The sources of EU law and their relationships: Lessons for the field of taxation
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Chapter 8

Primary law and secondary law in the field of taxation

8.1. Introduction

When examining the interaction between primary and secondary law in the field of taxation the same ‘big questions’ arise as the ones we have set out from in Chapter 7: While dogmatically and theoretically primary law prevails over secondary law in the Union’s legal order, is the Court willing and if so, to what extent, to enforce this hierarchical superiority of primary law? While the Court’s deference towards the Union legislature is a rational reflection of the peculiarities of supranational lawmaking in a multilevel constitutional and legal system, does it not, in fact, lead to a renunciation of effective constitutional control over Union legislation? These ‘big questions’ boil down to similar technical inquiries to those in the non-tax field: What techniques does the Court apply to avoid addressing conflicts between primary and secondary law? How do these techniques work to the effect of maintaining the validity of secondary law? Where are the limits of these techniques? When answering these questions we need to take into account certain characteristics specific to the field of taxation under EU law.

In the area of taxation, the role of primary law and that of secondary law depends on whether one looks at direct taxes or indirect taxes. It is common ground that the Member States’ direct tax systems are scarcely harmonized. There are just a handful of Union measures adopted in this field which bring about harmonization of certain specific, isolated and rather narrowly defined issues of direct taxation. Specifically, the acts of secondary Union law which concern direct taxes are the Parent – Subsidiary Directive,933 the

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Merger Directive,\textsuperscript{934} the Interest and Royalties Directive\textsuperscript{935} and the Savings Directive.\textsuperscript{936} All of these are based on – in the absence of a specific provision which would enable the harmonization of direct taxes and due to the exclusion from the scope of Article 114 of fiscal provisions – Article 115 TFEU. The latter is a general legal basis provision, which allows harmonization of those laws and regulations of the Member States which directly affect the establishment or functioning of the internal market. As discussed above, this legal basis provision prescribes a special legislative procedure that requires unanimity in the Council for the adoption of legal acts, it confers only a consultative role on the European Parliament and allows the adoption of one form of legal acts only, namely, directives (see Section 5.2.). The unanimity requirement is precisely the reason why only four acts have been adopted on direct taxes in the history of European integration. Conversely, indirect taxes, such as turnover taxes, excise and customs duties, are extensively harmonized under EU law despite the fact that the specific legal basis provision – Article 113 TFEU – which authorizes their harmonization requires unanimous voting in the Council just as Article 115. The most important pieces of secondary Union law concerning indirect taxes are the VAT Directive,\textsuperscript{937} the Horizontal Directive on excise duty,\textsuperscript{938} the Modernized Customs Code\textsuperscript{939} and the Capital Duty Directive.\textsuperscript{940} Finally, secondary law also exists on administrative cooperation in the assessment and recovery of taxes.\textsuperscript{941}

\textsuperscript{934} Original directive: Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States; codified: Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States (codified version).

\textsuperscript{935} Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.


The conspicuous difference between the degree of harmonization of direct and indirect taxes indicates the different roles that positive and negative integration have played in these two areas of taxation. Positive integration – meaning primarily harmonization through the enactment of Union legislation – has been successful only in the approximation (or sometimes even unification) of the indirect tax regimes of the Member States. In contrast, positive integration achieved very little in aligning the direct tax systems of the Member States. Apart from the four directives mentioned above, the Member States have resisted, in defence of their national sovereignty, the adoption of harmonization measures on direct taxes. At the same time, the differing direct tax systems of the Member States do entail serious obstacles to the internal market including discriminatory or restrictive direct tax provisions hindering intra-Union trade, investment and business, and selective tax advantages which distort the conditions of competition as well as disparities between the direct tax systems that can burden cross-border activities and distort competition. These obstacles required answers from EU law and articulated a need for an alternative to positive integration. Such alternative was presented by negative integration in which the Court has taken the leading role by interpreting the Treaty freedoms with a view to abolishing restrictive national direct tax provisions which are incompatible with those freedoms. In addition, the application of the Treaty’s State aid rules by the Commission, and ultimately by the Union Courts, also belongs to the sphere of negative integration as it leads to the elimination from the Member States’ direct tax systems of selective aids thereby contributing to the approximation of such systems. The process is called negative integration because it is based on the prohibitions embodied in the free movement provisions and Article 107 TFEU, and because it is predominantly destructive in nature insofar as it results in the setting aside of incompatible national direct tax provisions without replacing them with any positive rule.\textsuperscript{942}

Another route to European tax integration is the coordination of the tax systems of the Member States unilaterally or in cooperation with each other either voluntarily or following soft law initiatives issued by the Union institutions for this purpose. Coordination is normally considered a form of positive integration besides harmonization.\textsuperscript{943}


\textsuperscript{943} P. Pistone, \textit{Legal pluralism and international taxation in the European Union}, in: Traditional and Alternative Routes to European Tax Integration (D. Weber ed., IBFD 2010), pp. 97-114, at p. 98. Pistone considers that coordination may be realized through both binding and non-binding legal instruments, an example of the former is the conclusion of multilateral tax treaties by the Member States and the latter is the issuance of soft law by the Union institutions.
The weight of the Treaty freedoms in the area of indirect taxation is much less than in direct taxation. There is a large body of secondary legislation existing in relation to indirect taxes and the TFEU also contains some specific provisions dealing with them, such as the provisions on the customs union (Articles 28-32) and the prohibition of discriminatory internal taxation (Article 110 TFEU) besides the already mentioned legal basis provision (Article 113). Therefore in the overwhelming majority of cases there is no need to have recourse to the fundamental freedoms. The situation is opposite in the field of direct taxation where the fundamental freedoms constitute the most powerful tool in driving European tax integration. As a consequence, the character of the CJ’s case law on indirect taxes and on direct taxes differs to a great extent. Wattel describes the indirect tax case law as being real ‘tax law’ in that it concerns the interpretation and application of detailed technical rules set out in the Union directives for the purpose of answering the question whether similarly detailed and technical implementing national rules correctly transpose the former into the laws of the Member States. On the other hand, the direct tax case law of the CJ hardly deals with implementation questions of those few directives that exist on direct taxes; instead, it concerns the question whether national tax provisions comply with the prerogatives of the highly general Treaty freedoms. In the words of Wattel, the direct tax case law is much more ‘EU law’ than ‘tax law’. It is rather chaotic EU law, however, due to the difficulties inherent to the task of applying abstract principle-like norms, such as the freedoms, to detailed technical tax legislation in order to test the compatibility of the latter with the requirements of the internal market.

Positive integration based on harmonizing secondary legislation and negative integration based on the primary law provisions prohibiting restrictions on the fundamental freedoms, on the one hand, and State aid, on the other, serve the same ultimate purpose, that is, attaining an internal market where products, services, workers, companies, investors and capital move freely without regard to their origin or nationality and compete with one another under equal market conditions.

That the fundamental freedoms and the State aid rules pursue the same fundamental objective, i.e. a level playing field for all products and producers in the form of an internal market, has been long settled case law. The Court spelled this out with regard to the free movement of goods:

944. Terra and Wattel, supra note 942, p. 55.
945. Ibid. pp. 36-37.
946. Ibid.
“[...] rules [on the free movement of goods] and the Treaty provisions relating to State aid have a common purpose, namely to ensure the free movement of goods between Member States under normal conditions of competition. [...]”947

The fact that the internal market is the ultimate purpose of the harmonization of the tax legislation of the Member States is apparent from the legal basis provisions on which such harmonization is based. Article 113 TFEU permits the harmonization of indirect taxes to the extent that it is “necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition”.948 The instruments of secondary legislation adopted on the basis of this provision reaffirm that their underlying objective is the promotion of the internal market. For example, the Preamble to the VAT Directive states that:

“The attainment of the objective of establishing an internal market presupposes the application in Member States of legislation on turnover taxes that does not distort conditions of competition or hinder the free movement of goods and services. It is therefore necessary to achieve such harmonisation of legislation on turnover taxes by means of a system of value added tax (VAT), such as will eliminate, as far as possible, factors which may distort conditions of competition, whether at national or Community level”949

Similarly, the Horizontal Directive on excise duty states that it harmonizes the levying of excise duty within the Union in the interest of the internal market:

“Conditions for charging excise duty on the goods covered by Directive 92/12/EEC, hereinafter ‘excise goods’, need to remain harmonised in order to ensure the proper functioning of the internal market”950

Article 115 TFEU also refers to the fundamental objective of the internal market when it authorizes the “approximation of such laws, regulations and administrative provisions of the Member States as directly affect the establishment or functioning of the internal market”. The direct tax directives

947. ECI, 20 March 1990, Case C-21/88 Du Pont de Nemours Italiana SpA v Unità sanitaria locale N°2 di Carrara, para. 20. See also ECI, 7 May 1985, Case 18/84 Commission v France, para. 13; GC, 9 September 2010, Case T-359/04 British Aggregates Association and Others v Commission, para. 91.
948. The reference to the avoidance of distortion of competition was added by the Lisbon Treaty. As Terra points out, the relevance of this addition may not be too great given that the reference to the functioning of the internal market must have already implied that harmonization aimed at avoiding distortion of competition is within the scope of the provision, see B. Terra, Value Added Tax and State Aid Law in the EU, 40 INTERTAX 2 (2012), pp. 101-111, at p. 101, FN 1.
949. Preamble to the VAT Directive, fourth recital.
950. Preamble to the Horizontal Directive on excise duty, second recital.
enacted on the basis of Article 115 TFEU all explain the need for their adoption by reference to the internal market. According to the Preamble to the Parent – Subsidiary Directive:

“The grouping together of companies of different Member States may be necessary in order to create within the Union conditions analogous to those of an internal market and in order thus to ensure the effective functioning of such an internal market. Such operations should not to be hampered by restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States. It is therefore necessary, with respect to such grouping together of companies of different Member States, to provide for tax rules which are neutral from the point of view of competition in order to allow enterprises to adapt to the requirements of the internal market, to increase their productivity and to improve their competitive strength at the international level.”

The Preamble to the Merger Directive uses very similar language to the above.

The Savings Directive refers to the existence of distortions in the capital movements between Member States which are incompatible with the internal market and which it aims to eliminate through the harmonized rules it provides for. The directives on administrative assistance also mention in their Preambles the functioning of the internal market which would be in jeopardy without the harmonization of the rules of the Member States on exchange of information and administrative assistance in the collection of taxes.

If all the means of tax integration discussed here serve the common purpose of promoting the internal market, the question arises how to delimit their respective functions and the scopes of the Union law norms on which they rely. We will discuss the scope of the fundamental freedoms and the State aid rules in Part III of this thesis. In the following Sections, we will only deal with the question of the scope of secondary law and the primary law provisions on free movement and, to a lesser extent, State aid in the context of taxation. As secondary law is the principal instrument on which positive integration relies whereas the fundamental freedoms and the State aid rules are the catalysts of negative integration, the issue of the scope of these different norms in relation to one another translates to the question of the

functions of positive and negative integration in the field of taxation. This is what we will examine in the first part of this Chapter. In the second part we will examine some concrete aspects of the relationships of primary law and secondary law in the field of taxation in a structure which is parallel with that of Chapter 7. We will apply the general lessons and principles that we identified in Chapter 7 to the field of taxation.

8.2. Interaction between positive integration and negative integration

8.2.1. Recollections from non-tax fields

As we saw in the previous Chapter, the Court laid down early on in its general case law that in the absence of harmonization of legislation, the Member States are free to act in a certain policy field; their action, however, must remain within the limits set by the fundamental freedoms (see Section 7.2.3). As regards direct taxation, the Court reminds us in almost every direct tax judgment that “whilst direct taxation falls within the competence of Member States, the latter must nevertheless exercise that competence in a manner consistent with Community law” where – due to the absence or negligible presence of harmonization – ‘Community law’ first and foremost refers to the Treaty freedoms. It has also been long-standing case law that the application of the freedoms cannot be made dependent on the existence of harmonization in a given field:

“ [...] The fundamental principle of a unified market and its corollary, the free movement of goods, may not under any circumstances be made subject to the condition that there should first be an approximation of national laws for if that condition had to be fulfilled the principle would be reduced to a mere cipher. [...]”

It follows that the fact that there are no common rules or harmonization directives on the production and marketing of specific goods is not sufficient to remove those goods from the scope of the prohibition enacted in Article 30 of the Treaty [now Article 34 TFEU]”

955. Case 120/78 Cassis de Dijon, para. 8; Case C-51/94 Commission v Germany, para. 29; Case C-470/93 Mars GmbH, para. 12. This, evidently, does not apply to the areas which fall within the exclusive competence of the Union set out in Article 3 TFEU, see Terra and Wattel, supra note 942, pp. 9, 36.
956. See e.g. ECJ, 18 July 2007, C-231/05 Oy AA, para. 18.
And in the context of the freedom of establishment:

“[...] The right to form a company in accordance with the law of a Member State and to set up branches in other Member States is inherent in the exercise, in a single market, of the freedom of establishment guaranteed by the Treaty. In this connection, the fact that company law is not completely harmonised in the Community is of little consequence. [...]”  

Moreover, the absence of harmonization of direct taxes cannot serve as a justification ground for a restriction on the fundamental freedoms.  

The existence of harmonization is not a precondition for the application of the primary law freedoms; quite to the contrary, the freedoms have the most important function in non-harmonized areas where they constitute the only EU law constraint on the actions of the Member States. In this regard, it is important to recall that in certain non-tax areas the fundamental freedoms have substituted for lacking harmonization (see Section 5.3.2.1.). By way of negative integration, the Court brought within the scope of the fundamental freedoms obstacles which were created by the cumulative application of divergent product requirements (see Section 7.4.3.2.). Double regulatory burdens on imported goods were considered a restriction on the free movement of goods for which the Member State of importation was held liable leading to the obligation to recognize the product regulations of the Member State of origin. Thus, the primary law provisions on the free

958. ECJ, 9 March 1999, Case C-212/97 Centros Ltd v Erhvervs- og Selskabsstyrelsen, paras. 27-28. The Court clarified as early as the beginning of the 1970’s that the failure of the Union institutions to adopt the directives that the Treaty provided for in the Chapter concerning the freedom of establishment could not deprive the freedom of its effect, see ECJ, 21 June 1974, Case 2/74 Jean Reyners v Belgian State. The same reasoning was applied with respect to the now repealed Article 293 of the EC Treaty which urged the Member States to conclude not only tax treaties with each other but also agreements on the mutual recognition of companies and their transfer of seat, see ECJ, 5 November 2002, Case C-208/00 Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC), para. 55. See J. Snell, Non-discriminatory tax obstacles in Community law, 56 International and Comparative Law Quarterly (ICLQ) 4 (2007), pp. 339-370, at p. 363. In the context of the free movement of workers, see ECJ, 28 January 1992, Case C-204/90 Hans-Martin Bachmann v Belgium, para. 11 and in the context of the prohibition of discriminatory or protective internal taxation (Article 110 TFEU), see ECJ, 27 February 1980, Case 171/78 Commission v Denmark, para. 20.


960. Besides product regulations, a sort of mutual recognition approach has been applied in the area of provision of services (e.g. Case 76/90 Süger; Case C-43/93 Vander Elst; Case C-222/95 Société civile immobilière Parodi), free movement of workers and freedom of establishment regarding recognition of professional qualifications (Case C-340/89 Vlassopoulou; Case C-234/97 Fernández) and recognition of companies of other Member States (Case C-212/97 Centros; Case C-167/01 Insipire Art; Case C-208/00 Überseering).
movement of goods preclude the Member States from restricting the import of products from other Member States by requiring compliance with their own product rules where those products are lawfully produced and marketed in the Member State of origin unless such restriction is justified on public interest grounds:961

“Obstacles to movement within the Community resulting from disparities between the national laws relating to the marketing of the products in question must be accepted in so far as those provisions may be recognized as being necessary in order to satisfy mandatory requirements [...]”962 (emphasis added)

In the case of product regulations, the obstacle to the free flow of goods resulted from differences between the respective laws of the Member States. Such obstacle is a typical case for the application of Article 114 or Article 115 TFEU which allow the adoption of Union acts for the approximation of the laws of the Member States which affect the functioning of the internal market, that is, harmonization. As harmonization was blocked at the time due to a political stalemate in the Union, the Court responded by expanding the scope of the free movement of goods to the effect of including the disparities at issue in their scope. Academic commentators observed with regard to this trend that the scope of harmonization and that of the freedoms mutually influence each other963 without the two being mutually exclusive.964 The latter means that although disparities do fall within the scope of the freedoms they can also be the subject of harmonization. Currall emphasised that the mutual recognition of product requirements and technical specifications introduced by Cassis de Dijon neither precludes harmonization nor makes the latter superfluous. To the contrary, as the mutual recognition principle may involve great difficulties in its practical application, it actually articulates the need for the enactment of directives which bring about specific rules and thereby certainty.965 As he concludes, the simultaneous applicability of Articles 34-36 and Article 115 (or now Article 114) has

962. Case 120/78 Cassis de Dijon, para. 8.
963. Slot, supra note 430, pp. 380-382; Kingreen, supra note 1, p. 521.
964. Currall criticized the Commission’s Communication on the consequences of the Cassis de Dijon judgment (OJ C256, 03.10.1980) insofar as the Communication expresses the view that the judgment enlarged the scope of Article 34 at the expense of Article 115, which suggests a mutually exclusive relationship between the two, see Currall, supra note 513, p. 184.
965. Ibid. p. 185.
become an established principle in the aftermath of *Cassis de Dijon*. The principle of simultaneous application means not only that the applicability of the freedoms in a certain field does not exclude harmonization but *vice versa* – as we recall from the previous Chapter (see Section 7.2.6.) – the existence of harmonization measures in a certain area does not exclude the applicability of the freedoms unless the measure results in exhaustive harmonization of that area and even in the latter case, the freedoms are superseded only in terms of the order of application by secondary law without their applicability being completely excluded.

From the above we can conclude that, in general, there is a dynamic relationship between positive and negative integration, as the ambit of negative integration is adjusted and aligned to that of positive integration in the sense that obstacles to the internal market which are not eliminated by harmonization measures are dealt with by the fundamental freedoms through the expansion of their scope to such obstacles. In other words, negative integration is complementary to positive integration. As regards the field of taxation and particularly, direct taxation, negative integration has substituted for a lack of comprehensive harmonization, at least, as far as the removal of discriminatory direct tax provisions from the Member States’ tax systems are concerned. However, the question is whether the complementary function of negative integration has also worked with respect to other direct tax obstacles to the internal market reproducing the phenomenon that occurred in non-tax fields, that is, the expansion of the scope of the fundamental freedoms to non-discriminatory obstacles. This leads us to the question of the scope of the fundamental freedoms in the field of taxation.

8.2.2. The scope of the fundamental freedoms in relation to tax measures

8.2.2.1. Types of tax obstacles to free movement

As we saw in the previous Chapter, hindrances to free movement in the internal market may result not only from measures which distinguish between domestic and foreign operators or, generally, between domestic and cross-border situations, but also from indistinctly applicable measures which, nevertheless, hinder the exercise of the fundamental freedoms. In the field of taxation, the distinction between discriminatory and non-discriminatory obstacles is of relevance mainly with regard to indirect taxes. This is because an indirect tax which, although indistinctly applicable, is so high that it makes the exercise of the free movement rights impossible
or excessively difficult may – at least, in theory – qualify as a prohibited restriction on the fundamental freedoms. Contrarily, a direct tax which does not discriminate between domestic and cross-border situations, even if it is overly high, is not likely to have the effect of making the exercise of free movement impossible or excessively difficult.\footnote{966} In addition, in the direct tax field, the Court has expanded the concept of discrimination to such an extent that there is little scope left for non-discriminatory restrictions which would result from the tax laws of a single Member State.\footnote{967} Accordingly, there are hardly any cases in the Court’s direct tax jurisprudence dealing with a genuine non-discriminatory measure.\footnote{968} For these reasons, in this Section, we examine the question whether or not non-discriminatory tax obstacles deriving from the laws of one Member State fall within the scope of the fundamental freedoms only in the context of indirect taxes (see Section 8.2.2.2.).

A further distinction that is normally drawn between the various types of obstacles to free movement is that between (discriminatory or non-discriminatory) restrictions which result from the (tax) rules of a single jurisdiction, i.e. one-country problems, and disparities which derive from the differences between the legal (or tax) systems of two or more jurisdictions, i.e. two-country problems.\footnote{969} As far as the field of direct taxation is concerned, the essential question as regards the scope of the fundamental freedoms is whether two-country problems fall within their scope. Within the category of two-country problems, a further distinction can be made. In particular, Wattel distinguishes disparities and dislocations. He defines the latter as “impediments to free movement [which] emanates from [the] splitting up of one tax base (the income) over two jurisdictions, leading to (literally) a double burden or to the separation of the positive part of the income from the negative part of the income (in the other jurisdiction), incapable of canceling each other out, as they would in a one-country situation.”\footnote{970} Dislocations differ from disparities, as dislocations are two-country problems where both Member States apply the same system. The obstacle therefore does not arise

\footnote{966} Terra and Wattel, supra note 942, pp. 56, 90. 
\footnote{967} Ibid. pp. 54-55. 
\footnote{968} As possible examples of such measures, Douma mentions thin capitalization rules applying both to domestic and cross-border loans or change of control rules excluding loss-carry forward where the ownership of substantial shareholdings is changed in a company irrespective of the residence of the acquirer, see Douma, supra note 387, pp. 226-227.  
\footnote{969} Terra and Wattel, supra note 942, p. 93; Weber, supra note 960, p. 9. Advocate General Geelhoed called these two categories of obstacles ‘true restrictions’ and ‘quasi restrictions’, see Opinion of Advocate General Geelhoed, 23 February 2006, Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation v Commissioners of Inland Revenue, paras. 36-40.  
\footnote{970} Terra and Wattel, supra note 942, p. 95.
from the differences between the national tax systems. Wattel explains that dislocations, as a type of obstacle to free movement, are specific to the field of direct taxation and they result from the Court’s acceptance that residents and non-residents are taxed differently, i.e. the former on worldwide income and the latter only on income sourced in the State concerned.971 Advocate General Geelhoed also distinguished disparities and dislocations but he identified a third category of obstacles “resulting inevitably from the co-existence of national tax systems”; namely, cumulative administrative compliance burdens on companies operating cross-border.972 Similarly, Weber mentions double formalities, double taxation and non-utilization of losses as the disadvantages which may follow from disparities. In his view, the notion of disparities does not presuppose differences between the tax systems of the Member States. He uses the term ‘disparities’ also for the situation when two identical tax systems are applied alongside each other and this causes disadvantages for cross-border economic activities.973

Cordewener differentiates between situations where the mere coexistence of different tax systems causes a disadvantage as a consequence of intra-Union movement and those where the disadvantage is caused by the coactions of tax systems.974 The first of these categories appears to correspond to disparities in the narrow sense while the second to the exercise of tax jurisdiction by two Member States causing international double taxation. Englisch makes a distinction between disparities which may lead to increased compliance and administrative costs and distortions of competition, on the one hand, and competing tax claims of the Member States which lead to double burdens, on the other.975 The term ‘double burden’ is used to describe a situation where the disadvantage is created by the uncoordinated application of two or more national legal (tax) systems.976 Kofler goes further and distinguishes between double burdens in the direct tax field and outside such field. He suggests that ‘double burdens’ in the direct tax area

971. Although, as Wattel points out, obstacles would persist even if these two categories of taxpayers were taxed in the same way. In particular, double taxation would occur even if both residents and non-residents were taxed on worldwide income and loss relief for foreign losses would be unavailable even if both residents and non-residents were taxed only on source-basis, see Terra and Wattel, supra note 942, p. 95.
972. Opinion of Advocate General Geelhoed, Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation, para. 37.
974. Cordewener, supra note 783, p. 38.
975. J. Englisch, Tax Coordination between Member States in the EU – Role of the ECJ, in: Horizontal Tax Coordination (M. Lang et al. eds., IBFD 2012), Online Books IBFD, Ch.1.1.
976. Kofler, supra note 960, p. 110.
create restrictions which cannot be reduced to mere ‘disparities’,\textsuperscript{977} which implies that double burdens in other policy areas may, in fact, correspond to disparities.

In the forthcoming parts of this Section we will focus on obstacles stemming from differences between the tax systems of the Member States and double burdens, most importantly, those resulting from the simultaneous exercise of tax jurisdiction, that is, international juridical double taxation (see Section 8.2.2.3.). We will use the term ‘disparity’ for the former category and ‘double burden’ for the latter which, besides double taxation, encompasses regulatory double burdens, including those specific to the field of taxation, i.e. double administrative and compliance requirements. Consequently, a segment of what Wattel calls dislocation will not be discussed further. These are the obstacles to cross-border economic activity in the internal market which originate in the compartmentalization of the tax base, i.e. division of the tax base between two jurisdictions and which are specifically the consequence of the fact that Member States may choose differing connecting factors to define their tax jurisdiction over residents and non-residents.\textsuperscript{978} Weber describes them as disadvantages which flow from the sovereignty of the Member States to limit their tax jurisdiction\textsuperscript{979} and he considers that they also arise from disparities.\textsuperscript{980} In his view, the Member States’ sovereignty in direct tax matters means that they are free to decide upon the connecting factor which brings taxpayers and their income within their tax jurisdiction. If the choice of connecting factor is up to the MS, it is implied in their freedom that certain taxpayers and income will fall outside their taxing jurisdiction. Thus, the Member States cannot be obliged to bring certain (non-resident) taxpayers or (negative) income within their taxing jurisdiction. Most, but not all, of these obstacles described by Weber and Wattel are related to the inability to use foreign losses against domestic profits. In any event, we will not analyse the question whether or not these types of barriers to free movement fall within the scope of the fundamental freedoms.

8.2.2.2. Non-discriminatory indirect taxes as potential obstacles

In the previous Chapter, we described the Court’s non-tax case law under which most of the freedoms are interpreted as prohibiting not only

\textsuperscript{977} Ibid. p. 103.
\textsuperscript{978} Terra and Wattel, supra note 942, pp. 96-99.
\textsuperscript{979} Weber, supra note 960, p. 24-33.
\textsuperscript{980} Ibid. p. 63.
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discriminatory but also indistinctly applicable measures. We pointed out that the free movement of goods is an exception in this sense, as most of the provisions included in the Title of the TFEU relating to this freedom capture only discriminatory measures. This is the case with the prohibition of customs duties and charges having equivalent effect (Article 30) and the prohibition of quantitative restrictions and measures having equivalent effects on exports (Article 35). The corresponding prohibition on imports (Article 34) is broader in scope, as it does cover some non-discriminatory obstacles; however, a significant group of the latter – indistinctly applicable selling arrangements – are excluded from its scope. The scope of the other freedoms, on the other hand, extends not only to measures which discriminate either in law or in fact but also to equally applicable measures which nevertheless hinder market access. The question is whether the scope of the freedoms can be circumscribed in the same manner with regard to fiscal measures. As the TFEU contains some specific provisions on such measures, i.e. Articles 30 and 110, it is logical to look at the scope of these provisions first. Both of these provisions cover only distinctly applicable measures. Customs duties and charges of equivalent effect which are levied by reason of the fact that goods are crossing the border are inherently discriminatory, as by definition, they can only burden imported and exported goods. Article 110 TFEU prohibiting internal taxation which discriminates against foreign products as compared to domestic ones or otherwise has a protectionist effect towards the latter is expressly formulated in discrimination terms. These provisions are related to the free movement goods. In the context of this freedom, regulatory obstacles are dealt with in separate provisions, i.e. Articles 34 and 35, the former covering also certain types of non-discriminatory obstacles. Under the other three freedoms, we cannot find separate provisions on fiscal obstacles, on the one hand, and regulatory barriers, on the other. Therefore, the question is whether these freedoms follow the model of Articles 30 and 110 and thus encompass only discriminatory fiscal barriers or, alternatively, they cover all restrictive tax measures irrespective of their discriminatory character just as they do in the case of general (non-tax) measures.981

Furthermore, even with regard to the free movement of goods the question can be asked whether indistinctly applicable taxes on certain products or transactions could qualify as measures having equivalent effect to quantitative restriction under Article 34 in spite of the fact that Articles 30 and 110 specifically deal with fiscal obstacles in this domain.

