asserts that the position of the shareholder is not necessarily altered in the meaning of its earlier case law by the fact that the income has already been taxed in another Member State. This is an entirely inadequate response. In fact, it does not deserve to be called reasoning at all, as the Court does not offer any reasons, but simply lays down a conclusion without explaining how it is arrived at.

[122] See also the discussion in Vanistendael (n 85) 217–22. It should be noted that *Manninen* concerned the obligations of the home State and according to *ACT Group Litigation* (n 49) the same does not apply to the source State.

[123] On a formal level *Kerkhaert* does differ from the previous judgments. The UK system in *Marks & Spencer* that provided group relief in the case of resident subsidiaries but denied it if the subsidiaries were established in other Member States could easily be characterized as a restriction, just like the Finnish system in *Manninen* where a tax credit was granted if the dividends originated in Finland, but not if they originated in Sweden. There was a difference in treatment depending on whether the situation was internal or cross-border. By contrast, in the case of multiple taxation, the State treats both internal and cross-border situations in the same way.

[124] On the various meanings that can be attached to the notion of discrimination, and the 'labyrinth of impossibility' that an overly broad concept can create, see Graetz and Warren (n 57) 1215–23, and more generally G Davies, *Nationality Discrimination in the European Internal Market* (Kluwer Law International, The Hague, 2003). See also S Douma, 'The three Ds of direct tax jurisdiction: disparity, discrimination and double taxation' (2006) 46 Eur Taxation 522, 532–3 on the concepts of dislocation and discrimination.

[125] Case 13/63 *Commission v Italy* [1963] ECR 165 and *Schumacker* (n 62) para 30. Further, Art 58(1)(a) EC seems to depart from the premise that the place where capital is invested may render otherwise identical situations different.

[126] Case 15/81 *Gaston Schul* [1982] ECR 1409.

[127] See *American Trucking Associations, Inc v Scheiner* (n 117).

[128] Because of this, any distinction between (unlawful) discrimination caused by a single jurisdiction and (lawful) difficulties arising out of the existence of different legal system may be logically difficult to maintain. It can be argued that a State is at fault for failing to consider the effects of the rules of another State.

Thirdly, the statements that any adverse consequences for the plaintiffs arise from the parallel exercise of fiscal sovereignty by two States and that in the absence of Community measures its apportionment is purely a matter for the Member States are highly significant expressions of principle that will undoubtedly influence the future direction of case law. However, they are not entirely free of doubt,[129] and once again the Court's reasoning is not as full as might be hoped for, given that Article 293 EC does not necessitate such a conclusion; in other areas of Community law the Court has allocated regulatory powers on the basis of free movement rules, and the US Supreme Court has managed the task in tax context without overstepping the judicial role.

The EC Treaty recognizes the problem of double taxation in Article 293 EC, which provides that Member States are to enter into negotiations with each other, to the extent necessary, to abolish double taxation within the Community. Although at first sight this could be interpreted, *a contrario*, as indicating that the Treaty has not solved the problem of double taxation and additional conventions are needed to deal with the issue, this interpretation is not necessary. Already in *Reyners*[130] in 1974 the Court held that the failure by the Community political institutions to agree on directives envisaged in the Chapter of the EC Treaty on the right of establishment did not deprive Article 43 EC of its effect. Rather, the directives could serve to facilitate the exercise of the right of establishment, but the right itself arose directly from the EC Treaty. This reasoning was transposed to Article 293 EC in *Überseering*.[131] The case concerned the retention of the legal personality of a company following the transfer of its seat, another topic on which Article 293 EC envisages negotiations. The Full Court expressly rejected the argument, advanced by three governments, that in the absence of a multilateral convention under Article 293 EC the freedom of establishment did not cover the issue, and held that 'although the conventions which may be entered into pursuant to Article 293 EC may . . . facilitate the attainment of freedom of establishment, the exercise of that freedom can none the less not be dependent upon the adoption of such conventions.'[132] Accordingly, the Court held that the denial of legal capacity for a company moving its actual centre of administration to Germany in the absence of domestic reincorporation, which was a consequence of the real seat doctrine of German company law, ran counter to Community rules on the right of establishment. For double taxation this means that Article 293 EC