981. Snell, supra note 958, p. 345.
It appears to be a reasonable proposition that tax measures should constitute an infringement on the freedoms only when they discriminate against foreign products, producers, service providers, economic operators or investors as compared to their domestic counterparts. Otherwise, if indistinctly applicable tax measures hindering the exercise of free movement rights fell within the scope of the freedoms, the tax itself could become a prohibited restriction given that all forms of taxation hinder economic activity or, at least, render it less attractive. Wattel observes that the Treaty drafters could not have meant to assign such unreasonably broad scope to the freedoms with the result that all national taxes could be scrutinized by the Court and monitored for their justifiability. Nevertheless, the case law does not exclude unequivocally that, under certain circumstances, an even-handed tax may constitute a restriction on the freedoms. Specifically, Viacom Outdoor and Sea Land Service indicate that the Court may be willing to include indistinctly levied indirect taxes and levies within the scope of the fundamental freedoms. In Viacom Outdoor, the Court decided that an Italian municipal advertising tax, which applied equally whether the advertising service was provided to domestic or foreign recipients, did not restrict...
the freedom to provide services. Despite this outcome, the reasoning of the Court suggests that even-handed indirect tax measures may come within the scope of Article 56 TFEU. The Court used the terminology characteristic to the restriction approach ("liable to prohibit, impede or otherwise make less attractive") and specifically referred to the "modest" level of the tax when finding no infringement of the freedom. Consequently, an indistinctly applicable tax of a substantial amount may be capable of infringing Article 56. In the earlier case of Sea Land Services, a Dutch tariff for State-provided vessel traffic services imposed only on seagoing vessels longer than 41 metres was considered to restrict the freedom to provide services despite the fact that it was an even-handedly applied charge. The Court’s simple statement that the payment of the tariff "is liable to impede or render less attractive" the provision of services is not far from saying that any tax or tariff is a restriction on the cross-border exercise of economic activities. Before drawing such far-reaching conclusion, it has to be pointed out that the decision may have been influenced by the fact that the seagoing vessels subject to the tariff were exclusively providing cross-border services but the conditions for finding de facto discrimination were not present in the case.

In the context of the free movement of capital, we also find a case in which the Court held an indistinctly applicable indirect tax to be, at least prima facie, restrictive. In Sandoz the Court scrutinized an Austrian stamp duty on loans taken out by resident individuals or legal persons which was applicable irrespective whether the loan was contracted in Austria or in another Member State. According to the Court, such legislation:

"[...] 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 [...]"

It follows that such legislation constitutes an obstacle to the movement of capital [...]

988. As seagoing vessels were not comparable and not in competition with vessels used on inland waterways due to the different traffic services they required and the different markets they served, see Terra and Wattel, supra note 942, p. 88.
989. Snell, supra note 958, p. 346 FN 38.
990. Terra and Wattel, supra note 942, p. 88.
991. ECJ, 14 October 1999, Case C-439/97 Sandoz GmbH v Finanzlandesdirektion für Wien, Niederösterreich und Burgenland.
992. Ibid. paras. 19-20.
However, the obstacle was found to be justified on the ground that it prevents taxable persons from evading the requirements of domestic tax legislation through the exercise of the freedom of movement of capital. If this justification were meant to be that of prevention of tax avoidance, it is an extremely lax form of the latter, as it finds a restrictive measure which is based on the assumption that everybody who takes out a loan abroad does it for tax evasion purposes justified. If it is so easy to justify an obstacle to the free movement of capital, one may suspect that it is not a real obstacle from the outset. Therefore, the Court’s qualification of the indistinctly applicable stamp duty as a restriction on the freedom has to be viewed in the light of the extremely eased treatment of justification.993

Contrary to the above, in Mobistar,994 the latest case in the series, the Court resorted to a clear discrimination analysis when examining a Belgian communal tax on communication infrastructure in the light of the freedom to provide services. Most indicatively, the Court stated that “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 56 TFEU]”.995

As regards the second question above, i.e. whether indistinctly levied indirect taxes may fall under the prohibition set out in Article 34, the Court’s statements are as open-ended as those in Sea Land Service and Viacom Outdoor with regard to the scope of the freedom to provide services. In this regard, Snell refers to two cases concerning the Danish car registration tax which was so high that it could triple the price of a new car.996 The Commission started an infringement procedure against Denmark because of the tax on the basis of Article 110, which was dismissed by the Court on the ground that Article 110 cannot be used for “censuring the excessiveness of the level of taxation [...] in the absence of any discriminatory or protective effect”,997 the latter obviously lacking in the case at issue in the absence of any domestic car production in Denmark. However, the Court left the possibility open for a tax to fall under the prohibition laid down in Article 34 if the amount of the tax were to impede the free movement of

994. ECJ, 8 September 2005, Joined Cases C-544/03 and C-545/03 Mobistar SA and Belgacom Mobile SA v Commune de Fléron and Commune de Schaerbeek.
995. Ibid. para. 31.
996. Snell, supra note 958, pp. 342-344.
997. ECJ, 11 December 1990, Case C-47/88 Commission v Denmark, para. 10.
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goods. The infringement of Article 34 was not, however, claimed by the Commission in the proceedings at issue. In the subsequent case, De Danske Bilimportører, the challenge brought against the car registration tax by the Danish association of car importers was based precisely on Article 34. It was argued that the excessive level of the tax hindered the importation of new cars to Denmark contrary to Article 34. The Court held that:

“The scope of Article 28 EC [now Article 34 TFEU] does not extend to the obstacles to trade covered by other specific provisions of the Treaty and obstacles of a fiscal nature or having an effect equivalent to customs duties, which are covered by Articles 23 EC, 25 EC and 90 EC [now Articles 28, 30 and 110 TFEU], do not fall within the prohibition laid down in Article 28 EC [now Article 34 TFEU] [...].”

The Court again acknowledged that, in accordance with its earlier case law, charges of such an amount which impede the free movement of goods in the internal market would be prohibited by Article 34; however, it held that it was not the case at hand, as proved by the number of new cars registered annually in Denmark which, in the absence of domestic car production, equalled the number of imported cars. As a result, the Danish car registration tax did not cease to be internal taxation within the meaning of Article 110 and thus, could not be qualified as a measure having equivalent effect to a quantitative restriction for the purposes of Article 34. Although the Court has seemingly maintained the possibility for an indistinctly applicable tax or duty which is so excessive that it practically excludes importation of certain goods to come within the scope of Article 34, Snell points out that if the Danish car registration tax, which could reach up to nearly 200% of the value of the imported car, had not been considered as such it is quite unlikely that any tax or duty ever would be.

Snell infers from the case law above that in the context of the two freedoms which are relevant for indirect taxes, i.e. the free movement of goods and services, the Court seems to follow a uniform ‘disparate impact’ approach towards indirect taxes and is not seeking to strike down measures without distinction. He adds that despite some indications in the jurisprudence that indistinctly applicable indirect taxes could come under scrutiny if they

998. Ibid. paras. 12.
999. ECJ, 17 June 2003, Case C-383/01 De Danske Bilimportører v Skatteministeriet, Told- og Skattestyrelsen.
1000. Ibid. para. 32.
1001. Ibid. paras. 40-41.
1002. Snell, supra note 958, p. 344.
Interaction between positive integration and negative integration

are excessive, the Court does not seem to go down this road in practice. \(^{1003}\) Wattel also concludes that the Court appears to follow a discrimination analysis under the Treaty freedoms with regard to (indirect) tax measures. However, he observes that an obstacle-based approach may not be completely excluded specifically when the situation is similar to that of the non-tax cases of *Bosman* and *Caixa Bank*, that is, when the obstacle which equally affects cross-border and domestic situations is such as to render the exercise of the Treaty freedoms virtually impossible or excessively difficult. \(^{1004}\) Indeed, the Court reservations in *De Danske Bilimportører* regarding taxes of such level which impede free movement and in *Viacom Outdoor* regarding taxes which are not “modest” in nature indicate that the Court might be willing to declare prohibitively high origin-neutral taxes to infringe the fundamental freedoms. In the two other cases in which an indistinctly applicable indirect tax or charge was held to be a (prima facie) restriction on the applicable freedom, i.e.* Sea Land Service* and *Sandoz*, the peculiarities of the case or the Court’s non-standard reasoning as regards justifications explain such holding.

In conclusion, indistinctly applicable indirect taxes are not, as a rule, considered to fall within the scope of the prohibitions set out in the fundamental freedoms. This suggests that the Court, different from non-tax measures, takes a discrimination-based approach to tax measures. It remains to be seen whether this conclusion stands with regard to direct tax measures as well.

8.2.2.3. Two-country problems in the field of taxation

(i) Disparities

In the context of direct taxation the most acute question is not whether non-discriminatory restrictions which originate in the direct tax laws of one Member State fall within the scope of the freedoms but rather whether two-country problems do so.

The two-country problems that we are focusing on are disparities and double burdens. As we have explained above, we consider that disparities are impediments to free movement that arise from the differences between the tax systems of the Member States. It has been suggested that to verify

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1003. Ibid. p. 348.
the existence of a disparity one should assume that both States involved were to have exactly the same tax rules; if under such condition the disadvantage disappears it is, indeed, a consequence of a disparity. If the disadvantage does not disappear, it is a discrimination or restriction stemming from the unilateral rules of a single Member State or a dislocation caused by the division of the tax base between the two States. 1005 The classic case of disparity in the direct tax field is *Schempp*. 1006 In this case, Mr Schempp, a German resident, could not deduct from his income the alimony he paid to his ex-wife who had, in the meantime, moved to Austria whereas he could have deducted such payments if his ex-wife had been resident in Germany. The German rules provided that the alimony payments are deductible for the payer if they are taxed in the hands of the recipient. As Schempp’s ex-wife was not taxed on the alimony in Austria, he was not allowed to deduct the payments in Germany. The German and Austrian tax laws were different insofar as the former laid down the rule of ‘deduction-taxation’ for alimony payments whilst the latter that of ‘no deduction-no taxation’. As regards the claim that the German rules were in breach of the prohibition of discrimination based on nationality, the Court pointed out that:

“[... ] it is apparent that the unfavourable treatment of which Mr Schempp complains in fact derives from the circumstance that the tax system applicable to maintenance payments in his former spouse’s Member State of residence differs from that applied in his own Member State of residence.” 1007

and:

“[... ] Article 12 EC [now Article 18 TFEU] is not concerned with any disparities in treatment, for persons and undertakings subject to the jurisdiction of the Community, which may result from divergences existing between the various Member States, so long as they affect all persons subject to them in accordance with objective criteria and without regard to their nationality [...].” 1008

The Court also dismissed the argument that the German legislation restricted the exercise of the free movement and residence rights of Union citizens set out Article 21(1) TFEU. It held that:

“[... ] it is true that the transfer of his former spouse’s residence to Austria entailed unfavourable tax consequences for Mr Schempp in his Member State of residence.”

1005. Terra and Wattel, supra note 942, p. 94; Kofler, supra note 960, p. 99.
1006. ECJ, 12 July 2005, Case C-403/03 *Egon Schempp v Finanzamt München V*.
1007. Ibid. para. 32.
1008. Ibid. para. 34.
However [...] the Treaty offers no guarantee to a citizen of the Union that transferring his activities to a Member State other than that in which he previously resided will be neutral as regards taxation. Given the disparities in the tax legislation of the Member States, such a transfer may be to the citizen’s advantage in terms of indirect taxation or not, according to circumstances.\(^1\)

Both of the statements of the Court cited above had precursors in the case law. The Court had already given an indication in *Peralta*\(^2\) that difficulties which Union undertakings face due to disparities between national laws governing the tax system are outside the scope of the fundamental freedoms.\(^3\) The Court had also held, in *Wiegel*, in the context of indirect taxation that the transfer of activities from one Member State to another can have adverse consequence in terms of taxation which cannot be tackled by the fundamental freedoms.\(^4\)

In the context of direct taxation, the Court had also relied on the concept of disparity well before *Schempp*. Specifically, in *Gilly*, it held that the disadvantage which results from the limitation of a tax credit granted by the State of residence to an amount which corresponds to its own tax on the foreign income (i.e. ordinary tax credit) where the income at issue is subject to a higher rate in the source State than in the residence State cannot be considered a restriction on the free movement of workers.\(^5\) Rather, such disadvantage is a result of differences between the tax rates of the Member States involved. According to our definition, this is, indeed, a disparity which is confirmed by the test mentioned above. If both Member States involved had exactly the same tax rate, no disadvantage would have arisen from the fact that Mrs Gilly worked across the border.\(^6\)

\(^1\) Ibid. para. 44-45.
\(^2\) ECJ, 14 July 1994, Case C-379/92 *Criminal proceedings against Matteo Peralta*, para. 34.
\(^3\) Weber, supra note 960, p. 15. Terra and Wattel, supra note 942, p. 94.
\(^4\) ECJ, 29 April 2004, Case C-387/01 *Harald Weigel and Ingrid Weigel v Finanzlandesdirektion für Vorarlberg*, para. 55.
\(^5\) ECJ, 12 May 1998, Case C-336/96 *Mr and Mrs Robert Gilly v Directeur des Services Fiscaux du Bas-Rhin*, para. 49.
\(^6\) In later case law the Court specifically distinguished *Gilly* from a case where the method of application of exemption for relieving double taxation resulted in partial loss of personal and family allowances in the State of residence of the taxpayer which the Court considered to be caused solely by the laws of the State of residence and not by differences between the tax rates of different Member States, i.e. disparities, see ECJ, 12 December 2002, Case C-385/00 *F.W.L. de Groot v Staatssecretaris van Financiën*, para. 85-86.
Despite the fact that they both involved disparities, there is a difference between *Gilly*, on the one hand, and *Schempp* (or *Wiegel*), on the other, as pointed out by Cordewener and Weber. Namely, in *Gilly* the disparate tax systems interacted to the effect of creating a disadvantage for the taxpayer, that is, tax jurisdiction was cumulatively exercised by two Member States whilst in *Schempp* (and *Wiegel*), the mere existence of disparate systems resulted in a disadvantage for the taxpayer who moved from one Member State to another.\textsuperscript{1015} It is rather obvious that the mere existence of different tax systems with different taxes, differing tax rates and different tax advantages etc. cannot be considered a prohibited restriction on the movement of the taxpayer when he or she moves from a more advantageous to a less advantageous system. Similarly, a *Schempp*-like situation cannot either be brought within the scope of the freedoms.\textsuperscript{1016} *Gilly* shows that not even disadvantages which result from the interaction of different tax systems belong to the realm of the fundamental freedoms. This could be taken as an indication of what was settled only much later in the case law, that is, that double taxation falls outside the scope of the fundamental freedoms. In this regard, it has to be noted that although *Gilly* concerned a situation of double taxation, the double taxation had been relieved and it was precisely the mechanism of double taxation relief which was challenged in the case. Therefore, *Gilly* is not conclusive on the question of whether when the interaction of tax systems results in full unrelieved double taxation the resulting obstacle to free movement qualifies as a prohibited restriction on the free movement provisions or rather stays outside the ambit of the latter.

(ii) Double burdens

Before turning to the issue of double taxation, we need to address another type of double burden on the exercise of free movement rights; particularly, double administrative burdens. The *Futura* case, which is frequently mentioned as one of the very few cases where a non-discriminatory tax measure was found to be a restriction on the fundamental freedoms, concerned such a double burden.\textsuperscript{1017} The case concerned a Luxembourg provision which made the carry-forward of losses by permanent establishments of non-resident enterprises subject to the condition that in the year in which the losses were made, separate accounts must have been kept in the State of the permanent

\begin{footnotes}
\item[1015] Cordewener, supra note 783, p. 38; Weber, supra note 960, p. 17.
\item[1016] Weber observes that in *Schempp*, there was more connection between the tax systems concerned than e.g. in *Wiegel*, as the German treatment of the alimony payments was linked to the treatment of the income in the other Member State, see Weber, supra note 960, p. 17.
\item[1017] ECJ, 15 May 1997, Case C-250/95 *Futura Participations SA and Singer v Administration des contributions*.
\end{footnotes}
establishment in accordance with the tax accounting rules of that State. The obligation for a non-resident company to keep separate accounts in the Member State of the permanent establishment in addition to the accounts kept in the Member State where its seat is located according to the accounting rules of that State created a double burden. The Court qualified such double burden a restriction on the freedom of establishment. The case is exceptional as, on the one hand, a neutral tax measure which applied without distinction to resident companies and (permanent establishments of) non-resident companies was held to infringe the freedom of establishment while in the overwhelming majority of the cases only discriminatory tax measures are condemned by the Court. On the other hand, the Court’s approach in *Futura* is the opposite to its approach which it took later in the other type of double burden cases, i.e. cases relating to double taxation. Commentators have attempted to explain *Futura* in various ways. One of the explanations intends to reconcile *Futura* with the Court’s perceived discrimination-based approach to tax measures suggesting that *Futura* represents the application of the discrimination concept as well, just the second leg thereof according to which discrimination may arise also through the “application of the same rule to different situations”. As a permanent establishment of a non-resident company is not in the same situation as a resident company, given that the former has already had to comply with the tax accounting rules of its home State, the application of the same accounting requirements to both results in discrimination. Another line of commentary endeavoured to answer the question whether the mutual recognition approach taken in *Futura* whereby the Court required the permanent establishment State to acknowledge the tax accounting rules of the head office State would be transposed to double taxation. In this regard, Weber emphasized that *Futura* concerned procedural rules therefore, in his view, it was doubtful whether its solution would be extended to substantive rules. Indeed, the fact that *Futura* concerned double administrative requirements brings it closer to non-tax cases involving double regulatory burdens than to double taxation cases. In a similar vein, Wattel observes with reference to *Futura* that the only area of taxation where mutual recognition may work is procedural rules, specifically, tax accounting rules. Zalisinski argues that *Futura* cannot be understood as the application of the mutual recognition principle in

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1019. Discussion with Professor Michael Lang at the Vienna Institute for Austrian and International Tax Law in April 2010 during a research period spent in the Institute.
1021. Terra and Wattel, supra note 942, p. 904. As regards double administrative compliance burdens, Advocate General Geelhoed proposed that those should be qualified
the case of a direct tax measure, as *Futura* is different from *Cassis de Dijon* in the sense that there was no cross-border movement in the case, the losses were Luxembourg losses and they stayed in Luxembourg, contrary to the liquors in *Cassis de Dijon* which were imported from France to Germany.1022

Double burdens stemming from the cumulative exercise of tax jurisdiction by two or more Member States are different from regulatory double burdens or the type of administrative double burden which was at issue in *Futura*. In particular, a regulatory double burden conceptually is no different from a disparity. The restriction inherently derives from the differences of two regulatory regimes and from the fact that imported goods (or migrating companies or persons with professional qualification) would have to comply with the requirements of both regimes. If the two regimes were identical, the restriction would disappear. That is not the case with double taxation. Even if the tax systems of two Member States were the same, applying the same but inconsistent rules to residents and non-residents, double taxation would persist. For this reason, most academics do not call double taxation a ‘disparity’ but rather label it ‘dislocation’ or another term. Double taxation is thus not a disparity which – according to the case law discussed above – falls outside the scope of the fundamental freedoms in the field of taxation but nor is it a prohibited discrimination, as it is caused by the interaction of the tax jurisdiction of two Member States neither of which treats cross-border situations less favourably than domestic ones. As Kofler describes, “[d]ouble taxation would occur even if all the Member States concerned had tax systems that were completely discrimination-free, and double taxation would still prevail even if all Member States (hypothetically) had the same tax system, as source and residence based taxation would still remain in place in both jurisdictions and would continue to overlap.”1023 Besides this conceptual ambiguity, double taxation is also a highly sensitive political problem in European tax integration. While, on the one hand, Member States fiercely guard their sovereignty in the field of direct taxation and therefore, hardly tolerate any interference from ‘Europe’ in how they allocate taxing powers between themselves, on the other hand, unrelieved double taxation “is the most serious obstacle there can be to people and their capital as ‘quasi restrictions’ and as such should remain outside the scope of the freedoms, see Opinion of Advocate General Geelhoed, Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation*, para. 42.


1023. Kofler, supra note 960, p. 106.
interaction between positive integration and negative integration crossing internal borders”. Having regard to these opposing interests, it is no surprise that the status of juridical double taxation under the fundamental freedoms has remained unsettled for a long time even after the Court intensified its negative integration efforts in the area of direct taxation. It was only in 2006, in the judgment in Kerckhaert-Morres, followed by Block and Damseaux, that the Court finally clarified that juridical double taxation is not a prohibited restriction on the exercise of the fundamental freedoms.

For the sake of completeness, it has to be recalled that the status of economic double taxation under the Treaty freedoms had been settled much earlier. The Court held in a series of cases that it is a restriction on the freedom of establishment or the free movement of capital if a Member State grants economic double taxation relief for domestic distributions of dividends while it denies such relief for cross-border dividends. Vanistendael explains that the reason for the opposing treatment by the Court of economic double taxation, on the one hand, and juridical double taxation, on the other, is that the Court applies a discrimination-based analysis for testing national direct tax measures in the light of the fundamental freedoms. When there is an internal mechanism under the laws of a Member State aimed at eliminating or mitigating double taxation and that mechanism is not applied in cross-border situations there is clearly a discrimination in place. This is normally the case with mechanisms of economic double taxation relief. Juridical double taxation relief mechanisms confined to one jurisdiction (e.g. crediting withholding tax on domestic-source investment income against the final income tax liability) are very rare, as juridical double taxation itself is very rare in a purely domestic scenario. Therefore, juridical double taxation is a problem which is specific to two-country situations. When international juridical double taxation is left unrelieved there is no discernible discrimination at stake by either of the Member States involved which could be tackled by the fundamental freedoms. There is undoubtedly an obstacle to free movement which is, however, considered by the Court to

1024. Opinion of Advocate General Colomer, 26 October 2004, Case C-376/03 D v Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen, para. 85.
1026. ECI, 14 November 2006, Case C-513/04 Mark Kerckhaert and Bernadette Morres v Belgian State; ECI, 12 February 2009, Case C-67/08 Margarete Block v Finanzamt Kaufbeuren; ECI, 16 July 2009, Case C-128/08 Jacques Damseaux v État belge.
1027. ECI, 6 June 2000, Case C-35/98 Staatssecretaris van Financiën v B.G.M. Verkooijen; Case C-315/02 Lenz; Case C-319/02 Manninen.
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fall outside the scope of the fundamental freedoms. This was the essence of the Court’s ruling in Kerckhaert-Morres where it had to decide whether or not Belgium, as the residence State of the shareholder, restricts the exercise of the fundamental freedoms when it applies a uniform 25% flat rate tax to both domestic and inbound dividends without granting a credit for the withholding tax which has been levied in the source State on the inbound dividends. After pointing out that the legislation at issue did not make a distinction between domestic and inbound dividends, the Court examined whether the application of the uniform 25% rate to these two streams of dividends could be regarded as treating different situations in the same way and thus constituting discrimination. It rejected the argument on the ground that the position of a shareholder receiving dividends is not necessarily altered by the fact that he receives such dividends from another Member State which, in exercising its fiscal sovereignty, levies a withholding tax at source on those dividends. In the absence of discrimination, the Court considered that:

“[...] the adverse consequences which might arise from the application of an income tax system such as the Belgian system [...] result from the exercise in parallel by two Member States of their fiscal sovereignty”.1029

Thereafter, the Court recalled the role of tax treaties in mitigating the negative effects on the functioning of the internal market resulting from the coexistence of national tax systems. Referring to the few existing instruments of harmonization in the field of direct taxation, which did not apply to the situation at hand, the Court stressed that:

“Community law, in its current state and in a situation such as that in the main proceedings, does not lay down any general criteria for the attribution of areas of competence between the Member States in relation to the elimination of double taxation within the Community.”1030

The Court reaffirmed all these conclusions in Block and Damseaux. First, that juridical double taxation arises from the parallel exercise of tax jurisdictions by different Member States.1031 Second, that the sovereignty of the Member States in the field of direct taxation entails that:

“In the absence of any unifying or harmonising Community measures, Member States retain the power to define, by treaty or unilaterally, the criteria for

1029. Case C-513/04 Kerckhaert-Morres, para. 20.
1030. Ibid. para. 22.
1031. Case C-128/08 Damseaux, para. 27. See also Case C-67/08 Block, para. 28; ECJ, 6 December 2007, Case C-298/05 Columbus Container Services BVBA & Co. v Finanzamt Bielefeld-Innenstadt, para. 43.
allocating their powers of taxation, particularly with a view to eliminating
double taxation [...] It is for the Member States to take the measures necessary
to prevent situations of double taxation by applying, in particular, the criteria
followed in international tax practice [...]”¹⁰³²

Third, that Union law does not contain any criteria according to which it
could be decided which Member State should enjoy a priority in exercis-
ing its taxing power and which should refrain from exercising thereof in
situations of double taxation:

“In a situation where both the Member State in which the dividends are paid
and the Member State in which the shareholder resides are liable to tax those
dividends, to consider that it is necessarily for the Member State of residence
to prevent that double taxation would amount to granting a priority with re-
spect to the taxation of that type of income to the Member State in which the
dividends are paid.

Even though such an attribution of powers complied, in particular, with the
rules of international legal practice as reflected in the model tax convention on
income and on capital drawn up by the Organization for Economic Cooperation
and Development (OECD), in particular Article 23B thereof, it is not in dispute
that Community law, in its current state and in a situation such as that at issue
in the main proceedings, does not lay down any general criteria for the attri-
bution of areas of competence between the Member States in relation to the
elimination of double taxation within the Community [...]”¹⁰³³

Finally, that in the absence of such Union law criteria, one Member State
cannot be obliged to yield to the taxing powers of the other Member State:

“[...] in the current stage of the development of Community law, the Member
States enjoy a certain autonomy in this area provided they comply with
Community law, and are not obliged therefore to adapt their own tax systems
to the different systems of tax of the other Member States in order, inter alia,
to eliminate the double taxation arising from the exercise in parallel by those
Member States of their fiscal sovereignty”¹⁰³⁴

It is apparent from the above that the Court does not apply the approach
that it developed with regard to regulatory double burdens to double bur-
dens caused by the parallel exercise of taxing powers. Regulatory double
burdens are caught by the prohibitions of the fundamental freedoms and are
resolved by the mutual recognition principle which requires the host State

¹⁰³². Case C-128/08 Damseaux, para. 30.
¹⁰³³. Ibid. paras. 32-33. See also Case C-67/08 Block, para. 30; Case C-298/05 Columbus
Container, para. 45.
¹⁰³⁴. Case C-67/08 Block, para. 31.
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to recognize the rules of the State of origin of products, service providers and professionals moving across the border and to allow the latter to enter the host State’s market without having to satisfy its own rules. In contrast, (juridical) double taxation falls outside the scope of the fundamental freedoms and the domain of the mutual recognition principle. Therefore, no Member State is required to recognize the exercise of tax jurisdiction by another Member State to the effect of giving up its own right to tax. Snell explains the Court’s refusal to apply the mutual recognition principle to double taxation by recalling that in Cassis de Dijon and other cases on regulatory double burdens the principle was applied on the ground that the host State’s interest that it sought to protect by the application of its own rules had already been safeguarded by the rules of the home State. This rationale does not apply to tax measures where the interest at issue is the collection of revenue for the State. Evidently, the collection of tax revenue by one State will not fill up the pocket of the other State.1035

Even though the logic of the mutual recognition principle may not work in the domain of taxation, the Court’s self-restraining attitude towards juridical double taxation has generated a good deal of criticism in academic circles. Scholars have suggested various alternatives to the non-solution offered by the Court. Vanistendael has argued that double taxation occurring as a result of cross-border movement caused by the interaction of national tax systems is contrary to the fundamental freedoms, as it is contrary to the principle of neutrality.1036 According to him, disparities between the national tax systems remain outside the scope of the freedoms as long as the disparate tax systems do not interact with each other resulting in a disadvantage for the cross-border movement. A contrario, as soon as there is an interaction between different tax systems, the fundamental freedoms can be put into use to eliminate the impediments created by them. As it appears from the case law described above, the main reason for the Court for not considering juridical double taxation as a restriction prohibited by the fundamental freedoms is that Union law does not lay down any criteria according to which it could be decided which Member State has to give up the exercise of its taxing right in favour of the other; in other words, who has the prior right to tax. Vanistendael has suggested that the Court, in deciding which Member State should tax and which should refrain from taxing, could rely on the internal logic and coherence of the national tax systems and the international

1035. Snell, supra note 958, p. 365.
practices and mechanisms used to eliminate double taxation.\textsuperscript{1037} As regards the latter, he pointed out that both the Parent – Subsidiary Directive and the OECD Model Convention set forth clear rules on how juridical and economic double taxation should be resolved. In his view, both instruments indicate that the responsibility for the elimination of double taxation lies with the residence State. He concludes that the Court could safely assume to take a decision on double taxation in the same direction.\textsuperscript{1038} In contrast, Rust is of the view that the EU directives do not give guidance as regards the question which State should be held responsible by the Court for avoiding double taxation due to the fact that the directives follow different patterns.\textsuperscript{1039} Some directives grant primary taxing right to the source State, others to the residence State of the recipient of the income.\textsuperscript{1040} Nor does he consider the OECD Model Convention to be of help in deciding which of the two Member States should relinquish its taxing right.\textsuperscript{1041} Instead, he maintains that the answer to this question should be found in the specific tax treaty concluded by the Member States in question. If such tax treaty is in place, it shows how the Member States allocated taxing right between themselves and the Court should make them abide by that agreement.\textsuperscript{1042} Finally, Rust proposes that the cases where no tax treaty exists can be solved either by recourse to the equal treatment obligation, i.e. a Member State should grant a credit for a foreign withholding tax if it does so domestically, or the consistency argument, i.e. where a Member State would levy withholding tax if it were in the place of the source State it should grant a credit for the withholding tax of the other State.\textsuperscript{1043}

Kofler also criticizes the Court’s stance not to tackle juridical double taxation under the freedoms and especially the reason given by the Court for it, that is, Union law does not lay down any priority rules which could help the Court in allocating taxing rights between the Member States. He points out that the Court does create implicit priority rules in other areas of the direct tax case law where it uses a discrimination-based analysis, such as the granting of personal and family benefits, the double use of losses and the double utilization of a depreciation in the value of assets.\textsuperscript{1044}

\begin{footnotes}
\textsuperscript{1037} Vanistendael, supra note 1036, p. 419.
\textsuperscript{1038} Vanistendael, supra note 1028, Ch. 4.6.
\textsuperscript{1040} Ibid. pp. 145-148.
\textsuperscript{1041} Ibid. p. 149.
\textsuperscript{1042} Ibid. pp. 150-151.
\textsuperscript{1043} Ibid. 152-154.
\textsuperscript{1044} Kofler, supra note 960, p. 131.
\end{footnotes}
The Court’s reasoning regarding the lack of Union law laying down criteria for allocation of taxing rights between the Member States can be criticized also on the ground that it seems to contradict the Court’s settled general case law according to which, the application of the fundamental freedoms cannot be made subject to the existence of harmonization in the area concerned (see Section 8.2.1).

On the other extreme of academic opinions, Weber argues that the sovereignty of the Member States in direct taxation would be compromised if double taxation were characterized as a prohibited restriction falling under the scope of the fundamental freedoms. In that case, the Court would need to assume a political decision when deciding which Member State should have a priority to tax, which would violate the basic assumption of the Court’s case law, that is, Member States are free to choose the connecting factors according to which they define and allocate between themselves taxing jurisdictions.1045 Similarly, Wattel maintains that the mutual recognition approach does not work in direct tax matters, as there is no EU rule that would designate which jurisdiction should recognize which jurisdiction’s subjection to tax.1046

Another question regarding the Court’s approach to juridical double taxation is to what extent it is coherent with other segments of its case law. Kofler points out that the Court’s stance on juridical double taxation deviates not only from the case law on regulatory double burdens but also from that on indirect taxes and social security contributions.1047 In particular, with regard to double burdens in cases involving social security contributions the Court held that not taking into account by the host State of social security obligations already fulfilled in the Member State of origin constitutes a restriction on the exercise of the freedoms. For example, in Arblade it held:

“National rules which require an employer, as a provider of services within the meaning of the Treaty, to pay employers’ contributions to the host Member State’s fund, in addition to those which he has already paid to the fund of the Member State in which he is established, constitute a restriction on freedom to provide services. Such an obligation gives rise to additional expenses and administrative and economic burdens for undertakings established in another Member State, with the result that such undertakings are not on an equal

1046. Terra and Wattel, supra note 942, p. 904.
Likewise, the Member State of residence in calculating social security contributions payable there has to take into account any amount which has already been paid in another Member State on income received from the latter State.\textsuperscript{1049} As it appears, in the domain of social security contributions double burdens are qualified by the Court as prohibited restrictions on the applicable freedom. As regards the differing treatment of juridical double taxation, on the one hand, and regulatory double burdens and double burdens in the field of social security, on the other, Kofler suggests that it may be due to the fact that in the latter areas one can identify natural priorities as regards the exercise of regulatory or taxing powers whereas a natural priority does not exist in the context of juridical double taxation.\textsuperscript{1050} It is true that in the case of product regulations or qualification requirements there is a natural priority for the State of origin to exercise its regulatory power. In the area of social security, the existing EU coordination regulations may provide for priority rules. However, before the entry into force of such regulations or outside the scope of the regulations no priority rules were or are available which, however, did not prevent the Court from outlawing double burdens in the social security area.\textsuperscript{1051} Moreover, although ‘natural priority’ may not exist in the case of cumulative exercise of taxing powers, we have seen above a range of proposals by the academia as regards tools and guidance which can help the Court in deciding which Member State has the prior right to tax.

The leading case on double burdens in the Court’s indirect tax jurisprudence is \textit{Gaston Schul}.\textsuperscript{1052} In the early stages of VAT harmonization, cross-border private-to-private transactions could lead to double taxation, as in the case of supply by a private person no refund of VAT was granted on exportation while importation was subject to VAT.\textsuperscript{1053} In \textit{Gaston Schul}, the question was...
whether the levying of VAT in the Netherlands on the importation by a private person of a second-hand boat from another Member State supplied by another private person was compatible with what is now Article 110 TFEU prohibiting discriminatory indirect taxation. The Court held that:

“ [...] at the present stage of Community law the Member States are free, by virtue of Article 95 [now Article 110 TFEU], to charge the same amount on importation of products as the value added tax which they charge on similar domestic products. Nevertheless, this compensation is justified only in so far as the imported products are not already burdened with value added tax in the Member State of exportation since otherwise the tax on importation would in fact be an additional charge burdening imported products more heavily than similar domestic products.”  

Hence, the Court perceived the double charge to VAT as discrimination which creates a heavier burden on imported goods than on domestic ones. As we discussed above, Article 110 TFEU is based on a discrimination standard, therefore, an infringement of that provision cannot be established unless double taxation is qualified as a discriminative burden on imported products. The Court held that, in order to comply with Article 110, the Member State of import must credit the residual foreign VAT still present in the second-hand value of the boat when it levies its own VAT on importation:

“ [...] it is necessary also to take into account the value added tax levied in the Member State of exportation for the purpose of determining the compatibility with the requirements of Article 95 [now Article 110] of a charge to value-added tax on products from another Member State supplied by private persons where the supply of similar products within the territory of the Member State of importation is not so liable. Accordingly, in so far as such an imported product supplied by a private person may not lawfully benefit from a remission of tax on exportation and so remains burdened upon importation with part of the value added tax paid in the Member State of exportation the amount of value added tax payable on importation must be reduced by the residual part of the value added tax of the Member State of exportation which is still contained in the value of the product when it is imported. [...]”  

As it appears, in the context of value added tax, the Court interpreted Article 110 TFEU as requiring the recognition of the tax paid in another Member State. In other words, it applied the principle of mutual recognition. Weber calls this approach mutual acceptance having regard to the fact that the Member State of import is not completely barred from applying its own

1055. Ibid. para. 34.
tax. Rather, it has to accept the tax levied by the other Member State by
giving a credit for it. Thus, under the principle of mutual acceptance, the
Member State may apply its own tax system and may levy an additional
tax if there is room for that after granting a credit for the tax of the other
Member State.¹⁰⁵⁶ Weber, at the end, does not differentiate between the two
principles as regards the question whether they could be applied to the field
of direct taxation. In his view, both the principle of mutual recognition and
the principle of mutual acceptance can only be applied in those areas where
the basic assumptions, general contours and substance of the law governing
the area in question are harmonized throughout the Union. In such case,
the rules of the origin State, which – due to the harmonization – must be
similar to those of the destination State, can be recognized and can be given
priority.¹⁰⁵⁷ Along the same lines, most of the scholars do make a distinction
between harmonized and non-harmonized areas of law with regard to the
question whether double taxation can be regarded as a prohibited infringe-
ment of the freedoms (or other provisions of primary law) and whether it
can be resolved by applying the principle of mutual recognition. The major-
ity points out that the Gaston Schul approach only applies to harmonized
fields of law.¹⁰⁵⁸ This is, indeed, clear from the Court’s subsequent case
law excluding “charges regulated by independent national legislation” from
such approach.¹⁰⁵⁹ As held in Nygård with regard to a non-harmonized pig
slaughter levy:

“As it stands at present, Community law does not contain any provision desig-
ned to prohibit the effects of double taxation occurring in the case of charges,
such as that in issue in the main proceedings, which are governed by indepen-
dent national legislation, and, while the elimination of such effects is desirable
in the interests of the free movement of goods, it may none the less result only
from the harmonisation of national systems [...]”¹⁰⁶⁰

If the distinguishing criterion is, indeed, the harmonized or non-harmoni-
zed nature of the area of law in question, the Court’s approach seems to
be coherent.¹⁰⁶¹ While in Gaston Schul it qualified the (full) double charge
of harmonized VAT on a certain transaction as an infringement of primary
Union law, in Nygård – as regards a non-harmonized agricultural levy – and

¹⁰⁵⁷. Ibid. p. 19.
¹⁰⁵⁸. Kofler, supra note 960, p. 110-111; Terra and Wattel, supra note 942, p. 16; Englisch,
supra note 975, Ch. 1.3.1.2.
¹⁰⁵⁹. ECI, 27 October 1993, Case C-72/92 Firma Herbert Scharbatke GmbH v Germany,
para. 15.
¹⁰⁶⁰. ECI, 23 April 2002, Case C-234/99 Niels Nygård v Svineaftgiftsfonden, and Ministeriet
for Fødevarer, Landbrug og Fiskeri, para. 38.
¹⁰⁶¹. Snell, supra note 958, p. 365.
in *Kerckhaert-Morres* – as regards non-harmonized income taxes – it held double taxation not to be prohibited by the provisions of primary Union law.\(^{1062}\)

8.2.2.4. Assessment

From the analysis above it appears that the Court – differently from non-tax fields – applies merely a discrimination standard to national tax measures when reviewing their compatibility with the fundamental freedoms to the effect that tax measures which apply without distinction to cross-border and purely domestic situations are not caught by the prohibitions set out under the free movement provisions.\(^{1063}\) As to the possible reasons for the divergent approach towards tax measures, political sensitivity of fiscal issues, the redistributive nature of tax rules and the practical difficulties in extending the broad restriction approach to fiscal measures are mentioned in academic literature.\(^{1064}\)

The use of the discrimination standard has consequences with regard to two categories of national tax measures. First, non-discriminatory tax measures stemming from the legislation of one Member State which, despite their equal effect on cross-border and domestic situations, could potentially hinder the exercise of free movement rights fall outside the scope of the fundamental freedoms. Admittedly, there are a few exceptions in the case law which point to the opposite direction. In the domain of indirect taxes the Court maintained the theoretical possibility for an indistinctly applicable indirect tax to infringe the freedoms if, due to its amount, it would prevent or render excessively difficult the exercise of the freedom concerned. However, on the basis of the case law, such theoretical possibility appears highly unlikely to materialize when it comes to the review of any actual

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1062. Kofler considers that *Nygård* is not a good precedent, as the double imposition of a charge on live pigs exported from Denmark to Germany which was at issue in *Nygård* can be distinguished from the case of juridical double taxation, as the charges in *Nygård* concerned two separate taxable events, i.e. export of live animals on the one hand and slaughtering abroad on the other hand. See Kofler, supra note 960, p. 119 FN 136. We do not fully agree with this analysis, as the taxable event in the case of the pig levy was the “withdrawal of the pigs from the national herd” whether by way of export or by way of slaughter in the national market (see Case C-234/99 *Nygård*, paras. 28-29). Thus, the German levy at the time of slaughter concerns the same taxable event, withdrawal from the (German) national herd, as the Danish levy at the time of export. It is true, however, that a double charge of an indirect tax may not be fully assimilated to juridical double taxation in the context of a direct tax.

1063. Differently, Douma, see supra note 387, pp. 204-205, 226.

1064. Snell, supra note 958, p. 355-357.
national indirect tax. As far as direct taxes are concerned, there are two cases—*Futura* and *Deutsche Shell*—which seem to refute the tenet that the Court considers only discriminatory tax obstacles to fall within the ambit of the freedoms. However, both cases show some peculiarities due to which they cannot affect the general validity of this statement. As we have discussed above, *Futura* can either be explained by the discrimination doctrine itself or by the fact that it represents a sort of regulatory double burden which generally falls within the scope of the freedoms in non-tax fields and is thus considered to be different from double burdens deriving from the exercise in parallel of taxing jurisdictions by two Member States. *Deutsche Shell* is peculiar in the sense that due to the nature of the disadvantage at issue—non-deductibility of currency exchange loss—no domestic situation could be identified as a comparator for the cross-border situation under review. Although in such a case a discrimination-based analysis is not feasible, the Court considered that a situation in which a financial loss is incurred as a consequence of the exercise of the freedom of establishment and in which the loss can only be taken into account by one of the Member States concerned cannot remain outside the scope of that freedom.

The second category of tax measures which remain outside the scope of the fundamental freedoms is constituted by those tax rules which entail no discrimination between cross-border and domestic situations in themselves but due to their interaction with different or even similar rules of other Member States, they cause obstacles to free movement. In other words, the use of a discrimination standard for measuring the compatibility of national tax provisions with the fundamental freedoms excludes two-country problems from the scope of the freedoms. The fundamental freedoms offer no solution for barriers caused by either disparities resulting from differences between the tax systems of the Member States or double burdens deriving from the exercise in parallel of taxing powers by two or more Member States.

1065. Case C-250/95 *Futura*; ECJ, 28 February 2008, Case C-293/06 *Deutsche Shell* v *Finanzamt für Großunternehmen in Hamburg*. See Kofler, supra note 960, p. 97. Douma mentions that the Court in *National Grid Indus* cited the broad restriction test (CI, 29 November 2011, Case C-371/10 *National Grid Indus* BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, para. 36) referring to *Caixa Bank* (ECJ, 5 October 2004, *CaixaBank France* v *Ministère de l’Économie, des Finances and de l’Industrie*), a case where an indistinctly applicable non-tax measure was held to be in breach of the freedom of establishment, see Douma (EC Tax Review), supra note 387, p. 78. We do not consider this conclusive on the question whether the Court would apply the restriction standard to a non-discriminatory direct tax rule, as the exit tax at issue was a discriminatory measure.

1066. Opinion of Advocate General Sharpston, 8 November 2007, Case C-293/06 *Deutsche Shell* v *Finanzamt für Großunternehmen in Hamburg*, paras. 32-34.

1067. Case C-293/06 *Deutsche Shell*, paras. 28-32.
8.2.3. Positive integration and negative integration in the field of taxation

8.2.3.1. Legal aspects

When examining the interaction between positive and negative integration in the field of taxation, we need to start with a legal-technical analysis of the scope of the legal provisions which underlie these methods of integration. As the real state of affairs may differ from what is laid down in the Treaty, in the following Section we will look at the actual roles that the different means of integration played in European tax integration as well as some policy considerations as regards what role they should play.

As we have discussed above, harmonization in taxation can be adopted on the basis of Article 113 TFEU (indirect taxes) or Article 115 TFEU (direct taxes). The wording of both provisions refers to the internal market as the ultimate objective of the harmonization measures adopted on their basis (see Section 8.1.). It follows from the non-tax case law regarding Article 114 TFEU that Article 115 TFEU – which is also a general legal basis provision worded similarly to Article 114 – can be used as a legal basis for adopting a harmonization measure concerning direct tax laws if such measure is actually intended to improve the conditions for the establishment and functioning of the internal market (see Section 5.2.).1068 This should apply not only to Article 115 but, most likely, also to Article 113.1069 Admittedly, the latter contains a specific authorization for the harmonization of indirect taxes, which implies that, in the eyes of the founders of the Treaty, such harmonization does contribute to the improvement of the conditions of the internal market. Therefore, it seems to be unnecessary to justify the use of Article 113 for the purpose for which it was inserted to the Treaty. However, the text of Article 113 includes an express proviso that harmonization on its basis can be enacted to the extent “necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition”. Therefore, the case law circumscribing the scope of Article 114 may still be relevant for the interpretation of such proviso in the context of Article 113.

1068. Case C-376/98 Tobacco Advertising, paras. 83-84. See also ECI, 12 December 2006, Case C-380/03 Germany v European Parliament and Council, para. 80; ECI, 20 May 2003, Joined Cases C-465/00, C-138/01 and C-139/01 Rechnungshof v Österreichischer Rundfunk and Others, paras. 41-42; ECI, 6 November 2003, Case C-101/01 Criminal proceedings against Bodil Lindqvist, paras. 40-41.

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The starting point in terms of the case law on Article 114 is that there must be disparities between the various national tax legislation in order for Article 115 or Article 113 to be used as a legal basis for harmonization measures. However, the mere existence of disparities between the tax rules of the Member States is not sufficient to justify recourse to Article 115 or 113; it is also necessary that the disparities create, or are likely to create, legal obstacles to trade or the exercise of the fundamental freedoms or result in appreciable distortions of competition. The condition that there must be a trade barrier or other obstacle to the exercise of the freedoms links these legal basis provisions to the fundamental freedoms whilst the prerequisite of distortion of competition connects them to the State aid rules.

Therefore, the question is which obstacles to the exercise of the fundamental freedoms are to be tackled by having recourse to the freedoms, and which by using Article 115 TFEU for the purpose of adopting harmonization. On the one hand, the case law cited above sets, as a precondition for the use of Article 115, the existence of disparities. On the other hand, as concluded in the previous Section, the scope of the fundamental freedoms does not extend to disparities or to other two-country problems. Hence, in the field of taxation the scope of the fundamental freedoms and that of harmonization can be delineated in a way that the former covers discriminatory tax provisions stemming from the legislation of one Member State whereas the latter extends to disparities, that is, differences between the tax systems of the Member States which impede the exercise of the freedoms or distort competition. In this context, ‘disparities’ should be understood as covering double burdens caused by the cumulative exercise of tax jurisdiction by more Member States even if the latter do not (always) derive from differences between the tax rules of various Member States. Thus, harmonization based on Article 115 or Article 113 is intended to deal with disparities and double taxation. Besides the Tobacco Advertising case law, which applies only by analogy to Articles 113 and 115, this interpretation of the scope of the latter provisions is confirmed expressly by the Courts:

“The purpose of Article 93 EC [now Article 113 TFEU] is to reduce obstacles to trade resulting from differences between domestic systems of taxation, even when they are applied in a non-discriminatory manner.”

1070. Case C-380/03 Germany v European Parliament and Council, para. 51.
1071. Ibid. paras. 55, 58, 67-68.
1072. Case 171/78 Commission v Denmark, para. 20. Although the statement was made as regards the relationship of Articles 113 and Article 110 TFEU, it is also true for the relationship of the Article 115 TFEU and the fundamental freedoms as regards direct taxes especially that the freedoms operate with a discrimination standard in the field of direct taxation just as Article 110 does in the field of indirect taxation. See also GC, 21 March
In other words, whereas the freedoms are only concerned with one-country problems, tax harmonization is aimed at targeting two-country problems in the internal market.

The scope of the State aid rules and harmonization based on Article 113 or Article 115 can be delineated along similar lines. Tax measures, just as any other measure of a Member State, constitute State aid within the meaning of Article 107 TFEU if they satisfy the cumulative criteria of (i) conferring an advantage on the recipient, (ii) being financed by the State or through State resources, (iii) being selective, and (iv) affecting trade between the Member States and distorting competition. The wording of Article 113 TFEU expressly includes that indirect taxes can be harmonized on this basis if it is necessary to avoid distortion of competition. With regard to Article 115, the case law discussed above lays down that it can be used also for the purpose of eliminating (appreciable) distortions of competition. Thus, the existence of distortion of competition is a – necessary or alternative – condition for the application of all three Treaty provisions. Therefore, the question is again which obstacles causing distortion of competition fall within the scope of one or other of the provisions. The scope of the provisions cannot be delimited by giving a different interpretation to the notion of ‘distortion of competition’. This has been declared unequivocally by the General Court:

“[...] the rules governing the harmonization of domestic fiscal legislation, including the rules on exercise duties, laid down in Article 93 EC [now Article 113 TFEU] and in Directive 92/81, and the rules on State aid set out in Articles 87 EC to 89 EC [now Articles 107 and 108 TFEU] pursue the same objective, namely to promote the proper functioning of the internal market by combating, especially, distortion of competition. In the light of their common objective [...] in order for those different rules to be implemented consistently, the notion of distortion of competition must be regarded as having the same scope and the same meaning with regard to both the harmonisation of domestic fiscal legislation and State aid. [...]”

Hence, it appears to be logical to interpret the relative scope of the State aid rules and the harmonization provisions in the same way as that of the latter and the fundamental freedoms. Accordingly, the State aid rules are aimed at selective tax measures distorting competition which derive from

2012. Joined Cases T-50/06 RENV, T-56/06 RENV, T-60/06 RENV, T-62/06 RENV and T-69/06 RENV Ireland, French Republic, Italian Republic and Others v Commission, para. 66.

1073. Joined Cases T-50/06 RENV, T-56/06 RENV, T-60/06 RENV, T-62/06 RENV and T-69/06 RENV Ireland and Others v Commission, para. 72.
the laws of one Member State (see Section 9.4.1.) whereas harmonization based on Articles 113 and 115 targets those distortions of competition which are caused by disparities between the tax legislation of the Member States.

The picture is further complicated by the provisions under Articles 116-117 TFEU, which also refer to a situation where a difference between the legislation of the Member States distorts competition. Article 116 provides:

“Where the Commission finds that a difference between the provisions laid down by law, regulation or administrative action in Member States is distorting the conditions of competition in the internal market and that the resultant distortion needs to be eliminated, it shall consult the Member States concerned.

If such consultation does not result in an agreement eliminating the distortion in question, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall issue the necessary directives. Any other appropriate measures provided for in the Treaties may be adopted.”

Having regard to our conclusion that Articles 113 and 115 TFEU are intended to be used for adopting harmonization which eliminates, inter alia, distortions resulting from disparities between the laws of the Member States, the question arises what then is the function and role of Article 116 which could differentiate it from Articles 113 and 115. It is an especially acute question, as Article 116 TFEU authorizes the adoption of directives by the ordinary legislative procedure, that is, by qualified majority voting, which could offer an easy escape from the paralysing unanimity requirement under Articles 115 and 113.1075 The meaning and possible use of the provisions of Articles 116-117 TFEU is all the more unclear due to the fact that it has hardly ever been used or, at least, the procedure initiated under its provisions has never resulted in the adoption of a directive. An investigation into the purpose and function of these provisions is outside the scope of this thesis.1076 It suffices to point out here that, according to the most common

1074. Article 117 TFEU provides for a procedure by which Member States can consult the Commission before introducing or amending a provision which may cause distortion within the meaning of Article 116 TFEU and the Commission can make recommendations to the Member States concerned in order to avoid such distortion.

1075. Kemmeren appears to assume that the Lisbon Treaty brought about a change to this provision to the effect that the qualified majority voting had been changed to unanimous voting, see supra note 505, p. 47. He maintains that the ordinary legislative procedure in the field of taxation means unanimous voting. Contrarily, Article 294 TFEU defines a single and uniform ordinary legislative procedure, which entails qualified majority voting in the Council and which applies to all the policy fields and EU actions covered by the TFEU.

1076. For a thorough and detailed analysis of the provisions under Article 116-117 TFEU based on the Commission’s explanatory documents, case law and academic literature on the subject, see the forthcoming PhD thesis of Martijn Nouwen.
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interpretation, the application of the provisions requires the presence of specific distortions.1077 Advocate General Geelhoed, who took this view in his Opinion in GIL Insurance, explained that specific distortions are imbalances between or within the national economies that occur in parts of sectors within the national economies.1078 He opined that, besides the provisions of Articles 116-117 TFEU, the Treaty envisages the State aid rules for tackling specific distortions. What distinguishes the two sets of rules is that the State aid rules are aimed at specific distortions caused by State intervention which grants advantages to certain parts of a sector whereas Articles 116-117 are aimed at specific distortions resulting from public measures imposing a burden on certain parts of a sector.1079 His conclusion regarding the relationship of the State aid rules and Articles 116-117 is that “in terms of the history and structure of the Treaty, Articles 87 to 89 EC [now Articles 107-108 TFEU] are, by virtue of the specific nature of the intervention instrument, namely the grant of State aid, to be viewed as leges speciales under the aegis of the general rules laid down in Articles 96 and 97 EC [now Articles 116-117 TFEU]”.1080 Advocate General Geelhoed defined the scope of Articles 116-117 also in relation to Article 115. In his view, harmonization of legislation based on Article 115 is intended to address generic distortions, that is, imbalances at intermediate or sectoral level which are mostly traceable to disparities in legislation.1081 Hence, he perceives the State aid rules as dealing with specific advantages, Articles 116-117 with specific burdens and Article 115 with generic disparities between the legislation of the Member States. As we will discuss it in Part III, we do not agree with the view that the State aid rules capture only selective advantages to the exclusion of selective burdens (see Section 9.3.3.4.), therefore, in our view, this criterion is not capable of delimiting the State aid rules from Article 116. Further, the wording of Article 116 expressly mentions differences between the legal provisions of the Member States suggesting that its purpose is to deal with disparities just as Article 115. In contrast, in the interpretation of Advocate General Geelhoed, a selective burden itself – whose selectivity is to be judged within the framework of the jurisdiction of one single Member State – is

1077. The interpretation is based on the Spaak Report (Rapport – Des Chefs de Délégation aux Ministres des Affaires Etrangères, Bruxelles, 21 avril 1956, at pp. 60-66) and was adopted by the Commission in its internal documents relating to the use of Article 116 TFEU (Commission Legal Services, ‘Union politique – Article 101 du traité CEE’, doc. nr. JUR(91)02385, 16 avril 1991).