[129] See PJ Wattel, 'Corporate tax jurisdiction in the EU with respect to branches and subsidiaries; dislocation distinguished from discrimination and disparity; a plea for territoriality' [2003] EC Tax Rev 194, 199 for an argument that double taxation cannot be policed under free movement rules as it is impossible to determine which country has the responsibility to end the practice. Contra J Englisch, 'The European Treaties' implications for direct taxes' (2005) 33 Intertax 310, 324–5 who argues that the Court should allocate tax powers in accordance with general principles of international tax law, which the Court could discover by analysing bilateral tax conventions.

[130] Case 2/74 *Reyners* [1974] ECR 631.

[131] Case C-208/00 *Überseering* [2002] ECR I-9919.

[132] ibid para 55.

cannot automatically exclude the issue from the scope of free movement rules. Indeed, the Full Court in *Gilly* drew from Article 293 EC the conclusion that the abolition of double taxation is included within the objectives of the Treaty.[133]

Further, the Court has not been reticent in allocating regulatory competences in its general free movement law to avoid double regulatory burden. It is possible to argue that cases such as *Keck*,[134] *Groenveld*,[135] and *Alpine Investments*[136] serve to confer the power to regulate a product and its production to the home State, while the competence to regulate market circumstances has been given to the host State.[137] Allocation of tax competences would be politically more contentious, but not a fundamentally different exercise.[138]

Finally, the European Court of Justice could have drawn lessons from the case law of the US Supreme Court, which insists that each state tax only that portion of revenues from interstate activity that reasonably reflects the in-state component of the activity. The Supreme Court has not imposed any specific apportionment formula on the states, giving them a margin of discretion, but if the income attributed by a state to itself is out of all proportion with the business transacted in that state or if the attribution leads to a grossly distorted result, the tax will be struck down.[139] The approach does not ensure the abolition of all double taxation. Sometimes the application of fair but different formulas by the states involved may result in multiple taxation, but at least the spectre of unfettered double taxation has been avoided without the Supreme Court overstepping the judicial role.[140] In the Community the same might have been achieved through recourse to the overriding requirement of 'the preservation of the allocation of the power to impose taxes between Member States', which allows Member States to maintain measures that cause some disadvantage, provided that the aim is to allocate tax powers in a balanced manner and the means employed are proportionate.[141]

[133] *Gilly* (n 75) para 16.

[134] *Keck* (n 5).

[135] *Groenveld* (n 6).

[136] *Alpine Investments* (n 2).

[137] See N Bernard, 'La libre circulation des merchandises, des personnes et des services dans la Traité CE sous l'angle de la compétence' (1998) 34 CDE 11, 33–5, and J Snell and M Andenas, 'Exploring the outer limits: restrictions on the free movement of goods and services' (1999) 10 EBLR 252, 264–7.

[138] Terra and Wattel (n 69) 62–3 and 80–3 propose holding both the home and the host State responsible and requiring both countries to apply worldwide taxation. However, as they note, this would run counter to a number of previous judgments.

[139] Tribe (n 116) 1136.

[140] See *Moorman Manufacturing Co v Bair* 437 US 267 (1978) 277–81. However, the ECJ has always held in the European context that restrictions are prohibited even if of limited scope or minor importance. See, eg, Case C-9/02 *De Lasteyrie du Saillant* [2004] ECR I-2409, para 43. But see *FII Group Litigation* (n 80) para 53 where the Court accepted the imposition of additional administrative burdens in the case of foreign-sourced dividends, as they 'are an intrinsic part of the operation of a tax credit system' and also para 56 of the same judgment where the referring national court was tasked to investigate the frequency of discrimination.

[141] See in particular *Marks & Spencer* (n 85), Case C-470/04 *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo* [2006] ECR I-0000, and AG Kokott in Case C-231/05 *Oy AA* nyr, paras 46–71.