1078. Opinion of Advocate General Geelhoed, 18 September 2003, Case C-308/01 GIL Insurance Ltd and Others v Commissioners of Customs and Excise, para. 64. Concurringly, see Terra, supra note 948, p. 103.

1079. Opinion of Advocate General Geelhoed, Case C-308/01 GIL Insurance, 65.

1080. Ibid. para. 67.

1081. Ibid. para. 63.
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capable of triggering the application of Article 116 irrespective whether or not it interacts with differing provisions of other Member States. This seems to contradict the language of Article 116 which requires a distortion caused by differences between national legislations. Accordingly, in our view, the relationship of Article 107 and Article 116 cannot be regarded as that of \textit{lex specialis} – \textit{lex generalis}. The two provisions concern inherently different situations; Article 107 deals with one-country problems whereas Article 116 with two-country problems.

According to the Commission’s interpretation of the scope of Article 116, the requirement of specific distortion is met if (i) a group of companies in a Member State is subject to a lighter or heavier charge than other groups in the same Member State, (ii) in other Member States there is no similar deviation for a comparable group of companies and the national intervention at issue has an external influence affecting competitive conditions across the borders, and (iii) the deviation is not offset by compensating measures.\textsuperscript{1082} We cannot agree with this interpretation either. In essence, a measure which meets the conditions set by the Commission qualifies as a selective measure deriving from the legislation of one single Member State. As such, it too can be dealt with by the State aid rules which set forth a much more effective mechanism for dealing with selective measures distortive on competition than Article 116 does. Therefore, to target such measures we do not need Article 116.

In our view, in defining the scope and function of Article 116 TFEU, the starting point is that it is intended to deal with distortions flowing from differences between the legislations of the Member States. Hence, it is aimed at two-country problems which delineates it from the State aid rules. Thus, a national measure or regime which falls under Article 116 must be non-selective, i.e. a general measure within the reference framework constituted by the legislation of the Member State which introduced it. The specific distortion requirement would be met by such measure or regime if it were only one Member State, or very few Member States, which has the measure in place under its laws. This is the criterion which distinguishes the scope of Article 116 from that of Article 115 which should be reserved for rules which are widespread across the Member States and which vary from one Member State to the other. Under Article 116 the distortion would be caused by the interaction of the special regime or measure with the normal rules of the other Member States. An example could be the introduction of general rules for the tax treatment of interest according to which interest

\textsuperscript{1082} Commission Legal Services ‘Union politique – Article 101 du traité CEE’, p. 5.
is non-deductible for the payer and exempt for the recipient. If one single Member State (or two or three Member States) introduces such a reverse tax treatment for interest it could cause considerable distortions in the internal market. Article 116 could be the right instrument to deal with such distortions. Potentially, the measure could also fall under the Code of Conduct as a harmful tax measure; however, as the Code of Conduct is a non-binding instrument, Article 116 could be used to reinforce the latter if the ‘soft mechanism’ under the Code does not lead to the elimination by the Member State of the harmful measure. Article 116 could all the more fulfil such function due to the qualified majority voting rule that it contains.

In summary, the theoretical model for defining the scope of the various Treaty provisions on which positive and negative integration is based is as follows: (i) Articles 113 and 115 are aimed at disparities which derive from differences in tax rules that are present in the laws of numerous Member States and double taxation which occurs widely and frequently within the Union; (ii) the fundamental freedoms are aimed at discriminatory tax provisions which stem from the tax system of one Member State; (iii) the State aid rules are aimed at selective tax measures which stem from the tax system of one Member State; and (iv) Article 116 is intended to deal with disparities which cause specific distortions in the sense that a special regime of one or just a very few Member States which qualifies as a general measure within the national jurisdiction interacts with the standard regime of other Member States to the effect of causing distortion of competition. As we will see in the following Section, in practice, the scope of positive and negative integration does not correspond to this theoretical model, meaning that there are overlaps between their respective scopes and there are obstacles which are left mainly unresolved by both means of integration.

1084. Similarly, Kemmeren who suggests, with respect to the Dutch Group Interest Box, that combining Article 116 TFEU with the Code of Conduct for tackling distortions which do not qualify as State aid can be as effective as the combination of the Code of Conduct and the State aid rules were in the first years of 2000’s when the Commission initiated State aid procedures with respect to some of the regimes contained in the Primarolo Report (Report on Code of Conduct (Business Taxation), SN 4901/99, 23 Nov. 1999), see Kemmeren, supra note 505, p. 47.
8.2.3.2. Practical and policy aspects

To recall again, obstacles stemming from disparities – i.e. differences between the tax systems of the Member States – do not fall within the scope of the fundamental freedoms. Nor do double burdens caused by the exercise in parallel of tax jurisdiction by more Member States. According to the Tobacco Advertising case law, harmonization based on Articles 115 or Article 113 can be adopted if it aims at disparities which create obstacles to the exercise of the freedoms or distort competition. As tax disparities and juridical double taxation undoubtedly create obstacles to the exercise of the freedoms – in the words of Advocate General Colomer, in fact, the most serious obstacles that can exist in an internal market – such obstacles should evidently fall within the scope of harmonization authorized by Article 115 or Article 113. Nevertheless, some academic commentators suggest that the fact that such barriers were expressly found by the Court to fall outside the scope of the Treaty freedoms may mean that they cannot qualify as ‘obstacles to the exercise of the freedoms’ for the purpose of having recourse to Article 115 and therefore, they cannot form the subject of harmonization.1085

In other words, according to this view, competence to harmonize exists only where the fiscal treatment accorded by a Member State to a situation amounts to a restriction within the meaning of the free movement provision. The view that “if there is no Treaty prohibition, there is theoretically no competence to harmonize” is thus derived from the Tobacco Advertising case law.1086 In our opinion, this cannot be the meaning of the case law interpreting the scope of the legal basis provisions for harmonization. First, the terms used by the Court in the relevant case law, such as ‘obstacles to the exercise of the fundamental freedoms’, ‘disparities that impede the free movement of goods and services’, ‘obstacles to trade’ and ‘barriers’,1087 do not suggest that what is required for the adoption of harmonization is a ‘restriction’ in the formal legal sense which would be prohibited by the provisions on the Treaty freedoms. Second, as pointed out by Schrauwen, the proponent of the contested opinion herself, the Court has indicated in some cases that harmonization is the proper instrument to deal with the disadvantageous

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1085. Schrauwen, supra note 1069, p. 18-19 and the sources she refers to in FN 11.
1086. Ibid. Schrauwen adds that even if ‘restriction’ on the freedoms is not present in the case of juridical double taxation, harmonization targeting such double taxation may be based on the premise that it is necessary for the elimination of ‘appreciable distortion of competition’ which is acknowledged by the Tobacco Advertising case law as another reason justifying the use of Article 114 TFEU, see Schrauwen, supra note 1069, FN 13.
1087. Case C-380/03 Germany v European Parliament and Council, paras. 58, 55, 67, 68.
effects of double taxation. Apart from the legal arguments, the view that harmonization measures can only be adopted to deal with those restrictions on the internal market which are otherwise prohibited by the fundamental freedoms should be rejected for practical reasons as well. Due to the limits on the scope of the fundamental freedoms, harmonization seems to be – apart from voluntary coordination and the theoretically available option under Articles 116-117 TFEU – the only integration instrument that could tackle disparities and juridical double taxation. It would make no sense to limit the scope of harmonization to those impediments which anyway, can be dealt with by the Treaty freedoms. This would deprive harmonization of its main function and usefulness. Thus, we fully agree with the view – shared with the great majority of the academic community – that “a chief objective of tax harmonization by acts of the EU institutions […] is to reduce disparities between national tax systems and allocate taxing rights between the Member States”, which the Court cannot achieve by way of negative integration.

Another concern that can be raised with regard to the case law laying down the conditions under which recourse can be had to Article 114 – and in turn, to Articles 115 and 113 TFEU – is that it may possibly question the correctness of the legal basis of the tax directives dealing with administrative assistance and exchange of information. The Savings Directive is based solely on Article 115 whereas the Directive on administrative cooperation and the Directive on mutual assistance for the recovery of tax claims are based on the joint basis of Article 113 and Article 115. They are aimed at developing administrative cooperation between the Member States in order to help them assess and collect the taxes due to their treasuries in times of increased mobility of taxpayers and globalized businesses. With this aim, they certainly do not contribute to eliminating ‘obstacles to the exercise of the freedoms’. However, the other ground acknowledged by the case law cited above (and expressly included in Article 113), namely, dealing with disparities causing ‘distortion of competition’, can justify the use of Articles 115 and 113 as a legal basis for these directives. The inability of the Member States to assess and collect taxes on international transactions and transnational business operations in the absence of exchange of information between their authorities and the resulting patterns of tax evasion

1088. Case C-234/99 Nygård, para. 38 cited by Schrauwen, supra note 1069, p. 19. For a statement, in the context of Articles 113 and 110 TFEU, that harmonization and the primary law prohibitions target different kind of obstacles, see Case 171/78 Commission v Denmark, para. 20 andJoined Cases T-50/06 RENV, T-56/06 RENV, T-60/06 RENV, T-62/06 RENV and T-69/06 RENV Ireland v Commission, para. 66.

1089. Englisch, supra note 975, Ch. 1.1.
and fraud can, unquestionably, distort competition in the internal market. The Preamble to the Savings Directive makes this point when it expressly refers to “distortions in the capital movements between the Member States”. Having regard to this we can conclude that harmonization measures tackling issues of administrative assistance do improve the functioning of the internal market and thus, can be based on Articles 115 and/or 113.

As we concluded above, legally speaking, nothing prevents the harmonization of national tax provisions for the purpose of eliminating disparities and juridical double taxation. Nonetheless, harmonization has not been able to fulfill such function in the field of direct taxation, the latter being an area that the Member States regard as the last reservoir of their national sovereignty which they firmly protect through their veto power accorded to them by the unanimity rule of Article 115 TFEU. In the non-tax field, in a similar situation the Court interpreted the fundamental freedoms in a dynamic way to the effect of expanding their scope to disparities which led to double burdens on the intra-Union movement of goods. Such adaptation of the scope of the fundamental freedoms has not occurred in the domain of direct taxation. Thus, one of the aspects of the interaction between harmonization and negative integration based on the fundamental freedoms in the direct tax field is that there is a certain category of obstacles – disparities and juridical double taxation – which remains largely unresolved both by the freedoms and by harmonization based on Article 115. While the former has legal reasons, i.e. the interpretation given to the scope of the fundamental freedoms by the Court, the latter is due to practical circumstances, i.e. difficulty to bring about harmonization in a sensitive policy area.

Another aspect of the relative scope of harmonization and the freedoms relates to the question whether the problems that the existing direct tax directives address could also be resolved by having recourse to the fundamental freedoms. Obviously, the Savings Directive and the two directives on administrative assistance attend to problems – insufficient cooperation and exchange of information between the authorities of the Member States – with regard to which the fundamental freedoms, which confer rights on individuals, would be of no use. However, the Parent – Subsidiary Directive, the Merger Directive and the Interest and Royalties Directive lay down rules which are intended to facilitate the internal market by giving effect to the fundamental freedoms in the interest of European (corporate) taxpayers that are also the beneficiaries of the fundamental freedoms. From a legal point of view, harmonization and negative integration are not mutually exclusive (see Section 8.2.1.) and not even the theoretical model, which only describes the intended scope of the relevant legal provisions (see Section 8.2.3.1.),
suggests such. Yet, from a pragmatic point of view, the question can be raised whether the harmonized systems that the above mentioned direct tax directives set up are, indeed, necessary in view of what could be achieved by the application of the fundamental freedoms. The fact that the regimes introduced by these directives are – to a certain extent – substitutable by the fundamental freedoms can be demonstrated by a case in which the tax neutrality regime provided for under the Merger Directive was claimed to be applied to a share exchange between a Finnish and a Norwegian company. The Merger Directive does not apply in a context involving a company resident in an EU Member State and another company resident in a third State party to the Agreement on the European Economic Area (EEA). Nevertheless, the Court held that the tax neutral treatment had to be granted to the transaction concerned on the basis of the freedom of establishment laid down in the EEA Agreement. The Court specifically stated:

“[...] the application of Article 31 of the EEA Agreement to legislation such as that at issue in the main proceedings does not lead to an extension of the scope of Directive 2009/133 to companies established in a third country that is a party to the EEA Agreement. Pursuant to the principle of non-discrimination in Article 31 of the EEA Agreement a Member State is in fact required to apply the tax treatment reserved for exchanges of shares between domestic companies to exchanges of shares which also involve a company established in a third country that is a party to the EEA Agreement.”

The fact, however, that the same result can – sometimes – be achieved under the freedoms as that under the harmonized rules of a directive does not conclusively prove that there is no need for such harmonized rules. We can examine the Parent – Subsidiary Directive more closely from this perspective. The Directive defines its objective in the following terms:

“The objective of this Directive is to exempt dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes and to eliminate double taxation of such income at the level of the parent company.”

While this seems to be a rather general objective, subsequently the emphasis is placed on the objective of eliminating discriminatory Member State rules on the taxation of dividend distributions:

“Before the entry into force of Directive 90/435/EEC, the tax provisions governing the relations between parent companies and subsidiaries of different

Member States varied appreciably from one Member State to another and were generally less advantageous than those applicable to parent companies and subsidiaries of the same Member State. Cooperation between companies of different Member States was thereby disadvantaged in comparison with cooperation between companies of the same Member State. It was necessary to eliminate that disadvantage by the introduction of a common system in order to facilitate the grouping together of companies at Union level.  

If indeed the objective of the Directive were no more than neutralizing the discriminatory dividend tax rules of the Member States such objective could also have been achieved by applying the freedom of establishment or the free movement of capital to such national rules. However, compliance with the fundamental freedoms and their non-discrimination standard can be achieved not only by extending the beneficial tax rules to cross-border situations but also by abolishing such rules altogether. Thus, while negative integration could result in a situation that economic and juridical double taxation on distributed dividends remain equally unrelieved in domestic and cross-border situations, the common system set up by the Parent – Subsidiary Directive guarantees the resolution of such double taxation in cases where distribution is made between companies of different Member States irrespective of the corresponding treatment of domestic distributions. In this sense, the system set forth by the Directive goes beyond the non-discrimination requirement of the freedoms. The fact that the objective of the Directive consisting in the elimination of economic double taxation on cross-border dividend distributions cannot be reduced to an obligation of non-discrimination has been expressly confirmed by the Court in Cobelfret: 

"Accordingly, even though, in applying that system to the dividends distributed by both resident subsidiaries and those established in other Member States, the Kingdom of Belgium seeks to eliminate all penalisation of cooperation between companies of different Member States as compared with cooperation between companies of the same Member State, that does not justify the application of a system which is not compatible with the system for preventing economic double taxation set out in the first indent of Article 4(1) of Directive 90/435."

The Preamble to the Merger Directive includes a statement which may be interpreted as an express reference to the fact that a common Union system

1092. Preamble to the Parent – Subsidiary Directive, sixth indent,
1093. ECJ, 12 February 2009, Case C-138/07 Belgische Staat v Cobelfret NV, para. 46. See also ECJ, 4 June 2009, Joined Cases C-439/07 and C-499/07 Belgische Staat v KBC and Beleggen, Risicokapitaal, Beheer NV v Belgische Staat, para. 42.
adopted by way of harmonization can achieve more than the general requirement, which the freedoms entail, that national treatment be extended to comparable cross-border situations:

"It is not possible to attain [the] objective [of the Directive] by an extension at Community level of the systems in force in the Member States, since differences between these systems tend to produce distortions. Only a common tax system is able to provide a satisfactory solution in this respect." 1094

In addition to the fact that the common systems set up by the direct tax directives are independent from any domestic tax treatment, they also enhance legal certainty and transparency by setting forth harmonized specific and – relatively – detailed rules for the taxation of intercompany dividend-, interest-, and royalty payments and corporate reorganizations. Moreover, in 1990, at the time of the adoption of the Parent – Subsidiary Directive and the Merger Directive negative integration in the field of direct taxation was still at an embryonic stage 1095 and the fact that a withholding tax on outbound dividends or the denial of economic double taxation relief on inbound dividends may be an infringement of the fundamental freedoms was just a vague idea discussed by some academics whose voice is rarely heard from the ivory tower of science. Therefore, it did not seem at all superfluous to lay down the specific rules contained in the directives.

In the light of the above, it seems that even if there are overlaps between the scope of the existing harmonization measures in the field of direct taxation and that of the fundamental freedoms, these harmonization measures still serve a useful purpose. Therefore, we cannot draw the conclusion that in the areas covered by negative integration there is no need for harmonization. This is all the more true if we take into account that negative integration had become the driver of European direct tax integration out of necessity due to the lacking harmonization in this field and, accordingly, it is fraught with considerable shortcomings. These shortcomings are discussed extensively by academics who mention the fact that the Court is not a specialized tax court; it cannot decide which cases it takes but has to adjudicate on all the issues brought before it and, in many cases, on the basis of incomplete information. In addition, they point to the difficulty inherent in applying abstract highly general norms to detailed technical tax legislation and the

1095. Up to 1990 the Court decided merely three cases on direct taxation, one on individual taxation (ECJ, 8 May 1990, Case 175/88 Biehl v Administration des Contributions du Grand-Duché de Luxembourg) and two on corporate taxation (ECJ, 28 January 1986, Case 270/83 Commission v France (Avoir Fiscal); ECJ, 27 September 1988, Case 81/87 The Queen v Daily Mail and General Trust plc).
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fact that the Court as a judicial authority decides individual cases without being able to formulate a comprehensive tax policy. All these necessarily lead to the inconsistency of the case law. Due to this, it is a widely-held view that positive integration is much more apt to tackle direct tax obstacles to the internal market than negative integration which currently dominates this field. Advocate General Geelhoed opined along the same line:

“[...] judicial intervention is, by its nature, casuistic and fragmented. As a result, the Court should be cautious in giving an answer to questions arising before it raising issues of a systematic nature. The legislator is better placed to deal with such questions, in particular when they raise issues of inherent fiscal-economic policy considerations.”

While harmonization should not be excluded in areas which are, or have been, subject to negative integration, sometimes it is questioned what a harmonization measure can achieve in such domains. When the Court had already interpreted the fundamental freedoms with regard to a certain issue, the subsequent harmonization measure dealing with that issue must, in principle, be in line with the Court’s previous interpretation given that secondary law cannot overrule primary law in accordance with the principle of hierarchy of norms (see Section 7.3.4.). Therefore, the situation resulting from the Court’s direct tax case law, which is frequently described by commentators as being inconsistent and incoherent, may be difficult to remedy by way of future Union legislation even if the Member States showed far greater willingness to agree on such legislation than they do currently. A solution to this potential problem might be the method of consistent interpretation, which, as we saw in the previous Chapter, the Court uses in a very liberal manner – sometimes even in the reverse, i.e. adapting primary law to secondary law – which can give room to the reconciliation of the Court’s case law on primary law and any potential future secondary legislation. As direct taxation is dominated mainly by technical questions, the regulation of which requires expertise and a policy-based approach, it is very likely that the Court would show a higher degree of deference to the choices of the Union legislature in this field than, for example, in the area of Union citizenship where most of the interpretation questions have a strong fundamental right – aspect.

1096. See Terra and Wattel, supra note 942, p. 37; Snell, supra note 958, p. 369.
1097. Opinion of Advocate General Geelhoed, Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation, para. 39.
1098. Discussion with Professor Peter Wattel at the UvA, Amsterdam Centre for Tax Lax, Department meeting in April 2011.
As another aspect of the interaction between positive and negative integration, it is worth mentioning the analysis conducted by Englisch regarding the question to what extent the CJ’s case law facilitates horizontal tax coordination between the Member States, which – in Englisch’ terminology – encompasses harmonization by way of Union legislation. When answering this question, he draws a basic distinction between harmonized and non-harmonized fields of taxation. His conclusion is that in the non-harmonized domains of taxation the Court’s negative integration exercise contributes little to the coordination of the Member States’ tax systems. He names, inter alia, the use of the non-discrimination standard under the fundamental freedoms and the existence of the ‘rule of reason’ justification as factors being responsible for such a result. Englisch concludes that the situation in non-harmonized areas of taxation is quite grim insofar as the only impact that the CJ’s case law could – theoretically – have on tax coordination is that it could pressure the Member States to agree on harmonization proposals put forward by the Commission. Although a consistent policy-based approach, which the adoption of harmonization measures would entail, could be more attractive for many Member States than dealing with the consequences of the casuistic and sometimes chaotic CJ case law, the case law, in reality, lacks the effect of giving incentive to the Member States to harmonize. In Englisch’s view, the reason for this is that a few Member States have an interest in making use of their veto rights to reject harmonizing Union acts because they actually “benefit revenue-wise from an uncoordinated state of affairs after a ECJ ruling where profits may more easily be shifted to low-tax jurisdictions”.

As regards harmonized fields of taxation, primarily VAT, the CJ’s case law has had a much more positive effect on bolstering tax coordination. This positive effect follows, on the one hand, from the Court’s exclusive competence to give authoritative interpretation to Union legislation, which, evidently, contributes to the uniform implementation and application of secondary Union law throughout the Union. On the other hand, the Court has also used the primary law prohibitions for the purpose of pushing forward coordination in harmonized areas of tax law. Most importantly, as we have discussed in Section 8.2.2.3. (ii), the Court considers that double taxation which occurs in the sphere of application of the VAT Directive – even if it does not infringe any provision of the VAT Directive and thus seems to

1099. Englisch, supra note 975.
1100. Ibid. Ch. 1.2.1.1. and Ch. 1.2.1.2.
1101. Ibid. Ch. 1.2.1.1.
1102. Ibid. Ch. 1.3.
1103. Ibid. Ch. 1.3.1.1.
be endorsed by the latter – violates primary Union law. This conclusion was drawn by relying on Article 110 TFEU prohibiting discriminatory and protective internal taxation\textsuperscript{1104} and with reference to the fact that the fundamental objective of the harmonization of VAT is the encouragement of free movement of persons and goods and the prevention of double taxation.\textsuperscript{1105} Thus, as long as rather comprehensive harmonization is adopted in a certain field the Court feels comfortable to require the elimination of double taxation, even in situations where the provisions of the Directive seem to leave double taxation unresolved.\textsuperscript{1106} It is worth pointing out that, in the eyes of the Court, the degree of harmonization does make a difference. While in the extensively harmonized area of VAT it ventured on allocating taxing rights between the Member States\textsuperscript{1107} in order to resolve double taxation not resolved by the harmonized rules themselves, with regard to dividend taxation – where only a partial harmonization with fairly narrow scope exists – it refrained from such allocation where the situation fell wholly outside the scope of the Parent – Subsidiary Directive. This can be perceived as an acknowledgment by the Court of the fact that in extensively harmonized areas, the Member States have given up national sovereignty to a large extent and therefore, the Court’s interference to the effect of relieving the remaining double taxation can hardly be regarded as an unwarranted encroachment on the Member States’ sovereignty. At the same time, the Gaston Schul case law gives little support to the reasoning of the Court on the basis of which it refuses to resolve juridical double taxation occurring in direct tax cases. As discussed above, in those cases, the Court is not willing to decide which Member States should have a prior right to tax in the absence of any criterion of allocation laid down by Union law. However, in Gaston Schul, in a situation falling within the sphere of application of the VAT Directive – which clearly follows the principle of destination in determining where VAT should be paid – the Court decided the case by allocating taxing rights precisely in the opposite manner to the Directive, that is, it gave priority to the Member State of origin by requiring the Member State of importation to offset the tax paid in the Member State of exportation against its own tax. Apparently, the Court, even when secondary Union law does provide for an allocation rule, deviates from such rule in resolving double taxation.

\textsuperscript{1104} Case 15/81 Gaston Schul and cases referred to by Englisch, supra note 975, FN 172.
\textsuperscript{1105} ECI, 6 July 1988, Case 127/86 Ministère public and Ministre des Finances du royaume de Belgique v Yves Ledoux, para. 11.
\textsuperscript{1106} Englisch, supra note 975, Ch. 1.3.1.2.
\textsuperscript{1107} Englisch describes this allocation as “not so convincing” given that it leads to the taxation of consumption based on the origin principle instead of the destination principle, see Englisch, supra note 975, Ch. 1.3.1.2.
Finally, Englisch points out that the Court’s case law contributes to furthering tax coordination in the field of harmonized taxes by reviewing the Member States’ exercise of remaining legislative discretion against the standards of general principles of EU law and fundamental tax principles.\textsuperscript{1108} Even though indirect taxes, especially VAT, are much more extensively harmonized than direct taxes, the harmonizing Union legislation still leaves a certain margin of discretion to the Member States by way of optional regimes, possibilities for derogation or simply by not regulating certain aspects of the taxes covered (e.g. tax rates, procedural rules). The Court, by controlling the legislation adopted by the Member States under these permissive norms in the light of the general principles of EU law – such as the principle of proportionality, equality and legal certainty and the fundamental rights – sets minimum standards as regards the exercise of Member State’s discretion. Thereby it further approximates the Member States harmonized tax laws. In this respect, some fundamental substantive tax principles developed by the Court’s case law, primarily the principle of neutrality, fulfil the same function.\textsuperscript{1109}

Summarizing the above, negative integration in the field of direct taxation has played an immensely important role in removing discriminatory provisions from the Member States’ tax systems. However, its complementary function to positive integration has been more limited in direct taxation than in the non-tax fields. In particular, the lack of positive integration resolving juridical double taxation has not resulted in the expansion of the scope of the fundamental freedoms to the effect of subsuming obstacles deriving from such double taxation within their reach. In addition, negative integration has not facilitated direct tax coordination between the Member States more than to a negligible extent. Moreover, the dominance of negative integration in the domain of direct taxation has produced inconsistent outcomes bearing all the consequences of the absence of a comprehensive and coherent tax policy. Taking all these into account, positive integration must have a role to play in the area of direct taxation. It can neither be disposed of as being unnecessary with respect to the issues and aspects already covered by negative integration nor can it be dismissed as being practically unachievable. In order to overcome the blocking effect which the unanimity rule has on the adoption of positive integration instruments, various suggestions have been made in the academia, such as the use of enhanced cooperation for moving forward with tax harmonization.\textsuperscript{1110} This appears to have become a reality

\textsuperscript{1108} Ibid. Ch. 1.3.1.3.
\textsuperscript{1109} Ibid.
\textsuperscript{1110} Snell, supra note 958, p. 370; Kemmeren, supra note 505, p. 47; Schrauwen, supra note 1069, pp. 23-27.
now with regard to an indirect tax, as the Council has authorized 11 Member States to move forward with the introduction of a Financial Transaction Tax (‘FTT’)\textsuperscript{1111} and the Commission has already issued a proposal for a directive to that effect.\textsuperscript{1112} In addition, the provisions of Article 116 TFEU, which so far have remained idle in the process of European tax integration, could be activated to adopt directives with qualified majority voting to deal with specific distortions caused by disparities or double taxation. As regards indirect taxation, the situation appears to be much more balanced. Positive integration has led to comprehensive harmonization of the indirect taxes of the Member States leaving to negative integration only an ancillary role, such as the review in the light of primary law of the Member States’ exercise of their remaining discretion when enacting optional regimes or making use of derogations.