Despite the criticism of the European Court's reasoning expressed above, the judgment in *Kerckhaert* can also be defended, for two reasons that the Court did not mention. First, the ruling achieves coherence with the case law on Article 90 EC, where double taxation has been accepted.[142] The leading case is *Larsen and Kjerulff*,[143] which concerned a challenge by two Danish goldsmiths to a charge introduced by Denmark to cover supervisory costs. The Court found that the charge was a part of a system of internal taxation in the sense of Article 90 EC. The question then arose as to whether the charge was discriminatory, given that it was also imposed on products intended for export and given that the country of destination could also levy similar charges. The Court stated that the EC Treaty

> contains no provision prohibiting the effect of double taxation of this type . . . Although the abolition of such effects is doubtless desirable in the interests of the freedom of movement of goods, it can however only result from the harmonization of national systems.[144]

The case of *Scharbatke* extended the same line to a situation where the charge was imposed by the importing country,[145] and the approach has been confirmed in more recent decisions.[146]

Secondly, and more importantly, the logic of mutual recognition in *Cassis de Dijon*[147] and other cases dealing with regulatory double burden cannot be fully applied to double taxation. In the *Cassis* line of cases one State is prevented from applying its rules provided that the interest it seeks to protect is already fully safeguarded by another State. For example, importing country A may not apply its product requirements to protect public health because the rules of exporting country B have already ensured that the product does not represent a health risk. In the fiscal field the interest is revenue collection. The collection of revenue by one State in no way protects the revenue interest of another. The collection of taxes by country B does not benefit the Treasury of country A.[148]

The ruling in *Kerckhaert* does not look to be an isolated example of

[142] A close reading also reveals that the reference in *Mobistar* (n 41) para 34 to 'cumulative effect of *the* local taxes' (emphasis added) is to the overall impact of the Belgian local taxes in issue, not to the impact of local and foreign taxes.

[143] Case 142/77 *Larsen and Kjerulff* [1978] ECR 1543.

[144] ibid paras 33–4. As far as the *harmonized* common system of VAT system is concerned, double taxation may be policed under Art 90 EC. See *Gaston Schul* (n 126).

[145] Case C-72/92 *Scharbatke* [1993] ECR I-5509, para 15.

[146] Case C-234/99 *Nygård* [2002] ECR I-3657, para 38. See also AG Jacobs in Case C-213/96 *Outokumpu* [1998] ECR I-1777, paras 44–5 and AG Stix-Hackl in Case C-517/04 *Koornstra* [2006] ECR I-5015, para 50.

[147] *Cassis de Dijon* (n 92).

[148] See Cordewener (n 22) 847. Of course it could be argued that purely economic interests can never override free movement rights, as established in the case law of the Court cited at (n 99), but this formal legal argument does not undermine the contention that there is a significant difference between double regulatory and tax burdens.

unusual leniency. In *ACT Group Litigation*[149] the Grand Chamber of the Court, following Advocate General Geelhoed, has now decided that a source Member State granting relief for economic double taxation in case of profits distributed to residents does not have to extend the same relief for shareholders in other Member States. In other words, the home State is free to impose a second tax regardless of what the source State has done, and the source State is not obliged to provide relief in cross-border situations, even if it does grant such relief internally.[150]

The result of *Kerckhaert* is that the biggest open question relating to the application of free movement rules to direct taxes has been answered: international double taxation is not contrary to the Treaty. Member States may exercise their fiscal sovereignty in parallel, and its apportionment is a matter for them. The answer is totally different from the one the Court gave in the context of double regulation almost 30 years ago. Once again the Court is prepared to accommodate Member States in the field of taxation.