8.2.4. Interim conclusions

In the first part of this Chapter, we discussed certain specific characteristics of the tax field, primarily the roles and functions that secondary law and primary law play in this field and their mutual relations. We pointed out the basic difference between indirect taxes and direct taxes, namely, that positive integration has led to comprehensive harmonization of indirect taxes leaving only an ancillary role to negative integration contrarily to the area of direct taxes where the role of positive and negative integration is the reverse. In examining the interaction between these two means of integration we have noted their dynamic relationship and complementary roles. In the non-tax fields this meant that negative integration had substituted for lacking harmonization in the sense that the Court eliminated obstacles to free movement caused by disparities between the laws of the Member States which were left intact by blocked harmonization by bringing such obstacles under the scope of the prohibitions of the fundamental freedoms. On the basis of the examination of the scope of the fundamental freedoms \textit{vis-à-vis} tax measures, we drew the conclusion that such process did not occur in the field of taxation. In particular, the scope of the fundamental freedoms has not been extended to disparities and double burdens, notably double taxation, stemming from the differences between the tax systems of the Member States and the exercise in parallel of tax jurisdiction by two or more Member


States respectively. The Court in the field of taxation, and most notably that of direct taxation, applies a discrimination standard for measuring the compatibility of national measures with the freedoms. Thus, only such national direct tax measures are caught by the freedoms which treat cross-border situations less favourably than comparable domestic situations. Disparities and double taxation can, however, occur due to the application of national measures which are completely neutral and discrimination-free. The freedoms have not been expanded by the Court to these obstacles to the internal market despite the fact that only a few harmonization instruments have been adopted in the field of direct taxation which cover only narrow and specific segments thereof leaving most of the instances of (juridical) double taxation and other barriers caused by disparities potentially unresolved. Hence, while negative integration in the field of direct taxation has played a pivotal role in removing discriminatory provisions from the Member States’ tax systems, its complementary function to positive integration has been more limited than in the non-tax fields as regards two-country problems caused by the coexistence of the different tax systems of the Member States.

As regards indirect taxation, the situation appears to be different. The fact that VAT is comprehensively – although still not exhaustively – harmonized has important consequences as regards the assessment of double taxation occurring in its ambit. In particular, double taxation in the sphere of application of the VAT Directive – even where it seems to be endorsed by the Directive – is considered by the Court as a violation of primary Union law. Thus, as long as rather comprehensive harmonization is adopted in a certain field the Court feels comfortable to require the elimination of double taxation by the Member States and, unlike in the area of direct taxation, it does not shy away from allocating taxing rights between the Member States. The rationale behind the differing attitudes might be that the Court recognizes that in extensively harmonized areas the Member States have given up national sovereignty to a large extent and therefore, the Court’s interference to the effect of relieving the remaining double taxation can hardly be regarded as an unwarranted encroachment on the Member States’ sovereignty. Another difference between indirect taxation and direct taxation is that in the domain of indirect taxes the Court seems to have maintained the theoretical possibility for an indistinctly applicable indirect tax to infringe the freedoms if, due to its amount, it would prevent or render excessively difficult the exercise of the freedom concerned. Thus, while direct taxes are measured by the discrimination standard under the freedoms, the restriction standard might still play a role with regard to indirect taxes.
Interaction between positive integration and negative integration

In analysing the roles and functions of positive integration and negative integration in the field of taxation, we outlined a theoretical model for defining the scope of the various Treaty provisions which constitute the basis for these two means of integration. According to this model, (i) Articles 113 and 115 TFEU as legal basis provisions which enable the adoption of harmonization measures in the field of taxation are aimed at resolving disparities which derive from wide-spread differences in tax rules that are present in the laws of numerous Member States and double taxation if it occurs due to the standard tax legislation of the Member States; (ii) the fundamental freedoms, as the bases of negative integration, are aimed at discriminatory tax provisions which stem from the tax system of one Member State; (iii) the State aid rules, also as the bases of negative integration, are aimed at selective tax measures which stem from the tax system of one Member State; and (iv) Article 116 TFEU which enables the adoption of directives by qualified majority voting is intended to deal with disparities which cause specific distortions in the sense that a special regime of one or just a very few Member States, which qualifies as a general measure within the national jurisdictions of these Member States, interacts with the standard regime of other Member States to the effect of causing distortion of competition.

This theoretical model delineates the scope of harmonization and negative integration and in turn, the domain of secondary law and primary law rather clearly by identifying the obstacles that they are supposed to tackle. However, the scope of positive and negative integration in the direct tax field does not, in fact, correspond to this model. There are overlaps between their respective scopes and there are obstacles which are left mainly unresolved by both means of integration. In the latter category are disparities and (juridical) double taxation, which fall outside the scope of the fundamental freedoms, as interpreted by the Court, and which are mainly left unresolved also by harmonization blocked by the unanimity rule prescribed for the adoption of such harmonization.

As regards overlaps between harmonization measures – primarily the direct tax directives – and the fundamental freedoms as applied to the direct tax laws of the Member States, we have concluded that in many cases the beneficial treatment offered by the directives could also be claimed under the fundamental freedoms. However, the objectives of the direct tax directives go further than ensuring non-discriminatory treatment for intercompany dividend distributions or interest and royalty payments or corporate reorganizations. They grant benefits irrespective of the domestic law treatment of the comparable domestic situation. Furthermore, by laying down specific and concrete common rules and definitions they enhance legal certainty.
and the uniform treatment by the Member States of the transactions falling under their scope. Thus, harmonization measures serve a useful purpose even when they provide for benefits which are also available under the fundamental freedoms. Harmonization is not redundant in areas covered by negative integration de lege ferenda either. Comprehensive harmonization measures based on consistent tax policies are more apt to advance tax integration in the Union than a necessarily casuistic and destructive, judicially conducted negative integration process which unavoidably produces inconsistencies in the case law on which such process is based. On the other hand, looking at the results of harmonization in the field of direct taxation, they also show the drawbacks of harmonization. In particular, the difficulties in bringing about any amendment to the rules laid down in harmonizing secondary law due to – again – the notorious unanimity rule carries the risk that such secondary law cannot keep up with the development of the internal market and becomes obsolete by the passage of time. This problem will be discussed more in detail in the forthcoming part of this Chapter through the example of the Merger Directive.

8.3. Various aspects of the relationship of primary law and secondary law concerning taxation

8.3.1. Introduction

As discussed above, in the field of EU tax law a distinction needs to be made between direct and indirect taxation according to the extent to which they are harmonized. As indirect taxes – primarily VAT – is much more comprehensively harmonized than direct taxes, in the area of VAT one would expect a greater potential for interaction and in turn, for conflicts between the harmonized rules of secondary legislation and various norms of primary law than in the domain of direct taxation. In the latter area harmonization is scarce; the chance thus, that provisions of harmonizing acts would clash with primary law is expected to be smaller. Despite this divergence, there is actually no difference between the two areas of taxation in the sense that none of the provisions of the VAT Directive or those of the direct tax directives have so far been annulled or declared invalid by the Court on account of infringing primary law. Even the number of cases where the Court directly addressed the question of the compatibility of either the VAT directive or that of the direct tax directives with primary law is very low. As far as the general principles of EU law are concerned, the trend may be changing, as there have been recently a growing number of challenges to the VAT
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Directive in the light of these general principles. However, the review of compatibility of either the VAT Directive or the direct tax directives with the Treaty provisions – primarily the fundamental freedoms – remains negligible. There are only two cases which represent notable exceptions to this general trend: Schmelz concerning the VAT Directive and Gaz de France concerning the Parent – Subsidiary Directive. Questions on the compatibility of the various directives on excise duty with different Treaty provisions, such as Article 110 TFEU or the State aid rules, have been dealt with by the Court a bit more frequently. In this Section we will examine these cases in detail. We will deal with cases on the relationship between the tax directives – most importantly, the direct tax directives and to a lesser extent, the VAT Directive and the excise duty directives, and Treaty provisions – most importantly, the fundamental freedoms and to a lesser extent the State aid rules and Article 110 TFEU. Thus, the analysis will not extend to all acts of secondary law on taxation and it will only touch upon primary law norms other than the fundamental freedoms.

The small number of cases dealing with the compatibility of the tax directives with the fundamental freedoms is not surprising if we take into account that conflicts between these two sources of Union law are generally not expected to occur given that the ultimate objective of the tax directives is the promotion of the internal market. This is especially the case with the Parent – Subsidiary Directive, the Merger Directive and the Interest and Royalties Directive which are aimed at giving effect to the freedoms in their specific field of application. As such, in principle, they can be assumed to be in line with the fundamental freedoms. This distinguishes these directives from secondary law measures that we encountered in the previous Chapter. Although many of those directives were also based on Article 114 TFEU and thus were aimed at contributing to the functioning of the internal market, they also pursued objectives other than the internal market, such as public health, consumer or environmental protection. The Court actually confirmed in the Tobacco Advertising case that even if such objectives are the decisive ones in adopting Union legislation, the latter can still be based on Article 114 if it genuinely helps improve the conditions of operation of the internal market. Secondary legislation which primarily pursues such non-internal market related aims is more prone to come into conflict with the fundamental freedoms than the direct tax directives which are driven exclusively by the aim of facilitating the internal market. A noteworthy exception is the Merger Directive which expressly refers in its Preamble to

1113. See for an analysis Englisch, supra note 201.
the safeguarding of the financial interests of the Member States as being one of its aims besides the removal of tax obstacles to corporate reorganizations in the internal market.\textsuperscript{1115} The fact that the Directive follows conflicting objectives, that is, the internal market, on the one hand, and the financial interest of the Member States, on the other, is reflected in the serious limitations of the tax neutrality regime provided for by the Merger Directive which – in view of the rights offered by the fundamental freedoms – appear to be rather outdated. Thus, with the exception of the Merger Directive, the direct tax directives are free of objectives conflicting with the internal market and therefore they are less likely to cause restrictions to the free movement of goods, persons, services and capital than those non-tax directives which pursue some non-economic social-welfare aims.

Further, the direct tax directives seem to entail less confrontation with the fundamental freedoms than secondary law in other policy fields due to the fact that minimum harmonization in their context means that the Member States are permitted to introduce more favourable rules for the taxpayer than those laid down in the directives. By expanding the beneficial treatment beyond the boundaries of their prescribed scope, they reinforce the common regime. Thus, when the Member States make use of the possibility offered by the minimum harmonization technique, they actually push forward the liberalization of the market. In contrast, minimum harmonization in other domains, such packaging, labelling, food safety, working conditions etc., means that the Member States may introduce stricter requirements than those laid down in secondary law if they want to enhance the effect of the rules in view of their objectives. If national law implements stricter standards, it prescribes a higher burden on traders and economic operators who have to meet those standards thus it may impede the exercise of the fundamental freedoms by those economic operators. Hence, the relationship between secondary law prescribing minimum harmonization and the fundamental freedoms seems to be less problematic in the field of direct taxation than in other fields.

Finally, another reason why the direct tax directives are not likely to conflict with the freedoms is that they contain numerous optional rules which leave scope for the Member States’ discretion when exercising the option. These optional rules cannot infringe the fundamental freedoms themselves, as any infringement which would be caused by their exercise would not be attributable to them but to the national rules implementing them.

\textsuperscript{1115}. Preamble to Merger Directive, fifth recital.
However, there is one reason for which the direct tax directives may potentially get into conflict with the fundamental freedoms. Namely, two of the three directives governing substantive tax issues were adopted in 1990 and since then they have not been amended in a substantial manner. Since 1990, the internal market and the integration of the tax systems of the Member States have greatly progressed. This is mainly due to the negative integration process driven by the Court that continues to abolish discriminatory direct tax obstacles to free movement forcing the Member States to continuously adjust their tax systems and move towards a discrimination-free single market. This negative integration process has surpassed the stage where positive integration is stagnating and the freedoms, as interpreted by the Court, offer in many respects equivalent or even greater rights to the taxpayers than the direct tax directives. This raises the question whether the direct tax directives have become obsolete or whether they still fulfil some useful function by laying down specific and clear common rules which enhance legal certainty and uniformity in the field of EU tax law. These questions will be addressed in the forthcoming Sections.

In the light of the different types of Union rules that we distinguished in the previous Chapter (see Section 7.4.4.2. (iv)), the direct tax directives appear to be, at first sight, common rules. According to their title, they set up a common system of taxation in the area of intercompany dividend distributions and interest and royalty payments and that of corporate reorganizations. In fact, however, these common systems consist of rules which require one or the other of the Member States exercising tax jurisdiction over the income flows concerned to refrain (permanently or temporarily) from taxing. Thus, the rules of these directives rather allocate taxing rights between the Member States than set up wholly new common Union systems of taxation of intercompany dividends, royalties, interest and gains on reorganizations. The provisions of the VAT Directive, which lay down a comprehensive common system of value added tax, can indeed be characterized as common rules but they also allocate taxing rights between the Member States through the series of place of supply rules which brings the Directive to the category of coordination rules too. The Horizontal Excise Duty Directive is primarily a harmonizing rule approximating the excise duty rules of the Member States. All the directives contain authorizing rules as well. All in all, the directives cannot be clearly characterized as one or the other type of Union law rule. However, their individual rules can be so classified. Such classification can be relevant, on the one hand, in determining what type of obstacles they may pose to the fundamental freedoms and whether such
obstacles fall within the prohibitions of the freedoms and, on the other, in assessing the scope of discretion of the Union legislator when judging the proportionality of these rules.

Most of the factors mentioned above point to the direction that the tax directives, especially the direct tax directives, do not imply many potential conflicts with the fundamental freedoms. This does not mean, however, that they can never be in breach of the freedoms. In addition, the relationship of the tax directives and the primary law freedoms has many other facets than just the issue of potential infringement of the latter by the former. In the following Sections, we will examine some concrete aspects of the relationship between primary law and the tax directives. The structure of the analysis will follow that of Chapter 7 and will be based on the lessons drawn from that Chapter. Accordingly, we will examine again the relationship of national law – secondary law – primary law which in the field of taxation boils down to investigating the relationship between the tax directives, the national law that implements them and the fundamental freedoms and the State aid rules which are superior to both. The analysis will focus on authorizing measures and optional provisions which we have extensively discussed above in the context of the non-tax case law. Then we will discuss various scenarios in which the fundamental freedoms and the tax directives apply parallel with each other to the effect that national laws adopted within their reach must be measured against both for checking their compliance. Thereafter, we will examine examples in the Court’s case law of consistent interpretation as used in relation to the tax directives and primary law showing the diverse roles that this interpretation technique plays in aligning the two types of norms with each other. Finally, we will analyse the Court’s approach to those cases where an actual conflict occurs between the tax directives and the fundamental freedoms.

8.3.2. Authorizations and options granted by secondary law

8.3.2.1. Recollections from Chapter 7

In Chapter 7, we drew a distinction between situations where secondary Union law grants an authorization for the Member States to act in a certain way and where it affords an option to the Member States. An authorization does not allow any discretion for the Member States apart from taking a decision whether to exercise it or not. In other words, the Member States can decide whether or not to make use of the authorization but they cannot decide how to make use of it. On the other hand, a provision granting an
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option leaves room for the discretion of the Member States as to the manner of exercising the option. We concluded in Chapter 7, on the basis of the *Ouzo* case, that a national rule whereby a Member State exercises a clear-cut authorization granted to it by secondary law cannot infringe primary law in itself. As regards options granted by secondary law, such as the one in *Bosal*, we stated that the exercise of such option by the Member States must comply not only with secondary law but also with primary law. In fact, both *Ouzo* and *Bosal* are tax cases; the former concerns excise duty on alcohol which is rather extensively harmonized whilst the latter is about corporate income tax in respect of which only fragmentary harmonization exists on specific subject-matters, an example being the Parent – Subsidiary Directive, which was at issue in *Bosal*. In this Section, we will examine further cases from the domain of taxation in which authorizations and options granted by secondary law and exercised by the Member States came under the scrutiny of the Court in the light of primary law. Primary law in this respect includes not only the Treaty’s free movement provisions but also the State aid rules. The main question in all these cases is whether a potential breach of primary law is to be attributed to the Member State or the Union when such breach is caused by national law exercising an option or authorization granted by secondary law. In answering this question, we will rely on the distinction between options and authorizations and the conclusions that we drew with respect to the *Ouzo* and *Bosal*-line of case law in the previous Chapter.

8.3.2.2. Attribution of an infringement of primary law to the Member States or to the Union

In the context of the fundamental freedoms, a case which raised the issue of attribution or imputability of an infringement of the freedoms is *Schmelz*.\(^{1116}\) The case concerned the optional regime for small undertakings under the VAT Directive,\(^{1117}\) pursuant to which Member States are allowed to grant an exemption from VAT to small undertakings established in their territory but not to undertakings established in other Member States. Mrs Schmelz was a German resident who owned an apartment in Austria and rented it out in the financial years concerned. She did not charge VAT on the rent, as her turnover was below the threshold applicable to small undertakings and thus she considered that she fell under the VAT exemption for such undertakings. The Austrian tax authorities issued an assessment to her taking the view that due to the fact that she was neither resident nor established in Austria she

\(^{1116}\) CJ, 26 October 2010, Case C-97/09 *Ingrid Schmelz v Finanzamt Waldviertel*.

\(^{1117}\) Article 283(1)(c) of the VAT Directive.
was not eligible for the small undertakings’ exemption. Obviously, the fact that small undertakings established outside Austria are excluded from the benefit of the VAT exemption renders the provision of services in Austria less attractive for those small undertakings and therefore, it constitutes a restriction on the freedom to provide services. The question arose whether the restriction could be imputed to Austria who implemented the optional regime for small undertakings in its national laws or rather the restriction derived from the VAT Directive itself. The Court first pointed out that under the provisions of the VAT Directive, the Member States are prohibited from extending the benefit of the VAT exemption to small undertakings established outside their territory.  

1118 Accordingly, it held that:

“[...] the restriction cannot be attributed to the Member States, as the directives in question allow them to offer a VAT exemption only to small undertakings established in their respective territories.”  

1119 The case can be considered in parallel with Ouzo, as the Member States had no discretion to implement the optional regime in a way which would conform to the requirements of the freedom to provide services. In our terminology this would constitute an ‘authorization’. In Ouzo the conclusion was that the national law which exercised an authorization granted by one of the excise duty directives could not be considered to infringe primary Union law. The outcome of Schmelz, however, is – or at least, could have been – different due to the fact that, unlike Ouzo, it concerned a preliminary ruling procedure. We have emphasized in Chapter 7 that the outcome of Ouzo is peculiar to the form of the procedure at issue which was an infringement procedure. In an infringement procedure, the validity of secondary Union law cannot be examined which led in the Ouzo case to the unsatisfactory outcome that the national law which, in substance, clearly contravened primary Union law remained in force. Contrarily, in the preliminary ruling procedure of the Schmelz case, nothing prevented the legality of the VAT Directive, specifically, its provisions on the small undertaking regime, to be scrutinized in the light of the primary law freedom at issue. Had such provisions of the VAT Directive been found to infringe the freedom to provide services the same conclusion would have had to be drawn with regard to the national law transposing those provisions. All these are clearly reaffirmed by the Opinion of Advocate General Kokott in Schmelz:

“If this difference in treatment, laid down in the directives, based on the residence or place of establishment of the taxable person is not compatible with the Treaty on the Functioning of the European Union or with the general principles

1118 Case C-97/09 Schmelz, para. 52.
1119 Ibid, para. 54.
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of law applicable in its implementation, the Member States would not have any margin of discretion for implementing the directives in conformity with European Union law. In particular, they could not extend the small undertakings scheme to services provided by non-resident taxable persons. Rather, they could guarantee the equal treatment of established and non-established small undertakings only by abolishing the small undertakings scheme.

A provision of a directive which gives the Member States an option to act in contravention of European Union law and does not allow scope to exercise that option in conformity with European Union law would be just as unlawful as a national provision under which a Member State availed itself of such an option. [...] it must therefore be examined, first and foremost, whether the abovementioned provisions of the directives infringe higher-ranking rules of European Union law. Should this be the case, national rules transposing those provisions into national law are contrary to primary European Union law in exactly the same way as the provisions of the directives themselves. 1120

The question of attribution of infringement of primary law in the case of optional regimes, authorizations or other provisions of secondary law which are to be implemented by the Member States into their domestic tax systems is relevant not only in the context of the fundamental freedoms but also that of the State rules. The parallelism between the two scenarios has recently drawn the attention of scholars. 1121 Although the issue of imputability is common to them, there is a difference between the fundamental freedoms and the State aid rules in this respect. In particular, amongst the conditions of State aid as contained in Article 107(1) TFEU we find an express requirement that a selective advantage has to be granted ‘by a Member State or through State resources’. The second half of the condition, i.e. being financed ‘through State resources’, is always met by a fiscal aid which is granted in the form of a tax benefit or concession leading to a loss of tax revenue for the Member State granting it. 1122 Therefore, the more interesting element seems to be that of ‘being granted by a Member State’. The wording of Article 107(1) – specifically, the use of ‘or’ as a conjunction – suggests that these are two alternative conditions meaning that it is suf-

ficient if one of them is fulfilled by a measure suspect of being State aid. However, the Commission’s practice and the Court’s case law do not follow this literal interpretation of Article 107(1). As described by Englisch, the Commission’s practice is inconsistent in this respect.\(^{1123}\) As to the case law, Luja points out that in earlier cases, the Court only dealt with the requirement of aid being granted by a Member State in the context of cases where a public or private body was used as an intermediary in the process of awarding the aid.\(^{1124}\) The question whether the aid can be qualified as ‘State aid’ or it is rather a ‘Union aid’ has not been in the focus of the Court for a long time. More recently, the General Court took a stand on the issue and unequivocally stated that:

“[…] for advantages to be capable of being categorised as aid within the meaning of Article 87(1) EC [now 107(1) TFEU], they must, inter alia, be imputable to the State […]”

“[…] the imputability of aid to a State is separate from the question whether aid was granted through State resources. It is clear from the case law that they are separate and cumulative conditions […]”\(^ {1125}\)

According to Englisch, the General Court’s interpretation, which requires aid to be granted by the State and through State resources and which leads to the result that Union aid does not fall under Article 107(1), is sensible. It is supported not only by contextual interpretation of the State aid provisions within the TFEU but also by teleological interpretation having regard to the fact that historically the granting of aid had been perceived as a tool of promoting national interests and protectionist policies of the Member States and aid stemming from a Union measure – supposedly – does not carry such risk.\(^ {1126}\)

Thus, as Article 107(1) requires that an advantage be granted not only through State resources but also by the State in order to qualify as State aid, the Court examines the issue of imputability under the State aid rules just as under the freedoms. As the issue arises under both sets of rules, it makes sense to use the same criterion for determining to whom an infringement of

\(^ {1123}\) Englisch, supra note 1121, p. 14 and the Commission Decisions he refers to in FN 45, 46, 47.
\(^ {1124}\) Luja, supra note 1121, p. 120 and the cases he refers to in FN 7.
\(^ {1125}\) CFI, 5 April 2006, Case T-351/02 Deutsche Bahn AG v Commission, paras. 101, 103; Joined Cases T-50/06 RENV, T-56/06 RENV, T-60/06 RENV, T-62/06 RENV and T-69/06 RENV Ireland and Others v Commission, para. 74. The General Court refers precisely to the case which Luja mentions and which deals with the distinct issue of intermediary entities taking part in the granting of State aid (see ECJ, 16 May 2002, Case C-482/99 France v Commission, para. 24).
\(^ {1126}\) Englisch, supra note 1121, p. 15.
primary law is to be imputed when national law implementing secondary Union law is reviewed under the fundamental freedoms, on the one hand, and the State aid rules, on the other. Essentially, the criterion is the degree of discretion left by secondary law for the Member States. On one end of the scale is the situation where a compulsory rule of secondary law leaves no discretion at all for the Member States. Such was the case in Deutsche Bahn and Puffer.\footnote{1127} In Puffer, the question was whether a national provision which transposes the provision of the VAT Directive which restricts input VAT deductions to taxable persons carrying out taxable transactions can be in breach of Article 107(1) TFEU insofar as it entails financial advantages, such as a full and immediate deduction of input VAT on the construction of mixed-use buildings, to taxable persons carrying out taxable transactions as compared to taxable persons carrying out exempt transactions. The Court held:

“[...] the restriction of the right to deduct input VAT payable to only taxable transactions is an integral part of the VAT system set up by Community legislation which must be implemented in the same way by all Member States. Consequently, the condition of intervention by the State is not met, meaning that Article 87(1) EC [now Article 107 TFEU] cannot apply.”\footnote{1128}

In Deutsche Bahn the situation was slightly different. The Directive on the harmonization of the structures of excise duty on mineral oils\footnote{1129} provided for an exemption from excise duty for fuel used in commercial aviation. The exemption did not apply to fuel used in high-speed trains which were in competition with low cost airlines with respect to certain routes. Germany implemented the exemption which was part of the harmonized system into its national law. Deutsche Bahn considered that the exemption for fuel used in the aviation sector constituted State aid for commercial airlines and asked the Commission to start a formal State aid investigation. The Commission rejected the request. In its judgment, the General Court pointed out that the provisions of the excise duty directive at issue imposed on the Member States a clear and precise obligation not to levy the harmonized excise duty on fuel used in the aviation sector. Therefore:

“[...] In transposing the exemption into national law, Member States are only implementing Community provisions in accordance with their obligations...”

\footnote{1127. ECI, 23 April 2009, Case C-460/07 Sandra Puffer v Unabhängiger Finanzsenat, Außenstelle Linz; Case T-351/02 Deutsche Bahn. See Luja, supra note 1121, p. 120.}
\footnote{1128. Case C-460/07 Puffer, para. 70.}
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stemming from the Treaty. Therefore, the provision at issue is not imputable to the German State, but in actual fact stems from an act of the Community legislature.¹¹³⁰

A factor which could question this straightforward conclusion was that the excise duty directive gave an option to the Member States to extend the exemption to train fuels. Germany, however, did not exercise this option. In this regard, the Court held:

“[…] the Member States were perfectly entitled to limit themselves to transposing the mandatory provisions in the Directive and not to use the option of extending the exemption.”¹¹³¹

While it is fair that the implementation of mandatory provisions of Union acts into national law cannot give rise to a situation that any ensuing distortion of competition would be imputed to the Member State, the Court’s latter conclusion seems to disregard the fact that Germany could have eliminated the distortion by making use of the option to extend the exemption to the railway sector. By allowing such an option, the directive gave the necessary leeway to the Member States to avoid granting any selective advantages distortive on competition. Member States had a margin of discretion to avoid distortion of competition and Germany chose not to avoid it. In our view, on this ground the distortion of competition could have been attributed to Germany. Admittedly, this would imply a sort of paradox, as the Member States would be obliged to exercise an option if they wanted to avoid being held responsible for granting State aid. However, in view of the seriousness of the distortion of competition at issue and the fact that the Commission itself admitted that by laying down the exemption only for aviation fuel the directive caused such serious distortion,¹¹³² a remedy should have been provided in this situation.

The next group of cases according to the degree of discretion left by secondary Union law to the Member States consists of cases where secondary law authorizes the Member States to implement a special regime, exemption or other derogation from the harmonized system which they can exercise or not according to their discretion but which does not leave them any leeway as regards how to implement the optional rules. To stick to our terminology we do not call these optional rules ‘options’ but rather ‘authorizations’ to express their difference compared to third category of

¹¹³⁰. Case T-351/02 Deutsche Bahn, para. 102.
¹¹³¹. Ibid. 106.
¹¹³². See the Commission’s letter responding to Deutsche Bahn’s complaint cited in Case T-351/02 Deutsche Bahn, para. 11.
cases where secondary law leaves actual discretion to the Member States. Englisch observes that these authorizations are rather frequent in the common system of VAT and the common system of energy taxation. He maintains that the case law indicates that the Court would treat the selective advantages which could result from the exercise of these authorizations by the Member States as being attributable to the Member States. In particular, the following statement points to this direction:

“[Article 107(1) TFEU] refers to the decisions of Member States by which, in pursuit of their own economic and social objectives, they give, by unilateral and autonomous decisions, resources to undertakings or other persons or procure for them advantages intended to encourage the attainment of the economic or social objectives sought [...].”