VI. CONCLUSION

In summary, the Court has generally adopted a more cautious approach towards fiscal than regulatory obstacles. In the field of goods, it has not sought to extend the reach of Article 90 EC and has in practice refrained in *De Danske Bilimportører*[151] from using Article 28 EC to police national tax levels. It has now adopted a similar approach in an analogous services case, *Mobistar*,[152] only examining whether the local taxes discriminated against operators or services from other Member States. However, it has to be noted that the language of the ruling in *Sandoz*[153] strays from this line, describing the mere imposition of a stamp duty on loans as a restriction on free movement of capital. The Court has shown similar caution in the field of direct taxation. It has begun to use the language of obstacles and restrictions, albeit a few years later than for regulatory barriers, but has not in actual practice applied the full force of the *Gebhard* formula[154] in this field. It may accept different tax treatment of residents and non-residents, has proven receptive

[149] *ACT Group Litigation* (n 49).

[150] Formally the ruling is in line with *Manninen* (n 85) which involved the obligations of a home State, while *ACT Group Litigation* concerned a source State. However, the Court's basic approach appears rather different and the way the cases are distinguished is not particularly convincing. The statement in para 59 that if the source State had to extend the relief to non-residents, it would be obliged to abandon its right to tax profits generated in its territory, can be countered with the observation that the State would be free to adopt a neutral method by, for example, not granting relief to anyone. Further, the same line of reasoning, *mutatis mutandis*, could have been adopted in *Manninen*, but the Court declined to do so. Finally, it is not clear what the relevance of the ability to pay argument in para 60 is in the present context.

[151] *De Danske Bilimportører* (n 23).

[152] *Mobistar* (n 41).

[153] *Sandoz* (n 33).

[154] *Gebhard* (n 1).

to arguments about territoriality and reciprocity that it has generally rejected in the regulatory context, and accepts even the use of a nationality criterion when tax powers are allocated. Unfortunately the by-product of this case law has been legal uncertainty and lack of predictability.[155] The reasons for the caution are unclear, but may have to do with the political sensitivity of tax issues, with the different objectives of regulation and taxation, namely efficiency and redistribution, and with the practical difficulties inherent in the use of the obstacle approach in the fiscal context. The biggest open question has related to double taxation. In contrast to double regulation under free movement rules, double taxation has not been policed outside of harmonized areas under Article 90 EC. In the recent judgment in *Kerckhaert*[156] double taxation has now been accepted also in the case of direct taxes, albeit with somewhat unsatisfactory reasoning. This represents a decisive break between fiscal and regulatory fields, but can be defended due to the inapplicability of the logic of mutual recognition in the tax context.

It can be argued that the somewhat uncertain approach of the Court reflects a more fundamental ambiguity relating to the very nature of the single market. This ambiguity can be illustrated with reference to one possible interpretation of the concepts of common and internal market.[157] The original Treaty of Rome employed the term common market, which entailed the abolition of barriers to free movement as well as the elimination of distortions of competition. It can be argued that the fundamental aim was a marketplace where there were no barriers to movement of products and factors of production, and where there was a level playing-field in the sense that conditions of competition had not been rendered unequal by human actions. By contrast, the Single European Act invoked the concept of the internal market which was centred on the abolition of barriers and did not involve the elimination of distortions, with the result that the two different concepts now coexist in the EC Treaty.

[155] The US Supreme Court has similarly encountered problems when applying the Dormant Commerce Clause to state taxation, describing the case law as a 'quagmire' in *Northwestern States Portland Cement Co v State of Minnesota* 358 US 450 (1959) 458. More recently, W Hellerstein, MJ McIntyre, and RD Pomp, 'Commerce Clause restraints on state taxation after *Jefferson Lines*' (1995–6) 51 Tax L Rev 47, 50, write that the 'analysis of state taxes under the dormant Commerce Clause' has been 'historically unstable', JH Choper and T Yin, 'State taxation and the Dormant Commerce Clause: the object—measure approach' [1998] The Supreme Court Rev 193, 205, argue that the current '*Complete Auto* test has evolved into a collection of disparate requirements, some redundant, some toothless, others rather opaque', and Justice Scalia (concurring) in *American Trucking Associations, Inc v Michigan Public Service Commission* 545 US 429 (2005) refers scathingly to 'various tests from our wardrobe of ever-changing negative Commerce Clause fashions'.

[156] *Kerckhaert* (n 104).