In terms of this standard, indeed, the introduction by a Member State of an optional regime provided for by secondary law could lead, in itself, to the finding of State aid regardless of how much discretion was left by the secondary law to the Member States. However, in the case law there are also signs which point to the opposite direction. First, the Schmelz case – which can be applied by analogy to the issue of imputability under the State aid rules – demonstrates that the fact that a Member State chooses to introduce an optional regime available under a harmonized European system is not sufficient in itself to establish imputability to the Member State. As Luja explains, the Member State in such a situation has the possibility to refrain from a restriction by not applying the optional exemption; the fact, however, that it chooses to apply the optional regime does not make the restriction attributable to it. Similar conclusions can be drawn from the General Court’s second judgment in the Alumina case. The case concerned the same directive as the one at issue in Deutsche Bahn, the Directive on the harmonization of the structures of excise duties on mineral oils. The directive empowers the Council to authorize any Member State to introduce exemptions from the harmonized excise duty other than those expressly provided for in that directive. Pursuant to this, Ireland, Italy and France requested authorization from the Council to exempt mineral oils used in alumina production from excise duty. The Council granted such authorizations and in a series of successive decisions extended the authorizations until 31 December 2006.

1133. Englisch, supra note 1121, p. 15.
1135. Concurringly, Englisch, supra note 1121, p. 15; Luja, supra note 1121, p. 121.
1136. Luja, supra note 1121, p. 121.
1137. Joined Cases T-50/06 RENV, T-56/06 RENV, T-60/06 RENV, T-62/06 RENV and T-69/06 RENV Ireland and Others v Commission.
On the basis of these decisions, the three Member States kept applying the exemption for an extended period of time. After the last authorizing decision was taken and before the expiry of the period for which the exemption was authorized, the Commission initiated a formal State aid investigation with regard to the exemptions and decided that they constituted State aid incompatible with the internal market. The Commission ordered the recovery of the aid but having regard to its own involvement in the authorizing decisions – the Commission made the respective proposals to the Council – it limited the recovery obligation both in time and in amount. Ireland, France and Italy brought an action for annulment against the Commission’s State aid decision before the General Court (then CFI). The General Court annulled the decision but the annulment was set aside by the CJ. The case was then referred back to the General Court which brought a second judgment in the case. In this second judgment, the General Court upheld the claim of the applicants that, by classifying as State aid the exemptions from excise duty on oil used in alumina production applied on the basis of the Council’s authorizing decisions, the Commission infringed the principle of legal certainty and the principle of the presumption of legality attaching to Union measures. In particular, the contested decision, by calling into question the validity of the exemptions, also called into question – indirectly – the Council’s authorizing decisions and thereby it infringed the principles just mentioned. For our purposes the interesting part of the reasoning is that which states that the Commission was wrong to classify the exemptions at issue as State aid given that any advantages that the exemption may have entailed cannot be attributed to the Member States concerned. In this regard, the General Court emphasized that the Council’s decisions of authorization authorized in clear and unambiguous terms Ireland, Italy and France to apply the exemptions at issue and “in so far as certain restrictive conditions of a geographical and temporal nature were attached to them, those decisions were binding on the Member States concerned”. The Member States granted the exemptions “not only in reliance on the Council’s decisions of authorisation but also in pure and simple compliance with the conditions laid down in those decisions”. The General Court referred to the requirement for a unilateral and autonomous decision by the Member State by quoting the paragraph that we cited above. It held in that regard:

"in order to be classified as State aid within the meaning of Article 87(1) EC [now Article 107(1) TFEU], any advantages which the exemptions at issue might have conferred on their beneficiaries would have had to be attributable to a unilateral and autonomous decision of the Member States concerned. In the

1138. Ibid. para. 77.
1139. Ibid. para. 97.
1140. Ibid. para. 73.
Thus, according to the General Court when a Member State exercises a clear-cut authorization to apply exemptions from the harmonized excise duty given by a Council decision issued on the basis of a directive, a potentially selective and distortive advantage resulting from the exemptions cannot be attributed to the Member State. The General Court referred expressly to the Ouzo case when it described the Member State action as “complying purely and simply with an authorization granted by a European Union institution.” Thus, although there is an autonomous and unilateral decision involved in the choice of a Member State to make use of an authorization given by a Union measure, this, in itself, is not enough to attribute to the Member State any infringement of primary law caused by the authorized measure. Luja considers that this position is not fully convincing. He maintains that in the Alumina scenario, the conclusion that the aid is not attributable to the Member State is even less tenable. In particular, a unilateral and autonomous decision by a Member State is undoubtedly present in a situation where a Member State not only exercises an option laid down in a directive but it files a request to a Union institution for an authorization to apply a derogation. In our view, the situation in Alumina should be looked at from the opposite angle; that is, not only does a Union directive permit a derogation, a Union institution also expressly confirms by way of an individual decision that no distortion of competition is caused by the derogation and therefore, the requesting Member State is entitled to apply it. In such circumstances it is fair that any eventual distortion of competition will not be imputed to the Member State.

The Court would, most likely, arrive at the same conclusion as in Alumina if a directive directly granted a clear-cut authorization without the intermediation of a Council decision. Hence, if the Court scrutinized the implementation by the Member States of the optional exemptions and derogations provided for by the VAT Directive the selective advantages that they may

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1141. Ibid. para. 98.
1142. Ibid. para. 95.
1143. Luja, supra note 1121, p. 121.
1144. Ibid.
1145. Englisch mentions an exception to this; namely, when a directive explicitly provides that an optional measure authorized by it may constitute State aid and in that case it has to
cause would not be imputed to the Member State and thus would not constitute State aid as long as it is a clear-cut authorization leaving no margin of discretion to the Member States. The Commission apparently considers that most of the reductions and derogations included in the VAT Directive are of this nature, as it states in its 2004 Implementation Report:

“To be caught by the concept of state aid measures must favour certain undertakings by reducing the charges normally born by them. In this connection, VAT reductions are subject to strict Community rules and conform to the principle of equality of taxation for similar products. Such reductions are therefore not usually caught by Article 87(1) [now Article 107(1) TFEU]. As a general rule the same is not true for excise duties which directly affect businesses. A reduction in such duties which favours certain undertakings may constitute state aid.”1146

The third category is constituted by those cases where secondary law reserves a broad scope of discretion to the Member States when granting an option; at least, broad enough that the option can be exercised in conformity with primary Union law. If in such a scenario the exercise of the option by a Member State leads to an infringement of primary law the latter would be imputable to the Member State. In the context of the State aid rules the Courts have not yet dealt with such a case. As discussed above, in our view, the Deutsche Bahn case could have fallen in this category, which would have meant a different outcome for the case. In the context of the fundamental freedoms Bosal and Keller Holding continue to represent this category.1147

In contrast to the State aid rules, there is no requirement under the free movement provisions that in order to establish an infringement of the fundamental freedoms such infringement must originate from a Member State. To the contrary, as we have emphasised throughout the previous Chapter, the prohibitions under the freedoms are also addressed to the Union institutions:

“ [...] the prohibition on restrictions on freedom to provide services applies not only to national measures but also to measures adopted by the European Union institutions [...].”1148

be notified to the Commission, as Article 26(2) of the Energy Tax Directive does (Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity), see Englisch, supra note 1121, p. 15.

1147. Case C-168/01 Bosal; Case C-471/04 Keller Holding.
1148. Case C-97/09 Schmelz, para. 50.
Thus, while the State aid rules seem to exclude \textit{a priori} the possibility that aid granted by a Union act could breach Articles 107-108, a Union act may very well infringe the fundamental freedoms. This has consequences as regards the question to what extent restrictions and distortions in the internal market can effectively be eliminated irrespective of their source. To explain, we concluded in the previous Chapter that if a national measure merely implements an authorization granted under secondary law which does not leave any discretion for the Member States in transposition the national measure should be tested only against the secondary law granting the authorization. This seemingly rigid approach is not problematic, in most of the cases, as the act of secondary law itself can always be reviewed for its compatibility with the fundamental freedoms (unless the issue arises in an infringement procedure). The invalidation of secondary law on ground of incompatibility with the freedoms would necessitate the setting aside of the implementing national law as well. This mechanism ensures – at least, in principle – that restrictions on the fundamental freedoms cannot remain in place even where they originate from secondary Union law. This is different in the context of the State aid rules. If an act of secondary law gives an authorization for the Member States, without leaving them any margin of discretion, to introduce an exemption or other relief from a harmonized tax which is clearly selective and distorts competition the resulting aid could not be attributed to the Member State. Instead, it would have to be attributed to the Union and, being Union aid, it would escape the application of the State aid rules under Articles 107-108 TFEU. Thus, neither the national measure nor the Union act could be considered to infringe the State aid rules. As a result, the distortion of competition could not be eliminated. The question is whether the requirement that an aid must be attributable to a Member State means that Union measures are free to grant selective advantages to certain undertakings and thus free to distort competition. Or is there any alternative legal remedy in the arsenal of Union law which can be used against distortions caused by Union acts?

Englisch explains that it is logical that distortions of competition and selective advantages are not attributed to the Member States and therefore do not fall under the State aid rules if they result from the implementation of compulsory rules of secondary law or the exercise of authorizations granted by secondary law which leave no margin of discretion to the Member States. The fact that the Union institutions – the Commission which initiates Union legislation and the Union legislature which adopts it – have approved the Union measure which contains those rules and authorizations implies that they evaluated its intrinsic effects and did not find that it would cause
distortions which are harmful to the internal market.\textsuperscript{1149} This means, according to Englisch, that the measure is not susceptible to promoting national protectionist interests contrary to the internal market and therefore it does not have to fall under State aid control the initial and primary purpose of which is to fight such measures. On the one hand, it can, indeed, be argued that according to the distribution of competences under the State aid rules, the Commission has exclusive competence to decide on the compatibility of State aid with the internal market. When a Union act proposed by the Commission provides for aid to certain undertakings it can be assumed that such aid has been assessed by the Commission in the preparation of the legislation and has been found compatible with the internal market. Such aid does not have to be subjected to the procedure under Article 108 TFEU, which would be the consequence of qualifying it as State aid. The Commission’s assessment of the measure in the State aid procedure would not be different from that in the legislative procedure. On the other, it should be remembered that the Commission does not have unlimited discretion under the States aid rules to declare any sort of aid compatible with the internal market. The Commission can only declare such measure compatible aid which falls under one of the categories of Article 107(3). There are highly detailed guidelines which lay down the criteria of assessment for the compatibility analysis. Hence, this kind of specific assessment cannot be substituted for by the general considerations which form part of the preparation of legislative acts. In addition, the Commission’s proposal for a legislative act may go through rather substantial changes by the time it gets adopted as a Union directive and the necessary compromises in the supranational legislative process may well lead to insertions of selective and distortive elements in the final act which the Commission would not accept when carrying out an objective compatibility assessment under the State aid rules. Therefore, in our view, the argument that any sort of selective aid which may be entailed by Union legislative acts is necessarily compatible with the internal market due to the fact that the Commission proposed it cannot be accepted. Furthermore, in response to Englisch’s argument above, it can be pointed out that the State aid rules safeguard not only against distortions which are motivated by national protectionist interests but all kinds of distortions between economic agents operating in the internal market. Deutsche Bahn demonstrates how serious sectoral distortions a Union measure can cause in the internal market. According to Terra, “the EU value added tax provisions are full of favouritism”.\textsuperscript{1150} He mentions, \textit{inter alia}, the special treatment of VAT groups and of public bodies, the

\textsuperscript{1149} Englisch, supra note 1121, p. 15.
\textsuperscript{1150} Terra, supra note 948, p. 101.
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distinction between books and e-books and the various special schemes. In view of this, the outcome that competitive distortions in the internal market can only be tackled if they originate from the Member States is clearly not satisfactory. Thus, it is important to point out, as Englisch and Terra do, that in the case of Union measures the distortions that they may cause can be tackled by subjecting them to review in the light of the principle of equality.\textsuperscript{1151} \textit{Deutsche Bahn} and \textit{Puffer} demonstrate that this path is indeed available. However, the outcomes of the cases also show that the light-touch review applied by the Court and its high deference to the Union legislature do not ensure an effective constitutional-type review of Union legislation in the light of the general principles of EU law which could fulfil the function which the State aid rules fulfil in relation to national measures. Admittedly, this problem is not unique to the review of Union legislation in the light of the general principles of EU law. The Court uses a similarly low standard when it reviews Union legislation in the light of the fundamental freedoms. Therefore, in the end, not only competitive distortions but also restrictions on the fundamental freedoms tend to remain in place when they are caused by Union measures, as we will see below in Section 8.3.5.

In summary, the case law discussed above shows that the question of whether an infringement of primary law caused by a Member State measure exercising an option or authorization granted by secondary Union law is attributable to the Member State or the Union is relevant under both the fundamental freedoms and the State aid rules. While under the fundamental freedoms the question needs to be answered in order to know which norm, i.e. the implementing national law or secondary Union law, is to be tested against the freedoms, under the State aid rules imputability to a Member State is a constitutive element of the concept of State aid. This means that the conclusion that a potential infringement of the fundamental freedoms is attributable to a Union measure does not affect the answer to the question whether an infringement indeed exists. Conversely, the conclusion that a selective advantage is attributable to a Union measure excludes the possibility of such measure being qualified as State aid and in turn, contravening Articles 107-108 TFEU. In other words, although for different reasons, the question of imputability is relevant under both sets of Treaty provisions. Therefore, it makes sense to assess it under the two sets of rules on the basis of the same criterion, namely, the margin of discretion left by secondary law granting the option or authorization to the Member States. Three scenarios can be distinguished pursuant to this criterion. First, when a Member State measure implements a compulsory rule of secondary law, a potential infringement

\textsuperscript{1151} Englisch, supra note 1121, p. 15; Terra, supra note 948, p. 110.
of the fundamental freedoms or a potential selective aid which results from such implementation must be attributed to secondary law, i.e. the Union. Second, when a Member State measure exercises an authorization granted by secondary law which leaves no discretion to the Member State as regards how to exercise the authorization, any ensuing infringement of the freedoms or any ensuing aid is to be attributed to the Union again. Third, when a Member State measure exercises an option afforded by secondary law which leaves sufficient scope of discretion to the Member State to exercise the option in conformity with primary law, any potential infringement of the latter must be attributed to the Member State. Adding to these the conclusions drawn in Chapter 7 with regard to the fundamental freedoms, in the first and second scenarios the implementing national legislation is to be tested only against secondary law, however, as secondary law itself is in breach of the fundamental freedoms (or another Treaty provision, such as Article 110 TFEU) this should – at least, in principle – lead to the invalidation of secondary law which in turn, means that the implementing national law will have to be set aside too. In the third scenario the implementing national law is to be tested both against secondary law and the fundamental freedoms (or Article 110 TFEU). The fact that it may be in compliance with secondary law will not save it from condemnation as long as it is not in line also with the fundamental freedoms. As far as the State aid rules are concerned, in the first and second scenario the selective advantage deriving from a Union act does not amount to State aid and thus, will avoid the application of Articles 107-108 TFEU. However, this should not mean that a selective advantage which distorts competition in the internal market can remain in place. The Union act to which such selective advantage is imputable must be subjected to review in the light of the principle of equality as a general principle of EU law, which is a general norm in relation to the State aid rules and therefore, applies whenever the conditions for applying the more specific rules are not met. In the third scenario a Member State exercises an option provided for by secondary law while having a sufficient margin of discretion in order to avoid a selective benefit to be granted to any category of undertakings. If despite of this, such selective advantage occurs, it will be attributed to the Member State meaning that the infringement of the State aid rules can be established with regard to the national measure.
8.3.3. Simultaneous application of secondary law and the fundamental freedoms

8.3.3.1. Recollections from Chapter 7

As we concluded in Chapter 7, in policy areas covered by exhaustive harmonization, national law has to be tested only against the harmonizing secondary legislation and not against the fundamental freedoms. Thus, in exhaustively harmonized fields secondary law applies, as a rule of thumb, exclusively; this, however, does not mean that the fundamental freedoms are completely excluded from such areas. Secondary law supersedes the freedoms only in the order of application but not as a matter of hierarchy. In other words, the legality of secondary law itself remains reviewable in the light of the freedoms (see Section 7.2.5.). Conversely, in areas which are only partially harmonized or where secondary law lays down only minimum standards or otherwise leaves leeway for the Member States in implementation, the fundamental freedoms do apply to the actions of the Member States which fall outside the limited scope of harmonization measures or which go beyond the minimum standards or which enact detailed rules in transposition of general provisions (see Section 7.2.6). In all these cases secondary law and the fundamental freedoms apply simultaneously and function as a dual standard for measuring the compatibility of the measures that Member States adopt in the exercise of their discretionary powers.

8.3.3.2. Within and outside the scope of the direct tax directives

As the direct tax directives bring about harmonization in narrow and precisely circumscribed fields, they use the technique of minimum harmonization and they grant several options for the Member States, they leave a wide domain for the discretion of the Member States and in turn, for the application of the fundamental freedoms to control the use of such discretion. First, the personal and material scope of the directives is strictly defined; when situations fall outside such strictly defined scope, the fundamental freedoms fully apply and control the taxation by the Member State of such situations. As far as the Parent – Subsidiary Directive is concerned, it is well-settled case law that in relation to dividend distributions on shareholdings which do not reach the minimum participation threshold set by the Directive it is up to the Member States to decide whether or not they relieve economic double taxation; if they do so, however, they need to comply with the prerogatives of the freedoms. As the Court has consistently held:
“The mere fact that, for holdings to which Directive 90/435 does not apply, it is for the Member States to determine whether, and to what extent, a series of charges to tax and economic double taxation are to be avoided and, for that purpose, to establish, either unilaterally or through DTCs concluded with other Member States, procedures intended to prevent or mitigate such a series of charges to tax and that economic double taxation, does not of itself mean that the Member States are entitled to impose measures that contravene the freedoms of movement guaranteed by the Treaty.”

In another case, the distribution did not qualify for the benefit of the Directive because the recipient of the dividends did not hold full ownership title to the shares underlying the distribution as required, according to the Court’s interpretation, by Article 3 of the Parent – Subsidiary Directive. Nevertheless, the Court held that by virtue of the rights to free movement guaranteed by the Treaty, the Member State was obliged to relieve economic double taxation on foreign-source dividends received by the holder of usufruct rights over the underlying shares if it relieved such double taxation on similar domestic-source dividends.

Similarly, the Court emphasized that the fact that a dividend distribution falls outside the scope of the Parent-Subsidiary Directive because the companies involved in the distribution are not amongst the entities eligible for the benefits of the Directive or not subject to tax as required by the Directive does not mean that the distribution can freely be subjected to discriminatory treatment by the Member States:

“[...] the situation at issue in the main proceedings does not fall within the scope of Directive 90/435, since a company in the form of a SICAV does not satisfy the conditions set out in Article 2(1)(a) and (c) of that directive.

The Court has already held that, in respect of shareholdings which are not covered by Directive 90/435, it is for the Member States to determine whether, and to what extent, economic double taxation of distributed profits is to be avoided and, for that purpose, to establish, either unilaterally or by conventions concluded with other Member States, procedures intended to prevent or mitigate...

1152. ECJ, 12 December 2006, Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation v Commissioners of Inland Revenue, para. 54; ECJ, 12 December 2006, Case C-446/04 Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue, paras. 68-69; ECJ, 8 November 2007, Case C-379/05 Amurta SGPS v Inspecteur van de Belastingdienst/Amsterdam, para. 24; ECJ, 19 November 2009, Case C-540/07 Commission v Italy, para. 31; CJ, 3 June 2010, Case C-487/08 Commission v Spain, para. 40; CJ, 20 October 2011, C-284/09 Commission v Germany, para. 48.

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such economic double taxation. However, that does not of itself allow them to impose measures that are contrary to the freedoms of movement guaranteed by the Treaty [...]”

Hence, the case law described above unequivocally confirms that the fundamental freedoms constitute a limit to the exercise by the Member States of their powers in direct taxation even in areas where a harmonization measure exists but the concrete situation under review falls outside the material or personal scope of such measure. In this respect the Member States had previously argued to the effect that the direct tax directives had created a reserved domain for the Member States in the broad area of the subject matter which they cover meaning that in cases which concern such subject-matter but which do not meet the objective or subjective conditions for the application of the directives the Member States’ powers remain unaffected by EU law. This was plainly rejected by the Court. As summarized by Kofler, “the Court is not willing to accept [...] arguments, which aim at carving out domestic measures from the impact of the freedoms just because the existence of directive in the specific field of law, even if the concrete factual situation is not covered by the objective or subjective scope of such directive [...]”.

The 2003 amendment of the Parent – Subsidiary Directive shows that the fundamental freedoms not only apply outside the scope of the Directive but their impact is sometimes expressly confirmed by extending the scope of the Directive to situations which have not been covered before. The original 1990 version of the Directive did not cover situations in which dividends were received by EU permanent establishments of eligible parent companies. The Court’s case law – specifically Avoir Fiscal and Saint Gobain – settled early on that the freedom of establishment requires the Member States to treat permanent establishments of companies of other Member...

1154. ECJ, 18 June 2009, C-303/07 Aberdeen Property Fininvest Alpha Oy, paras. 27-28; ECJ, 1 October 2009, Case C-247/08 Gaz de France – Berliner Investissement SA v Bundeszentralamt für Steuern, para. 60.
1155. Case C-379/05 Amurta, paras. 21-23.
1156. Kofler and Tenore, supra note 603, p. 326.
1158. ECJ, 28 January 1986, Case 270/83 Commission v France (Avoir Fiscal); ECJ, 21 September 1999, Case C-307/97 Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt.
States equally to resident companies also with regard to granting relief for economic double taxation on the dividends they receive. Thus, the fact that distributions received by permanent establishments did not fall within the scope of the Directive did not mean that they could be subjected to discriminatory treatment. The amendment of the Directive explicitly included this scenario in the scope of the Directive. The only situation in which such inclusion would change the outcome compared to the protection under the freedoms is where the Member State in which the permanent establishment is situated taxes the dividends distributed by resident subsidiaries to resident parent companies. Such Member State would also want to tax dividends distributed by a resident company to a permanent establishment situated in its territory. In this case, the Directive would, in principle, require the grant of an exemption or indirect credit to the permanent establishment irrespective of the lack of discriminatory treatment under domestic law in comparison with purely domestic situations. However, it has to be noted that the amending Directive expressly excludes such a situation from its scope. It is stated in its Preamble that “[…] situations where the permanent establishment and the subsidiary are situated in the same Member State, can, without prejudice to the application of the Treaty principles, be dealt with on the basis of national legislation by the Member State concerned”. Thus, where there is no discrimination, neither the freedoms nor the Directive require the grant of relief to the permanent establishment. This means basically that the amendment of the Parent – Subsidiary Directive with regard to permanent establishments did not bring about any substantive change given that the same outcome had already been guaranteed by the freedoms. In any event, the statement above which refers to the application of national legislation but “without prejudice to the application of the Treaty principles” shows that the Union legislature shares the view that situations falling outside the scope of the Directive are not shielded from the effect of the fundamental freedoms.

The Merger Directive raises a similar issue to that of the situations falling outside the personal or material scope of the Parent – Subsidiary Directive. In particular, the Merger Directive provides for a deferral of capital gains taxation on mergers, divisions, partial divisions, transfers of assets or exchanges of shares and the transfer of seat of an SE or SCE

1160. Kofler and Tenore, supra note 603, p. 334.
1161. Ibid.
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(‘reorganization transaction’) on the condition that the assets of the company involved in the reorganization transaction remain effectively connected with a permanent establishment in the State of the transferring company or in the State from which the SE or SCE moves (‘exit State’). As Kofler describes it, the ‘permanent establishment requirement’ is a substantive prerequisite for the application of the beneficial regime provided for by the Merger Directive. The consequence of such requirement is that the exit State is obliged to grant a tax deferral on reorganization transactions only if a permanent establishment remains in its territory which guarantees that it can exercise its taxing right, at the time of alienation, over the transferred assets on which capital gains taxation had been deferred. Thus, the question arises whether the Member States are entitled to levy an immediate exit tax on all the reorganization transactions where no permanent establishment is left behind in the exit State. If we only take into account the provisions of the Merger Directive there is nothing which would preclude such immediate exit taxation. However, it is well-settled case law that the freedom of establishment prevents the Member States from taxing by way of an immediate exit charge the transfer of residence of individuals and – as has been recently clarified – the transfer of seat of companies and the transferring of assets from a permanent establishment to the head office or another permanent establishment situated in another Member State. According to this case law, the levy of immediate exit tax on all these movements and transactions is a disproportionate restriction on the freedom of establishment even if the assets on which the taxable capital gains have accrued are moved out of the tax jurisdiction of the exit State, that is, when no permanent establishment is left behind. On the basis of the premise that outside the scope of secondary law the fundamental freedoms are fully applicable, the freedom of establishment, as interpreted by the Court in the case law mentioned above, should prevent the Member States from charging an immediate exit tax on the reorganization transactions falling under the scope of the Merger Directive even where the permanent establishment requirement is not met. Thus, the situation in which the substantive prerequisite for tax

1162. Merger Directive, Articles 4(2)(b) and 12.
1163. Kofler and Tenore, supra note 603, p. 334.
1165. CJ, 29 November 2011, Case C-371/10 National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam; CJ, 6 September 2012, Case C-38/10 Commission v Portugal; CJ, 31 January 2013, Case C-301/11 Commission v Netherlands; CJ, 25 April 2013, Case C-64/11 Commission v Spain.
1166. This view is defended by the Commission, see Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee
deferral under the Directive is not met is deemed to fall outside the scope of the Directive and as such, it is subject to the application of the freedoms. Admittedly, the outcome of the parallel application of the Merger Directive and the freedom of establishment is that in the case of reorganisation transactions, where the taxpayer or the taxpayer’s assets leave the tax jurisdiction of a Member State which has a tax claim over capital gains accrued on the exiting assets, the Member State is precluded from levying an immediate exit tax whether or not a permanent establishment is left behind. From this perspective, it can be legitimately asked what the use or *raison d’être* of the Merger Directive is. It lays down a beneficial tax regime dependent on the fulfilment of a substantive prerequisite; however, the same beneficial treatment can be claimed under primary law without fulfilling such prerequisite as long as the Member State concerned grants such beneficial treatment on purely domestic reorganizations as well (which most, if not all, Member States do).

Having regard to the differing perspectives, academic commentators are divided on the issue. While the majority accepts the general premise that outside the scope of the Directive domestic legislation must comply with the fundamental freedoms, which means that tax deferral must be granted irrespective of the presence of a permanent establishment in the exit State, the opposite position can be taken by arguing ‘*a contrario*’. Namely, if the Merger Directive requires the Member States to grant tax deferral only when a permanent establishment remains in the exit State it follows *a contrario* that if no permanent establishment is left behind, the Member States are allowed to tax immediately upon exit. Furthermore, it could also be argued that the non-fulfilment of a substantive prerequisite for a beneficial treatment under the Directive does not mean that the situation falls outside the scope of the Directive. Rather it is within the coverage of the Directive while not meeting a positive condition set out by the Directive’s provisions exhaustively covering the area. Therefore, to these situations only the provisions of the Directive apply to the exclusion of the fundamental freedoms. Similar arguments have been put forward in academic commentary regarding a case decided by a German court on the transfer of seat of an

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825 final, Pont 3.1. Further on this, see *Letter of formal notice – Norwegian rules on exit tax*, EFTA Surveillance Authority (comments by Szudoczky), H&I 2010/7.8. A different approach is taken by Dourado who suggests that as long as the permanent establishment requirement of the Merger Directive is considered to be a precise, clear and unconditional rule (i.e. with direct effect) and not optional, the Directive itself is incompatible with the freedom of establishment, see Dourado, supra note 641, pp. 184-185.

1167. See for a comprehensive account of the academic literature expressing this view, Kofler and Tenore, supra note 603, FN 131.
SE from Germany to Austria where the capital gains accrued on the shareholdings held by the SE were taxed by Germany upon the transfer, as no permanent establishment was left in Germany.\textsuperscript{1168} This case demonstrates perfectly well the paradoxical result that follows from the argument which contends that this situation is still within the scope of the Directive and the fundamental freedoms do not require the relinquishing of the immediate exit tax. Specifically, according to this argument, the transfer of seat of an SE falls under the scope of the Merger Directive by virtue of Articles 2(k) and 12 of the Directive. The fact that the transfer does not meet the condition of leaving the assets behind connected to a permanent establishment does not take the situation out of the coverage of the Directive. As the condition for tax deferral is not met, the deferral can be denied and the capital gains can be taxed right upon exit. However, it should be noted that if the company transferring its seat were a national company formed under German law the transfer would, indeed, fall outside the scope of the Merger Directive, as the transfer of seat of national companies is not covered by the latter. Therefore, such a transfer would be governed by the fundamental freedoms which would prohibit the imposition of an immediate exit tax. As a consequence, a national company could transfer its seat with a tax deferral under the fundamental freedoms, whereas an SE – a European company form which was specifically created with the purpose of allowing it to move freely without legal obstacles in the internal market and which was specifically brought within the scope of the Merger Directive in order to facilitate such movement – would be liable to an exit tax precisely due to the application of the Directive. Such an absurd outcome unquestionably shows that the argument must be wrong. Therefore, we support the view that for the purposes of assets not connected with a permanent establishment in the exit State, the permanent establishment requirement of the Merger Directive is a ‘nonrule’ which leaves the situation to be decided by the application of primary EU law.\textsuperscript{1169}

This still leaves open the question what the exact use of the Merger Directive is. Undoubtedly, it brings about uniformity in defining the eligible transactions and enhances legal certainty by laying down detailed rules governing specific issues linked to intra-Union corporate reorganizations, for example, the transfer of a permanent establishment and transparent entities; however, as regards its main purpose, the fundamental freedoms guarantee tax

\textsuperscript{1168} FG Rheinland-Pfalz v. 7.1.2011, 1 V 1217/10, see W. Mitschke, Kein steuerfreier Exit stiller Reserven bei Sitzverlegung einer SE von Deutschland nach Österreich, Internationales Steuerrecht 8/2011, pp. 294-299.

\textsuperscript{1169} Kofler and Tenore, supra note 603, p. 338 with references to academic literature expressing this view in FN 132.
neural treatment of corporate reorganizations in a much broader scope than the Directive does.\textsuperscript{1170} This is the consequence of negative integration progressing at a much higher speed than positive integration in the field of direct taxation. Undoubtedly, in 1990 when the Directive was adopted the creation of a common tax neutral regime for cross-border reorganizations, even if limited by considerations of safeguarding the financial interest of the Member States, was a big step in furthering integration in the area of taxation. However, more than 20 years later, it is difficult to deny that the Directive has become rather obsolete in comparison with what has been achieved by the application of the fundamental freedoms.

Finally, another situation where the direct tax directives and the fundamental freedoms apply simultaneously is when the directives grant an option for the Member States which leave room for the exercise of their discretion. As we have discussed in the previous Chapter, the starting point for the Court in assessing these situations is that “the fact that a national measure may be consistent with a provision of secondary law [...] does not have the effect of removing that measure from the scope of the provisions of the Treaty.”\textsuperscript{1171} Thus, national measures which are adopted by the Member States in the exercise of an option granted by secondary law are subject to review for compliance with the Treaty freedoms.\textsuperscript{1172} The Bosal case, which unequivocally clarified this point, concerned the Parent – Subsidiary Directive, specifically, Article 4(3) thereof which gives an option to the Member States to exclude costs and losses relating to the holding in the subsidiary from deduction from the parent company’s profits. The Netherlands made use of this option by allowing Netherlands parent companies to deduct financing costs relating to their holdings in subsidiaries only insofar as the subsidiaries generated profits taxable in the Netherlands. As we have discussed above, the Court held that exercising the option in such a way infringed the freedom of establishment, as it discriminated against parent companies with subsidiaries resident in other Member States which normally do not generate taxable profits in the Netherlands. Although the Netherlands provision was

\textsuperscript{1170}. Notably, this is not the case with the Interest and Royalties Directive which provides for an exemption from tax at source of cross-border interest and royalty payments between associated companies of different Member States. An exemption from withholding tax at source could not be achieved by the application of the fundamental freedoms to such payments even if purely domestic payments are not subjected to withholding tax. According to the Court’s interpretation in \textit{Truck Center} (ECJ, 22 December 2008, Case C-282/07 \textit{État belge – SPF Finances v Truck Center SA}), such differential treatment of cross-border and domestic interest payments does not constitute discrimination under the freedom of establishment and the free movement of capital.

\textsuperscript{1171}. Case C-158/96 \textit{Kohll}, para. 25.

\textsuperscript{1172}. Dourado, supra note 641, p. 188.
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in line with the Directive, this did not mean *per se* that it also complied with the Treaty freedoms. The freedoms, in such cases, constitute a second standard against which the compatibility of national law is to be measured. This was reaffirmed in *Keller Holding* where the argument of compliance with the Directive was brought up as a justification for the infringement of the freedom at issue. In this regard, the Court held that the Member State concerned was not “entitled, in order to justify the national legislation at issue in the main proceedings, to rely on the fact that the legislation merely implements a taxing power provided for in Article 4(2) of Directive 90/435 [now Article 4(3) of the (recast) Parent – Subsidiary Directive] [...] such an option can be exercised only in compliance with the fundamental provisions of the Treaty [...].”

The principle laid down in *Bosal* governs the use of all the options granted by the Parent – Subsidiary Directive. Kofler mentions, *inter alia*, the choice permitted to the Member States by Article 4(1) of the Directive between the exemption and the indirect credit method to relieve economic double taxation on inbound dividends. The question whether this option can be exercised in a way that different methods are applied simultaneously to the effect that domestic-source dividends are exempted while foreign-source dividends are granted an indirect tax credit was at issue in the *FII Group Litigation* saga pending before the UK courts for several years and prompting three referrals to the CJ. It is evident that such asymmetrical use of the relief methods may lead to foreign-source dividends being treated less favourably than domestic-source dividends which, in turn, would entail an infringement of the fundamental freedoms. We will discuss this issue more in detail in Section 8.3.4.5. in connection with reverse consistent interpretation.

Finally, another optional provision in the framework of the Parent-Subsidiary Directive is Article 3(2) which permits the Member States to set a minimum holding period of up to two years for the application of the benefits of the Directive. The requirement of exercising this option in conformity with the fundamental freedoms seems to entail that if a Member State chooses to set a minimum holding period for participations falling under the scope of the Directive it has to do so with regard to domestic participations as well by setting the same minimum holding period for the latter, as it seems

1173. Case C-168/01 *Bosal*, paras. 25-27.
1174. Case C-471/04 *Keller Holding*, para. 45.
1175. Kofler and Tenore, supra note 603, pp. 342-345.
highly unlikely that a discrimination against cross-border participations in this respect could be justified on any ground under the Treaty’s free movement provisions.

In summary, the direct tax directives and the fundamental freedoms apply simultaneously to test the compatibility of national legislation which implements the directives or otherwise relates to the subject-matters governed by the directives. This is so because the direct tax directives do not result in exhaustive harmonization of the respective areas they govern. In particular, their subjective and objective scope is strictly circumscribed and even within the defined area they govern (i.e. dividend distributions, corporate reorganizations, interest and royalty payments), they are limited to specific taxpayers and certain specific transactions while the benefits they provide for are dependent on the fulfilment of certain substantive prerequisites. Therefore, all the situations in which these subjective and objective conditions or substantive prerequisites are not met remain to be subject to the fundamental freedoms. In addition, the direct tax directives contain numerous optional provisions which leave discretion for the Member States which avail themselves of the options with the result that the exercise of those options is also reviewable in the light of the fundamental freedoms.

8.3.4. Consistent interpretation

8.3.4.1. Recollections from Chapter 7

In Chapter 7, we concluded that the Court uses the technique of interpreting secondary law consistently with primary law mainly for the purpose of avoiding having to invalidate secondary law due to its incompatibility with primary law. We distinguished different groups of cases according to the extent to which the Court adjusts or bends the meaning of secondary law derived from its wording in order to arrive at a result which is in conformity with primary law. In some cases, the meaning of a term included in secondary law is completely open to interpretation; therefore, a reconciling interpretation of the term with primary law is a natural exercise. In other cases, the wording of secondary law allows, in principle, different interpretations. In such case, the Court holds that the correct interpretation is the one which renders secondary law compatible with primary law. Sometimes this leads the Court to favour a highly formalistic interpretation which ignores the actual effects of secondary law but which successfully maintains the validity thereof. Finally, there are cases where the technique of consistent
interpretation results in *contra legem* interpretation of secondary law. These different uses of the technique of consistent interpretation can be traced also in the interpretation of the tax directives.

8.3.4.2. Consistent interpretation instead of invalidation

One of the clearest examples of the application of the method of consistent interpretation is *Gaston Schul*.1177 As we discussed in Section 8.2.2.3. (ii), the Court held in this case that the full double imposition of VAT on private-to-private transactions which the VAT Directive in force at that time (the Sixth Directive) seemingly endorsed by allowing the levy of VAT on imports and not providing for a refund of VAT on exports was contrary to Article 110 TFEU. From this conclusion the question logically followed whether the Sixth Directive was invalid insofar as it allowed the levy of VAT on imports of goods which were already burdened with VAT in the Member State of exportation thereby resulting in the infringement of a Treaty provision. The Court first confirmed that the requirements of Article 110 TFEU are “of a mandatory nature and do not allow derogation by any measure adopted by an institution of the Community”.1178 Nevertheless, the Court avoided declaring the relevant provision of the Sixth Directive invalid by holding that Article 110 TFEU does not preclude the imposition of VAT on imports altogether. Rather it only requires the Member State of importation to grant a credit for the residual amount of VAT paid in the Member State of exportation which is still included in the value of the product on import. The wording of the relevant provision of the Sixth VAT Directive did not preclude such interpretation according to which the Member State of importation could tax but with an obligation to reduce its tax claim by the tax paid in the other Member State. Given that it rendered the provision of the Directive consistent with Article 110 TFEU, only this interpretation was correct. The Court thus held:

“[…] there are no grounds for considering Article 2, Point 2 of the Sixth Directive, according to which “importation of goods” is to be subject to value-added tax, to be invalid. It is simply necessary to define the scope of that provision and interpret it in a manner consistent with the requirements of the Treaty […]

[…] Article 2, Point 2 of the Sixth Directive is compatible with the Treaty and therefore valid since it must be interpreted as not constituting an obstacle to the obligation under Article 95 [now Article 110] of the Treaty to take into account,

1177. Case 15/81 Gaston Schul.
1178. Ibid. para. 42.
for the purpose of applying value added tax to imports [...], the residual part of the value added tax paid in the Member State of exportation contained in the value of the product when it is imported”

Considering the silence of the Sixth Directive regarding any obligation of the Member State of importation to grant a credit for the VAT levied in the other Member State, it is likely that the Union legislature did not intend to provide a solution for the ensuing double taxation. However, as the wording of the Directive did not expressly preclude it, the Court – with a creative move – was able to impose an interpretation on the Directive which prevented double taxation from occurring producing a result more in line with primary law and the internal market.

The Opinion of Advocate General Kokott in Schmelz provides a rather extreme example of consistent interpretation used for the purpose of avoiding the need for invalidating secondary law. As we discussed in the previous Section, in this case the VAT Directive provided for an optional regime for small undertakings which exempted them from VAT on the condition that they were established in the Member State where the turnover was generated. As explained above, the VAT Directive left no margin of discretion to the Member States in the implementation of the optional regime and therefore any potential infringement of the fundamental freedoms resulting from that regime would have to be considered as caused by the Directive. Having arrived at this conclusion, Advocate General Kokott continued with analysing whether the incriminated provision of the VAT Directive, indeed, restricted the freedom to provide services and therefore was invalid. The Directive treated the provision of cross-border services less favourably than that of domestic services by excluding service providers established in other Member States from the VAT exemption. As established and non-established service providers were in a comparable situation in a case such as that of Mrs Schmelz, the existence of a restriction on the freedom to provide services was established. As to the justification of the restriction, the Advocate General found that the exclusion of non-established persons from the regime was intended to ensure that each small undertaking benefits from the concession only once, that is, where it is established. Thus, the need to guarantee the effectiveness of fiscal supervision could, in principle, have justified the restriction. However, according to the Advocate General, the provision at issue was not proportional to achieve that objective in a situation such as that of Mrs Schmelz who only generated taxable turnover in Austria and could not benefit from the small undertakings regime in her

1179. Ibid. paras. 43-44.
Member State of residence. Hence, the Advocate General found that the exclusion of non-established service providers from the small undertaking regime unjustifiably restricted the freedom to provide services. However, she did not conclude from this that the contested provision of the VAT directive was invalid. Rather she raised the question whether this was necessarily the meaning of that provision or it could have been interpreted in a way which avoided this outcome and thus avoided the need for invalidation. First, she recalled the requirement of consistent interpretation:

“It is settled case-law that a Union act must be interpreted, as far as possible, in such a way as not to affect its validity. In that regard, all Community acts must be interpreted in accordance with primary law as a whole, including the fundamental freedoms, which prohibit less favourable treatment of cross-border situations compared with purely national situations, unless such treatment is objectively justified.”

In order to comply with this requirement, she proposed that the notion of ‘establishment’ – a Union law notion to be interpreted autonomously – should be given a broad interpretation. The term ‘establishment’ requires that a person has a permanent, fixed point of contact in the Member State concerned, which therefore allows the owner of a property to be regarded as an established taxable person even if he does not use the property himself for residential purposes. This interpretation of the term ‘established’ is not only broad, it is diametrically the opposite to the interpretation that she proposed for the same term just a few paragraphs earlier when discussing whether the freedom of establishment or the freedom to provide services applied to the case at hand. She concluded that the freedom of establishment did not apply to the case, as the letting of property in itself without active management thereof in the State where it is situated or business activity carried out from there does not fall within the scope of that freedom. The Advocate General considered that such diverging interpretation of the same term is acceptable as:

“[...] The notions of establishment within the meaning of Article 43 EC [now Article 49 TFEU] and establishment in the third subparagraph of Article 24(3) of the Sixth Directive and Article 283(1)(c) of Directive 2006/112 exist in a completely different legislative context.”

In our view, the consistent interpretation of secondary law with primary law requires precisely that when a term used in primary law also appears in secondary law the same interpretation be given to it in order to ensure
coherence and consistency in the application of Union law. In addition, we find it hard to explain how the question of where small undertakings are established for the purpose of a beneficial VAT regime is so different from the question where undertakings are generally established in the sense of participating in the economic life of a Member State on a stable and continuous basis. Overall, in this case, the Advocate General’s intent to save the validity of the Directive and, at the same time, to ensure that the freedom to provide services is not restricted produced a paradoxical result. Namely, in order to interpret the Directive consistently with the fundamental freedoms, the same term used in the context of both of them would have had to be interpreted inconsistently. The Court did not follow its Advocate General’s advice; this does not mean, however, that the Court’s solution was much more satisfactory in terms of remedying the apparent infringement of a fundamental freedom caused by the VAT Directive (see Section 8.3.5.3.).

Another example of a controversial application of consistent interpretation is provided by the **Socridis** case.\footnote{ECJ, 17 June 1999, Case C-166/98 Société Critouridienne de Distrubution (Socridis) v Receveur Principal des Douanes.} In this case, the validity of the excise duty directives on alcoholic beverages\footnote{Council Directive 92/83/EEC of 19 October 1992 on the harmonization of the structures of excise duties on alcohol and alcoholic beverages; Council Directive 92/84/EEC of 19 October 1992 on the approximation of the rates of excise duty on alcohol and alcoholic beverages.} was challenged to the extent that they provided for different excise taxation of beer and wine. One of the directives laid down minimum rates for excise duty for alcohol. It fixed the minimum rate for wine at 0 allowing it, practically, to be exempted whilst for beer it set an actual minimum rate, i.e. higher than 0. The other directive provided for the methods of calculating the excise duty. In the case of beer, it set forth taxation by reference to both volume and alcohol content whilst in the case of wine solely by reference to volume. The adaptation of French law to this harmonized system resulted in beer being taxed significantly higher than wine whilst prior to harmonization the two types of alcoholic beverages were taxed similarly. The applicant, Socridis, argued that the harmonized system authorized discriminatory and anti-competitive practices in contravention of the second paragraph of Article 110 TFEU prohibiting internal taxation which affords protection to domestic products \textit{vis-à-vis} imported products where the two categories of products are not strictly similar. In short, Socridis claimed that the excise duty directives were incompatible with Article 110 TFEU and therefore invalid. The Court
rejected the claim with a brief and hardly satisfactory reasoning arguing that the directives left sufficient scope of discretion for the Member States to implement its rules in conformity with the Treaty. In this regard, it stated:

“It is common ground that Directives 92/83 and 92/84 merely require Member States to apply a minimum excise duty on beer. Consequently, the Member States retain a sufficiently wide margin of discretion to ensure that the relationship of the taxes on wine and beer excludes any protection for domestic production within the meaning of Article 95 [now Article 110] of the Treaty.”

As far as we understand, the Court tells us that the minimum rate of excise duty on beer is a compulsory rule in the sense that the rate for beer cannot be lower than this minimum. However, the 0 minimum rate for wine is an optional rule in the sense that the Member States can always fix a higher rate than that for wine. Therefore, it is within the power of discretion of the Member States to avoid unequal treatment via differential rates and thereby, also to avoid violating Article 110. In fact, this means that although secondary law explicitly allows wine to be exempted from excise duty the Member States will infringe primary law if they avail themselves of that option. Thus, the option explicitly provided for in the directive is a non-option unless Member States want to go against primary law. Not only is this a formalistic reasoning but it contradicts the case law discussed in the previous Section, according to which where a Member State merely exercises an authorization granted by secondary law any ensuing infringement of primary law is not attributable to the Member State. The discretion left to the Member State no to excise the authorization is not such to change this conclusion. The Court’s hollow reasoning – which failed to address the other part of claim concerning the different methods of calculation of the excise duty on beer and wine – was motivated by the blatant intent to maintain the validity of the excise duty directives.

8.3.4.3. Interpretation causing the least restriction on primary law

The cases discussed above show that the technique of consistent interpretation can be stretched seemingly without limitation in order to preserve the validity of secondary legislation. This flexibility suggests that the method does not always serve as a firm guiding tool in the interpretation of secondary law, as it may support different or even opposing interpretations of the same provision of Union legislation. As a result, it can be quite difficult to identify the interpretation of secondary law which is most in line with

1184. Case C-166/98 Socridis, para. 20.
primary law or, in other words, which causes the least restriction on primary law. The *RVS Levensverzekeringen* case is a good example of this.\(^{1185}\) The case concerned the interpretation of the former Life Assurance Directive\(^{1186}\) as regards the question where the assurance premium tax is to be paid in the case of change of residence of the policyholder after the conclusion of a life assurance contract. The Directive provides that every assurance contract shall be subject exclusively to the indirect taxes and parafiscal charges on assurance premiums in the Member State of the commitment. The ‘Member State of commitment’ is defined in the Directive as the State in which the policyholder has his or her habitual residence. This can be, on the one hand, the Member State where the policyholder is a resident at the time of the conclusion of the assurance contract (‘static interpretation’). On the other, an interpretation according to which the Member State of commitment is that where the policyholder resides at the time of paying the assurance premium is equally plausible (‘dynamic interpretation’). Thus, the case was about the interpretation of a provision of a directive which attributes taxing rights between the Member States as regards insurance transactions, which we called in Chapter 7 a coordination rule. The Court in answering the question used various interpretation methods. It found that an interpretation based on the wording of the relevant provisions of the Directive permits both the static and the dynamic approaches. Therefore, it had regard to the objectives pursued by the relevant provision and that of the Directive as a whole.\(^{1187}\) It concluded that the objective pursued by the provision, i.e. prevention of double taxation and distortion of competition, called for the dynamic interpretation.\(^{1188}\) Then it examined whether such an interpretation was compatible with the general objective of the Directive, that is, the completion of the internal market in direct life assurance, in particular, from the point of view of the freedom of establishment and the freedom to provide services, to make it easier for assurance undertakings with their head office in the EU to cover commitments situated within the EU and to make it possible for policyholders to have recourse to assurers established in Member States other than in which they reside. Thus, at this point the Court had to decide whether the dynamic interpretation was consistent with the freedom to provide services. The Court affirmed that the dynamic interpretation was in line with that freedom despite the difficulties and administrative burden.

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1185. CJ, 21 February 2013, Case C-243/11 *RVS Levensverzekeringen NV v Belgische Staat*.
1187. Case C-243/11 *RVS Levensverzekeringen*, para. 47.
1188. Ibid. paras. 48-61.
that assurance undertakings may face if policyholders change their residence after the conclusion of the assurance contract.\textsuperscript{1189} Interestingly, the Advocate General in the case concluded to the contrary. She found that:

“[…] dynamic interpretation clearly has a greater adverse effect on the freedom to provide services than a static interpretation.

[…] In the event of the dynamic interpretation, to fulfil their fiscal obligations, assurance undertakings would have constantly to verify the current habitual places of residence of their policy-holders and, above all, the tax rules currently applicable at each such place. The undertakings would thus be forced to comply with many different tax rules laid down by the Member States solely because, whether they liked it or not, their contractual partners had moved their places of residence to other Member States.

In a static interpretation, on the other hand, the tax rules of another Member State need to be taken into account only if an assurance undertaking consciously decides to conclude a life assurance contract with a person who has his habitual place of residence in another Member State. Above all, only those tax rules are to be applied throughout the term of the contract.

A dynamic interpretation thus imposes a greater restriction on the cross-frontier services of an assurance undertaking, since it makes the contract subject to a different tax regime if the policy-holder changes his place of residence.”\textsuperscript{1190}

These conflicting interpretations by the Court and the Advocate General show clearly that choosing an interpretation of secondary law which causes the minimum restriction on the fundamental freedoms is not always a straightforward exercise.

8.3.4.4. Consistent interpretation of the same concept under primary and secondary law: some thoughts on abuse of EU law

(i) Introduction

Although the topic of abuse of Union law – in particular the question whether the Member States are entitled or obliged to counter such abuse and if so, according to which criteria abuse is to be established – is far too challenging and sweeping a subject to be dealt with in one (sub-sub)section of any academic study, it is worth a discussion here to the extent it provides a useful context to explain some aspects of consistent interpretation. It is

\textsuperscript{1189} Ibid. paras. 64-68.
\textsuperscript{1190} Opinion of Advocate General Kokott, 6 September 2012, Case C-243/11 RVS Levensverzekeringen NV v Belgische Staat, para. 83-86.
common ground that abuse of the rights derived from Union law is prohibited. This was first clarified with regard to the fundamental freedoms. In particular, the Court laid down in its early non-tax case law that the individual rights which the freedoms grant to EU nationals cannot be exploited in order to improperly circumvent the Member States’ rules.1191 This should apply equally when at issue is the circumvention of the tax laws of the Member States. Therefore, it is explicable that the notion of abuse1192 has slowly permeated from the non-tax case law to the tax fields appearing first in the harmonized field of VAT then in both the non-harmonized and harmonized domains of direct taxation. As far as VAT is concerned, the VAT Directive does not contain any specific anti-abuse or anti-avoidance provision; the Court thus, by relying on the doctrine of abuse, set standards according to which Member States can counter abusive practices in the sphere of VAT. In contrast to the VAT Directive, the direct tax directives do contain specific anti-abuse clauses the interpretation of which has also raised challenging questions especially in relation to the concept of abuse which was being developed by the Court in the other fields of EU tax law. In view of this, the question that occupies most of the academics who deal with the topic of abuse of Union law is whether the Court’s evolving – and on the surface undoubtedly diverging – case law in the different areas of taxation has resulted in the creation of a single, uniform concept or doctrine of abuse.1193

1191. One of the first cases was ECJ, 3 December 1974, Case 33/74 Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid. For a comprehensive list of non-tax cases and literature on them see A. Zalasiński, The Principle of Prevention of (Direct Tax) Abuse: Scope and Legal Nature – Remarks on the 3M Italia Case, 52 European Taxation 9 (2012), pp. 446-454, FN 29.

1192. Englisch points to the distinct concepts of ‘abuse of rights’ and ‘abuse of law’; the first referring to the excessive use of an individual right harming another person without good reason and the second to the circumvention of a legal provision (i.e. avoidance of a burden or obtaining an advantage) by creation of artificial arrangements, see J. Englisch, Curbing ‘Abusive’ International Tax Planning Under EU Law: The Case of the Merger Directive (Wolters Kluwer España 2012), pp. 32-33. Thus, he considers the correct term in this context is ‘abuse of law’. Similarly, Opinion Statement of the CFE ECJ Task Force on the Concept of Abuse in European Law, Based on the Judgments of the European Court of Justice Delivered in the Field of Tax Law – November 2007, 48 European Taxation 1 (2008), pp. 33-36, at p. 35. As the Court uses the term ‘abuse of rights’ (see e.g. ECJ, 5 July 2007, Case C-321/05 Hans Markus Kofod v Skatteministeriet, para. 38; ECJ, 22 May 2008, C-162/07 Ampliscientifica Srl and Amplifin SpA v Ministero dell’Economia e delle Finanze and Agenzia delle Entrate, paras. 27-30; CJ, 29 March 2012, C-417/10 Ministero dell’Economia e delle Finanze and Agenzia delle Entrate v 3 M Italia SpA, paras. 30-31) and in academic literature we can encounter all these terms used in the most varied ways, we also refer to ‘abuse’, ‘abuse of rights’ and ‘abuse of EU law’ interchangeably.

From our perspective, the question is more specific, namely, whether the various manifestations of the concept of abuse in the domain of primary and secondary Union law can lead to potential conflicts between the two sources of law and whether those conflicts can be or should be avoided via consistent interpretation. Having regard to the various contexts in which the concept of abuse appears one can legitimately ask why would there be a need for a unitary concept of abuse and thus for a consistent interpretation of the latter in all these fields and, if anything, what would require such consistent interpretation. These questions are especially complex, as both the status and the content of the doctrine of prohibition of abuse of EU law are far from being clear, a fact that is not much surprising in the case of a judicially developed unwritten doctrine that has only a short history in the field of EU tax law.

The starting point in answering the above questions is that, according to the Court, there is a general Union law principle which prohibits the abuse of rights.1194 As long as the prohibition of abuse of EU law has the status of a general principle of EU law ranking as primary law in the Union’s legal order, it implies that it should apply equally and uniformly in all fields of EU (tax) law. In addition, if there is a specific written provision under secondary law which is aimed at prohibiting abuse of its provisions in the specific field which it governs, such provision should be in line with the higher ranking general principle and should be interpreted consistently with the latter.1195

Under this assumption, consistent interpretation of the specific anti-abuse provisions of secondary law with the general principle of prohibition of abuse is required by virtue of the principle of hierarchy of norms. Even if the prohibition of abuse of EU law does not amount to – as is often argued in academia – a general principle of EU law but it is rather a principle of interpretation,1196 a requirement to interpret the criteria of abuse consistently

1194. Case C-321/05 Kofoed, para. 38.
1195. Concurrently Petrosovitch, see supra note 1193, p. 559.
1196. This was the position of Advocate General Maduro in his seminal Opinion in Halifax, see Opinion of Advocate General Maduro, 7 April 2005, Case C-255/02 Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd v Commissioners of Customs & Excise, para. 74.
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throughout all the areas of EU law and with regard to all types of Union norms may derive from the principle of equality which is, indeed, a general principle of EU law.