[157] The discussion here draws from PJG Kapteyn and P VerLoren van Themaat, *Introduction to the Law of the European Communities* (3rd edn, Kluwer, London, 1998) 123. See also LW Gormley, 'Competition and free movement: is the internal market the same as a common market' (2002) 13 EBLR 517, 517–18.

The view adopted on the nature of the single market matters, in particular given the open-ended language of the free movement provisions of the EC Treaty, which leave room for very different interpretations. If the aim is the common market, a patchwork of highly dissimilar national tax regimes is difficult to tolerate. Not only may the different national systems erect barriers to free movement, but they also negate the level playing-field that is promised. Companies and individuals will make financial decisions on the basis of legal benefits, rather than on the ground of 'real' economic factors. Consequently, it is natural to adopt a highly sceptical approach to national laws in the application of the free movement rules. By contrast, the internal market is more favourably disposed towards differing national rules. As long as they do not constitute barriers, in particular by imposing a heavier burden on a foreigner than a national or on a cross-border situation than a purely internal one, they should be tolerated, not least because competition between different national regimes may bring about more advantageous results than a harmonized system.[158] Accordingly, the Court should be more restrained in its application of free movement rules, in particular if the impact of a national law seems to be an inevitable consequence of the coexistence of distinct national systems.

As long as this fundamental ambiguity about the nature of the single market persists at the very heart of European economic law, the Court will struggle to achieve coherence in its case law. At the moment some of its decisions on national regulatory barriers to movement of persons, services, and capital seem to go further than the internal market would require,[159] in particular when they question even-handed but burdensome national rules. By contrast, the case law on tax barriers, just like the general law on free movement of goods, has so far steered away from such an approach, has focused on the question of discrimination, and has accepted that differing national tax systems will persist.

The case law has wider implications for the Member States. Despite the comparatively restrained approach adopted by the Court, considerable legal uncertainty has been created and the Member States have lost the vast majority of the cases in the field of direct taxation, sometimes with potentially significant budgetary consequences,[160] although the tide seems to have

[158] CM Tiebout, 'A pure theory of local expenditures' (1956) 64 Journal of Political Economy 416. For recent European discussion in the tax context, see, eg, WW Bratton and JA McCahery, 'Tax coordination and tax competition in the European Union: evaluating the Code of Conduct on Business Taxation' (2001) 38 CMLRev 677, in particular at 690–702 and W Schön, 'Playing different games? Regulatory competition in tax and company law compared' (2005) 42 CMLRev 331. See also M Kumm, 'Constitutionalising subsidiarity in integrated markets: the case of tobacco regulation in the European Union' (2006) 12 ELJ 503, 508–18.

[159] See J Snell, 'Who's got the power? Free movement and allocation of competences in EC law' (2003) 22 YEL 323, 325–37 and Spaventa (n 7) 764–6. See also T Kingreene, 'Fundamental freedoms' in A von Bogdandy and J Bast (eds), *Principles of European Constitutional Law* (Hart Publishing, Oxford, 2006) 570–2.

[160] The Court is aware of this. See V Skouris, 'Fundamental rights and fundamental freedoms:

turned.[161] This raises the question of whether resistance to qualified majority voting on all tax matters is a sensible approach.[162] As long as the unanimity requirement persists, the Community legislative process risks deadlock, sometimes over totally unrelated issues.[163] This was seen for example in the context of the savings tax package, where Italy for a time blocked a deal over an entirely unrelated issue of milk quota fines.[164] Further, although the unanimity rule preserves the national veto over the political process, there is no veto over the judgments of the Court. This means that the Member State tax policies are not coordinated by comprehensive legislative measures, but instead through a more haphazard judicial process. This has clear drawbacks. The European Court of Justice is not a specialist tax court, and may lack expertise, depending on the judges appointed to the bench at a particular time and sitting in a particular case.[165] The Court may not hear all parties that its decisions have an impact on or receive all the relevant information for an optimal ruling. The Court cannot set its priorities but has to decide whatever cases and issues litigants and national courts bring to it. To quote Advocate General Geelhoed, 'judicial intervention is, by its nature, casuistic and fragmented. As a result, the Court should be cautious in giving answers to questions . . . raising issues of a systematic nature. The legislator is better placed to deal with such questions'.[166] Accordingly, it has to be asked whether it would not be preferable to opt for qualified majority voting or, as a second best but more realistic option, activate the rules on enhanced cooperation in

the challenge of striking a delicate balance' (2006) 17 EBLR 225, 229. For example, in Case C-292/04 *Meilicke, Weyde, and Stöffler v Finanzamt Bonn-Innenstadt* nyr, the German Government argued that the result of the case could be a shortfall in tax revenue amounting to €5 billion. In their respective Opinions, AG Tizzano and AG Stix-Hackl adopted different views on the limitation of the temporal effects of the ruling. See generally on the temporal effects of judgments and budgetary consequences H Vording and A Lubbers, 'The ECJ, retrospectivity and the Member States' tax revenues' [2006] British Tax Rev 91.

[161] See in particular the recent rulings in *Kerckhaert* (n 104) and *ACT Group Litigation* (n 49), and also the nuanced result in *FII Group Litigation* (n 80), all of which were decided by the Grand Chamber and to a very large extent follow the Opinions of AG Geelhoed. See also Vanistendael (n 102) 413 and 417.

[162] See also F Vanistendael, 'Memorandum on the taxing powers of the European Union' [2002] EC Tax Rev 120, in particular 121–2 and 126–7.

[163] However, there is the possibility of resorting to 'enhanced cooperation' between some, but not all, Member States. In the tax context, see, eg, Commission Communication, 'Towards an Internal Market without tax obstacles' COM(2001) 582 final, 17.

[164] See F Guerrera and K Guha, 'Milk dispute sours EU savings tax deal', *Financial Times* (London, 22 Mar 2003) 9.

[165] See PJ Wattel, 'Red herrings in direct tax cases before the ECJ' (2004) 31 LIEI 81, 82. See ibid and PJ Wattel, '*Köbler*, *CILFIT* and *Welthgrove*: we can't go on meeting like this' (2004) 41 CMLRev 177, 179 and 184–5 for fierce criticism of some of the Court's rulings. See also M O'Brien, 'Company taxation, state aid and fundamental freedoms: is the next step enhanced co-operation?' (2005) 30 ELRev 209, 217, and more generally on the difficulties the Court is facing as a result of the wide variety of technical areas of law it needs to come to grips with J Snell, 'European courts and intellectual property: a tale of Hercules, Zeus, and Cyclops' (2004) 29 ELRev 178, 183–6.

[166] *ACT Group Litigation* (n 49) para 39.

respect of those areas of fiscal law where the coordination of national rules is essential for the operation of the single market,[167] thereby transferring some of the issues from the Community judicial process to the political one.[168]

[167] The Commission has put forward ambitious ideas on home State taxation and common tax base. See, eg, Commission Communication, 'Tackling the corporation tax obstacles of small and medium-sized enterprises in the Internal Market—outline of a possible Home State Taxation pilot scheme' COM(2005) 702 final and Commission Communication, 'Implementing the Community Lisbon Programme: Progress to date and next steps towards a Common Consolidated Corporate Tax Base (CCCTB)' COM(2006) 157 final. See also the discussion of various coordination initiatives in Commission Communication on 'Co-ordinating Member States' direct tax systems in the Internal Market' (n 80). Contrast however on the common tax base C McCreevy, 'Tax harmonisation—no thanks' Speech/05/679, where the European Commissioner for Internal Market and Services declares himself opposed to tax harmonization 'through the back door'.

[168] For a strong criticism of the US Supreme Court's case law on state taxation and the Commerce Clause see EA Zelinsky, 'Restoring politics to the Commerce Clause: the case for abandoning the dormant Commerce Clause prohibition on discriminatory taxation' (2002) 29 Ohio Northern U L Rev 29, where the author argues for shifting tax controversies from the courts to Congress.