Against this background, in this Section we examine to what extent the Court employs the method of consistent interpretation when it applies the doctrine or principle of prohibition of abuse of EU law to different areas of EU tax law. With regard to the application of the doctrine to the fundamental freedoms in the area of non-harmonized direct taxes and to the provisions of the VAT Directive it is up to the Court to what extent it aligns its own abuse doctrine in these two fields given that no anti-abuse rule enacted by the Union legislature applies to these fields. Contrarily, in the area of harmonized direct taxes the specific anti-abuse clauses laid down in the directives governing these taxes and their wording, constitute – at least in principle – a limit to their consistent interpretation with the case law-based general principle or doctrine of prohibition of abuse.

(ii) Doctrine of prohibition of abuse in the field of VAT and the fundamental freedoms

Although the Court considers that the prohibition of abuse of EU law is a general Union law principle, which implies a single principle applicable to all areas of EU (tax) law, the fact remains that the formulations of that principle differ in the various areas. In the area of comprehensively harmonized VAT, the Court, in the landmark Halifax judgment, described abusive practices as follows:

“ [...] in the sphere of VAT, an abusive practice can be found to exist only if, first, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions.

Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage. [...] the prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages.”

This dual test consisting of an objective criterion – frustrating the purpose of the law despite formal observance of its letter – and a subjective criterion – intent to obtain an advantage – had previously been developed by the

1197. ECJ, 21 February 2006, Case C-255/02 Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd v Commissioners of Customs & Excise, para. 74-75.
Court in its non-tax case law, notably in the seminal case of *Emsland-Stärke* regarding EU export refunds. The Court applied the test to the sphere of VAT in order to shed light on the question of when the exercise of the right to deduct input VAT can be considered abusive.

In the domain of non-harmonized direct taxes, the doctrine of abuse has a role to play when examining the compatibility with the fundamental freedoms of national anti-abuse rules discriminating against cross-border situations. In this situation, the argument relating to abuse can, in principle, be used in two ways. It can either be claimed that the activity or transaction to which the discriminatory national anti-abuse rule is being applied does not constitute a genuine exercise of a freedom, as it lacks economic substance altogether or, alternatively, that the national anti-abuse rule which *prima facie* restricts a genuine exercise of a freedom is justified on the ground of the need to prevent abusive practices circumventing national tax law. The two arguments are conceptually different; the first concerns the abuse of Union law, specifically the fundamental freedoms, and the second relates to the avoidance of national tax law. Commentators point out critically that the Court does not distinguish between the two situations and applies the doctrine of abuse in the same way using the same standard. As a consequence of this stand, in the area of direct taxation discriminatory national anti-avoidance rules can only be accepted to the extent that they fight the abuse of Union law which is not necessarily the same as fighting abuse of national law. In all events, the Court describes the standard of abuse in this area, in *Cadbury Schweppes*, in the following way:

“[...] in order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory.

[...]

[...] in order for the legislation on CFCs to comply with Community law, the taxation provided for by that legislation must be excluded where, despite the existence of tax motives, the incorporation of a CFC reflects economic reality.”

1199. Englisch, supra note 1192, p. 35.
1200. Ibid. 35-37.
1201. Vanistendael, supra note 1193, p. 194. Similarly, Englisch, supra note 1192, p. 36.
1202. ECI, 12 September 2006, Case C-196/04 Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, para. 55, 65.
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As it appears, the Court endeavoured to define the concept of abuse in the area of non-harmonized direct taxes in a way which is aligned with the concept of abuse in the area of VAT. The element of “wholly artificial arrangements which do not reflect economic reality” corresponds to the objective criterion of abuse. In the context of the freedom of establishment the objective of the law at issue is the facilitation of genuine cross-border economic activity in the internal market or, in other words, “economic and social interpenetration” within the Union by allowing economic agents to participate on a stable and continuing basis in the economic life in another Member State. The latter will not be attained by a wholly artificial arrangement which lacks economic substance, that is, an establishment where no genuine economic activity is carried on. The element of “with a view to escaping the tax normally due” corresponds to the subjective element of abuse, that is, the intention to avoid national taxes. This is reiterated again in the duality of “economic reality” and “tax motives” in the latter paragraph cited above. In the end, it seems the Court in Cadbury Schweppes made a link between the notion of wholly artificial arrangement, which had existed in the direct tax case law for a long a time, and the abuse concept developed in the context of Halifax (Emsland-Stärke) thereby moving closer to the creation of a single concept or doctrine of abuse.

While Cadbury Schweppes revolved around the objective criterion of abuse, i.e. the economic reality of a transaction, the Thin Cap Group Litigation case stressed the need to verify the subjective element, i.e. the purpose of a transaction which constitutes an artificial arrangement when assessed on the basis of objective and verifiable factors. In particular, the Court stated that the arms’ length principle can be legitimately used by a Member State in order to determine whether the objective element of abuse – lack

1203. Differently, Jiménez, supra note 1193, p. 275 and Weber, supra note 1193, at pp. 252-253 who consider artificiality to be part of the subjective element of the test. Weber emphasizes, however, that in the context of the fundamental freedoms the objective and subjective elements of the abuse test largely overlap, see p. 255.
1204. Case C-196/04 Cadbury Schweppes, paras. 52-53.
1207. The endeavour to make such a link is obvious from the explicit reference to Halifax and Emsland-Stärke, see Case C-196/04 Cadbury Schweppes, para. 64.
1208. ECI, 13 March 2007, Case C-524/04 Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue.
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of economic reality/artificiality – is fulfilled by a transaction, but in order for a restriction on the freedom of establishment to be justified on the ground of prevention of abuse it is also necessary that the Member State allows the taxpayer to provide evidence of the fact that the transaction had a purpose other than merely avoiding tax:

“[...] national legislation which provides for a consideration of objective and verifiable elements in order to determine whether a transaction represents a purely artificial arrangement, entered into for tax reasons alone, is to be considered as not going beyond what is necessary to prevent abusive practices where, in the first place, on each occasion on which the existence of such an arrangement cannot be ruled out, the taxpayer is given an opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that arrangement.”

With this judgment, the Court further consolidated the concept of abuse in the field of non-harmonized direct taxes and clearly demonstrated an effort to bring such concept into line with the criteria for identifying abusive practices in the field of VAT. In scholarly writing, there are diverging opinions as to the question to what extent the approximation succeeded. Zalasiński is of the view that the concept of abuse applied in direct and indirect tax cases continues to differ. He considers that the concept of direct tax abuse was born, in fact, from the “merger of the classic concept of tax avoidance and the concept of abuse of EU rights (fundamental freedoms)”. As a result of the merger, the tax savings motive – which is an inherent part of tax avoidance – is no longer essential to the EU concept of direct tax abuse. In addition, the notion of atypical arrangement – which is also a characteristic of tax avoidance – has been replaced by that of ‘wholly/purely artificial arrangements’. In contrast, in the area of VAT tax motive and atypical arrangements, as elements of the classic tax avoidance concept, remain fully valid. It is true that in Cadbury Schweppes artificiality was connected to the economic substance of the establishment set up in another Member State while in Thin Cap Group Litigation to the commercial terms of the transaction entered into between related parties. This economic reality test is, indeed, different from the test looking for atypical transactions whereby a certain economic result is reached through (often composite) transactions which take unusual forms or represent not the most straightforward route or create U-turns. Nevertheless, in our view, what matters is that both tests boil down to the ultimate question whether the transaction or activity car-

1209. Ibid. para. 81.
1210. Ibid. para. 82.
1211. Zalasiński, supra note 1191, p. 452.
1212. Ibid.
ried out by the taxpayer achieves the purpose of the law under which the taxpayer is exercising a right. In this sense, both tests can be considered to form part of the objective element of a broadly formulated abuse concept. As regards the tax motive, Vanistendael also points out when analysing Cadbury Schweppes that this element has lost its significance in that as long as there is effective economic transaction that reflects economic reality the tax motive is irrelevant.1213 While this is undoubtedly true with regard to Cadbury Schweppes, which focused on the objective element of abuse, Thin Cap Group Litigation – in our view – shows that the subjective element does form part of the concept abuse not only when it is applied in the sphere of VAT but also in the field of direct taxes. Hence, the objective and subjective criteria appear to be cumulative in the largely aligned concept of abuse.

Yet, there is a conspicuous difference between the concepts of abuse applied in the field of VAT and that in the area of non-harmonized direct taxes which is widely discussed in academia. It concerns the subjective criterion, more specifically, the question whether in order for a transaction to be qualified as abusive the obtaining of tax advantage has to be its sole or essential purpose.1214 In Cadbury Schweppes the Court used the formulation “wholly artificial arrangement intended solely to escape that tax”1215, which lays down the ‘sole aim’ test for the purposes of direct tax abuse. In contrast, in the area of VAT the ‘essential aim’ seems to prevail on the basis of Halifax as clarified by Part Service;1216 however, there is, admittedly, a great degree of inconsistency in this respect even within the VAT case law itself.1217 Jiménez proposes to consider this diverging language as the Court not having created different standards in the direct and indirect tax case law but rather using a single anti-abuse test with different expressions in cases presenting different facts. According to him, the essential aim test constitutes the minimum threshold for finding abuse in both fields.1218 Further doubts are cast on the existence of a single and uniform concept of abuse in EU tax law due to the basic difference in the operation of the concept in the field of non-harmonized direct tax law, on the one hand, and harmonized VAT, on the other. As discussed above, in the direct tax field the doctrine of abuse plays a

1214. Vanistendael, supra note 1193, p. 193; Englisch, supra note 1192, p. 46; Kofler and Tumpel, supra note 1193, Ch. III; Jiménez, supra note 1193, pp. 278-279; Weber, supra note 1193, pp. 255-257.
1215. Case C-196/04 Cadbury Schweppes, para. 63.
1217. See e.g. Case C-162/07 Ampliscientifica, para. 28 (sole aim); ECJ, 22 December 2010, Case C-277/09 RBS Deutschland Holdings, paras. 49, 51 (essential aim, solely, sole aim).
1218. Jiménez, supra note 1193, p. 278.
role in the justification of restrictions exerted on the fundamental freedoms by discriminatory national anti-avoidance rules. In this function the abuse doctrine inspires the criteria according to which the Court decides whether or not a national anti-abuse rule which targets abusive practices aimed at avoiding national tax law and, at the same time, restricts the exercise of the freedoms is justified. In the area of VAT, the abuse doctrine works as a “principle of interpretation which helps the Court determine the legitimate scope of subjective rights derived from EU law”,1219 which, in this case, is the right to deduct input VAT.

In summary, whether or not there is a single doctrine of abuse applying uniformly to non-harmonized direct taxes and comprehensively harmonized VAT is a highly controversial question which probably generates the most diverging views in contemporary academic thinking on EU tax law. What seems to be certain is that the Court strives for a converging interpretation and application of the doctrine in these fields. To reiterate, the question of interpreting abuse consistently in these two fields is not related to the hierarchy of norms in the EU legal order. Although the fundamental freedoms constitute primary law and the VAT directive secondary law, this does not mean in itself that abuse must be interpreted in the same way in the context of the VAT Directives as under the fundamental freedoms. It is perfectly arguable that the conditions are or should be different for denying rights that EU nationals derive from the freedoms, on the one hand, and the VAT Directive, on the other, on the ground of abuse. An argument in favour of this is that the application of an anti-abuse rule in the area of VAT often occurs in a purely domestic setting while in the domain of the freedoms it is always applied in a cross-border scenario. Furthermore, the specific features of VAT as an indirect tax where abusive transaction are mainly concerned with enhancing input VAT deduction may require a different approach to abuse than direct taxes do.1220 Along this line but from a more general perspective, Englisch argues that different criteria may be necessary to assess the permissibility of anti-abuse rules in different scenarios depending on the mechanism of operation of the rule (i.e. whether it defines the scope of an individual right or justifies a restrictive domestic anti-avoidance rule) and the presence, degree and objectives of harmonization in the area concerned.1221

1219. Zalasiński, supra note 1191, p. 452.
1220. Zalasiński, supra note 1191, p. 452. Advocate General Maduro also argues that the harmonized system of VAT has specific characteristics and principles and the criteria for applying the principle of prohibition of abuse of Union law must be established having regard to that, see Opinion of Advocate General Maduro, Case C-255/02 Halifax, para. 83.
1221. Englisch, supra note 1192, p. 40.
Chapter 8 - Primary law and secondary law in the field of taxation

An argument that seems to support a consistent interpretation and uniform application of abuse to the freedoms in the area of non-harmonized direct taxes and to VAT is the principle of equality. However, the latter cannot invalidate the plea for a differentiated approach as long as the contexts in which abuse must be assessed are different. The situation changes if we accept the Court’s contention that the prohibition of abuse of EU law constitutes a general principle of EU law having the status of primary law in the Union’s normative order. On such assumption the plea for consistent interpretation is based on much more solid grounds insofar as it appears to be an obligation deriving from the principle of hierarchy of norms. The prohibition of abuse as a general principle of EU law, which has a constitutional status and which serves as a standard for reviewing the validity of lower ranking Union norms, must have a sufficiently uniform and definite content and must apply equally to all areas of EU law.

Although, in the light of the above, it is arguable whether in the current state of affairs there is a single and uniform doctrine of prohibition of abuse of EU law applying the same criteria for abuse both in the field of non-harmonized direct taxes and VAT, for the purposes of the next Section we will assume that there is such. This doctrine of abuse consists of an objective element that boils down to the artificiality of the arrangement and a subjective element that focuses on the purpose of the arrangement.

(iii) Doctrine of prohibition of abuse and the specific anti-abuse provisions of the direct tax directives

The situation is different from what we have described above in the case of the specific anti-abuse clauses set out in the direct tax directives. Even if we do not regard the prohibition of abuse as a general principle of EU law but only a principle of interpretation there are very good arguments to maintain that the latter requires the criteria for abuse to be interpreted consistently under the fundamental freedoms and the direct tax directives. First, the direct tax directives can be considered as the implementation of the fundamental freedoms in their respective fields of application. Their ultimate purpose is the facilitation of the internal market and of the exercise of the fundamental freedoms. They set out concrete, specific rules on certain designated issues of direct taxation aimed at eliminating discriminations.

1222. It is a contentious statement and intensively disputed in academic circles. English opposes such qualification by the Court. Instead he states that the function of anti-abuse rules, such as the prohibition of abuse of EU law, is to strike a balance between genuine general principles, namely, the principle of equal treatment before the law and the principle of legal certainty, see Englisch, supra note 1192, p. 40.
restrictions and distortions which impede the grouping together of companies of different Member States and the restructurings of EU company groups. True, the VAT Directive – specifically, the common system of VAT – also serves the purpose of promoting the internal market by facilitating the free movement of goods and services. However, as we have already mentioned, the VAT Directive and the rules of the Member States implementing it are very frequently applied in a purely domestic context. In contrast, the direct tax directives, by virtue of the definition of their scope, apply only to cross-border situations just as the fundamental freedoms. The beneficial tax treatment provided for under the direct tax directives applies, as a rule, to transactions which constitute an exercise of the fundamental freedoms.1223 Therefore, if a very generous anti-abuse rule is applied under the direct tax directives, which permits the Member States to deny the benefits of the directives to a broad range of transactions, such broad anti-abuse rule can, in fact, impede the exercise of the fundamental freedoms. Therefore, in order to attain their objectives, it makes sense to apply the same standard for assessing abuse within the scope of the direct tax directives as the one applicable under the freedoms.1224 Arguably, a lower standard of abuse under the direct tax directives than under the freedoms would not result per se in an infringement of the freedoms given that for such infringement a discrimination between cross-border and domestic situations would have to be in place. The consequence of a lower standard of abuse under the directives is that national anti-avoidance rules which are over-inclusive – that is, target situations which are not, in fact, abusive – would be authorized. However, this would only infringe the fundamental freedoms if such national anti-avoidance rules were to apply only to cross-border situations falling within the scope of the directive to the exclusion of corresponding domestic situations. Notwithstanding the fact that a formal infringement may not always be in place, a lower standard of abuse under the directives than the freedoms would certainly entail that the directives could not achieve their objective of facilitating the exercise of the freedoms. Hence, the requirement of interpreting abuse consistently under the direct tax directives and the fundamental freedoms seems to be more compelling than in the case of the VAT Directive and the fundamental freedoms. As emphasised above, if the prohibition of abuse is considered a general principle of EU law, the specific anti-abuse provisions of the directives must comply with such higher ranking norm of EU law and their validity, at least in theory, is reviewable in the light of the latter.

1223. The fact that the majority of cases decided by the CJ on the Merger Directive arose in a domestic context (Leur-Bloem, Zwijnenburg, Foggia) does not affect the a priori validity of this statement.
1224. Differently English, see supra note 1192, p. 41.
In view of the considerations above, we need to examine the specific anti-abuse provisions of the direct directives to see whether they are in line with or, can be interpreted in line with, the case law-based doctrine of prohibition of abuse and to what extent the Court strives for a consistent interpretation in their regard.

When looking at the anti-abuse clauses of the direct tax directives, it is hard not to notice instantly the rich variety of terms used in those provisions. Besides ‘abuse’ they refer to ‘tax avoidance’, ‘tax evasion’ and ‘fraud’. The Parent-Subsidiary Directive mentions ‘fraud’ and ‘abuse’ whereas the Merger Directive refers to ‘tax avoidance’ and ‘tax evasion’. The Interest and Royalties Directive incorporates two anti-abuse clauses; one corresponding to that of the Parent-Subsidiary Directive and the other to that of the Merger Directive, thus incorporating all four terms. As regards this diversity in language, it has to be noted that according to common understanding, ‘tax evasion’ and ‘fraud’ refer to illegal activities consisting of non-disclosure, misrepresentation and concealing of facts from the authorities which frequently constitute criminal offence. In view of this, only ‘tax avoidance’ is related to the concept of abuse – in fact, it can be perceived as a specific, tax-related form of abuse – therefore, in the analysis below we will not deal with the other two terms.

The Parent-Subsidiary Directive provides, in Article 1(2), that it does not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse. As is apparent, it is merely an authorization for the Member States to apply within the scope of the application of the Directive the anti-avoidance rules (or unwritten anti-abuse doctrines) laid down either in their domestic laws or the tax treaties they concluded with other Member States. Although it is a very general language which seems to put no limits on the Member States in applying their domestic or treaty-based anti-avoidance rules, evidently, it cannot be understood as a general licence to deny the benefits granted by the provisions of the Directives on the basis of any sort of anti-avoidance rule. Therefore, in our view, the referral of the issue to the domestic laws of the Member States is to be construed as an option provided to the Member States which leaves

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1227. Interest and Royalties Directive, Article 5 (1) and (2). We will not deal with these provisions separately.
1228. See IBFD Glossary; Opinion Statement of the CFE ECJ Task Force, supra note 1192, p. 33; Englisch, supra note 1192, pp. 10-12.
1229. Opinion Statement of the CFE ECJ Task Force, supra note 1192, p. 34.
scope for their discretion. As discussed above, such an option granted by secondary law needs to be exercised in accordance with the fundamental freedoms. The application of domestic anti-abuse rules under the Directive – whether specific or general – may very well lead to discrimination against cross-border dividend flows due to the denial of relief under the Directive. For this reason, domestic anti-abuse rules need to apply the same criteria of abuse as those applicable under the freedoms so that any ensuing restriction on the freedoms can eventually be justified on the ground of prevention of abuse. This means, on the one hand, that when Member States introduce anti-directive shopping rules or other specific anti-avoidance rules on the basis of which they intend to deny the withholding tax relief or the relief on inbound dividend distributions provided for under the Directive, they have to make sure that such rules comply with the criteria of abuse developed by the Court under the Cadbury Schweppes – line of case law. Thus, such anti-avoidance rules must target “wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due”. In applying this test all the conditions developed under the case law on abuse within the context of the fundamental freedoms need to be taken into account. On the other hand, we submit that even general domestic

1231. The Commission has initiated infringement procedures against some Member States because of their anti-avoidance rules that they apply (also) within the scope of the Parent-Subsidiary Directive. See, for example, Press Release IP/06/933, Brussels, 5 July 2006, Direct taxation: Commission requests Spain to end infringement to the Parent-Subsidiary Directive, which was closed later on without having been referred to the Court. Another infringement procedure was started against Germany with regard to Article 50d (3) EStG (Einkommensteuergesetzes), second clause, setting out an anti-abuse rule for withholding tax relief, see Press Release IP/10/298, Brussels, 18 March 2010, Direct taxation: The European Commission formally requests Germany to amend its anti-abuse provision on withholding tax relief (see comments by A. Cordewener, H&I 2010/7.3, pp. 75-78). Interestingly, it does not turn out from the Press Release on which legal basis the Commission challenged the German provision. The Press Release only mentions that the German measure goes beyond what is necessary to attain its objective of preventing tax evasion and as such is disproportionate. We can only guess that the argument of the Commission was supposed to be that the rule when applied within the context of the Parent-Subsidiary Directive (or possibly the Interest and Royalties Directive) was disproportionate. The principle of proportionality, as a general principle of EU law, can only be applied to Member State measures when the latter implement EU law or otherwise the measure falls within the scope of application of EU law. In the light of this, the challenge could either have been that (i) Germany failed to observe the principle of proportionality when implementing the Parent-Subsidiary Directive or (ii) that the rule was discriminatory and thus incompatible with the freedoms whereby the principle of proportionality could have been brought to the analysis as part of the rule of reason justification. However, the infringement of the freedoms would rather be caused by the underlying legislation which provides for a discriminatory withholding tax than
anti-abuse rules (e.g. GAAR, substance over form, *fraus legis*) which apply equally to domestic and cross-border transactions can only be applied for the purpose of denying the benefits under the Directive if they target practices which qualify as abusive within the meaning of the Court’s fundamental freedom case law. All these follow from the requirement to interpret the concept of abuse as used in Article 1(2) of the Parent-Subsidiary Directive consistently with the Court’s unwritten doctrine of prohibition of abuse.

Wattel observes that Article 1(2) of the Parent-Subsidiary Directive does not represent much added value given that tax avoidance within the scope of the Directive could just as well be countered by the Member States in the absence of this provision on the basis of the Court’s general abuse of rights doctrine.\(^{1232}\) This implies that the inclusion of this specific provision to the Directive did not alter the conditions under which avoidance can be combated; thus, Article 1(2) must necessarily be interpreted consistently with the general doctrine of prohibition of abuse.\(^{1233}\) In one respect, however, the inclusion of a specific anti-abuse provision in a directive does make a difference. In particular, if Member States do not enact anti-avoidance rules making use of the authorization given by the specific provision of the Directive and they do not have a general (written or unwritten) anti-abuse rule or principle under their domestic laws which they can use within the scope of the Directive they cannot rely directly on the Directive’s anti-abuse provision to deny benefits provided for by the Directive.\(^{1234}\) Moreover, the Member States in such a situation are also precluded from relying on the general doctrine or – as the Court calls – general principle of prohibition of abuse of EU law.\(^ {1235}\) However, if the Directive did not contain a specific anti-abuse provision, the Member States could have recourse to the general Union law principle of prohibition of abuse in order to fight abuse within the scope of the Directive.

\(^{1232}\) Terra and Wattel, supra note 942, p. 648. In fact, Wattel concludes that the anti-abuse provisions of the direct tax directives are redundant in general for this reason, see pp. 697-698.
\(^{1233}\) Concurrently Bundgaard, supra note 1230, p. 492.
\(^{1234}\) This follows from the fact that the provisions of directives cannot be directly relied on by the Member States against individuals, as that would jeopardize legal certainty, see Case C-321/05 *Kofoed*, paras. 40-42.
\(^{1235}\) Weber, supra note 1193, p. 263 FN 83; Jiménez, supra note 1193, pp. 280, 288.
As far as the Merger Directive is concerned, it contains, unlike the Parent–Subsidiary Directive, a substantive anti-abuse provision, which defines the “abusive” transactions with respect to which the Member States may deny the application of the benefits of the Directive. In particular, Article 15(1)(a) of the Directive provides:

“A Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Articles 4 to 14 where it appears that one of the operations referred to in Article 1:

has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that the operation is not carried out for valid commercial reasons such as the restructuring or rationalisation of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives”

Apparently, this provision defines “abusive” operations completely differently from the Court’s doctrine of prohibition of abuse which requires both an objective condition, i.e. artificiality, and a subjective condition, i.e. purpose of obtaining a tax advantage or escaping tax, to be met in order for the finding of abuse. First, Article 15(1)(a) of the Merger Directive does not contain the term ‘abuse’ (which is why we only use the term in this context in quotation marks) but only that of ‘tax avoidance’ which is not defined in the provision. On the basis of the fact that ‘tax avoidance’ is referred to only as the purpose of an “abusive” transaction it seems that it cannot be equated to abuse. Second, the specific anti-abuse rule of the Merger Directive refers only to the objective (i.e. purpose) of the operation and it qualifies an operation “abusive” solely on the basis of its objective. Thus, the provision appears to incorporate merely the subjective element of the doctrine of abuse. The only way to construe the provision otherwise is to try to understand the term ‘tax avoidance’ itself as representing the objective element. In that case, ‘tax avoidance’ should refer to an arrangement which is artificial in the sense that it frustrates the purpose of the law the conditions of which it formally observes. However, we do not consider this interpretation convincing, as Article 15(1)(a) provides that tax avoidance should be the ‘objective’ of the operation, whereas artificiality is to be assessed with regard to the effects of any operation. The third difference of Article 15(1)(a) from the Court’s abuse doctrine is that Article 15(1)(a) explicitly states that it is sufficient if the principal objective or one of the principal objectives of the operation is tax avoidance in order for the operation to be “abusive”. Contrarily, in the context of the fundamental freedoms the ‘sole aim’ criterion prevails. In our view, the most important deviation is that if the provision under Article 15(1)(a) is, indeed, based exclusively on the
subjective element of abuse this means that the fact whether an operation is ‘wholly artificial’ or not is irrelevant. Hence a reorganizational operation the main purpose of which is reducing the tax burden can be qualified as abuse and deprived of the benefits of the Directive irrespective of whether it is artificial or not. The second part of the provision – which refers to ‘valid commercial reasons’ and allows a presumption to the effect that if the operation is not carried out for such reasons its principal objective is tax avoidance – does not change the impression that what we are dealing with here is merely a subjective abuse test.

The Court’s first interpretation of this provision in Leur-Bloem seems to confirm the fact that the objective element of abuse is, indeed, missing from this test. The Court by stating that “it is [...] possible that a merger by exchange of shares with the aim of creating a specific structure for a limited period of time and not on a permanent basis may have valid commercial reasons” basically held that an artificial transaction which does not constitute genuine merger can still be accepted if it has valid commercial reasons. This indicates that what matters is the subjective element, i.e. business purpose or valid commercial reason. Admittedly, it can be argued that this is not conclusive on the absence of the objective element, as the judgment is silent on the decisive question how a transaction which is not artificial but pursues predominantly tax purposes would be assessed under the provision.

The case from which the Court’s position regarding the Merger Directive’s anti-abuse provision became clear is Kofoed where the Court stated that:

“[...] Article 11(1)(a) of Directive 90/434 [now Article 15(1)(a) of Directive 2009/133/EC] reflects the general Community law principle that abuse of rights is prohibited. Individuals must not improperly or fraudulently take advantage of provisions of Community law. The application of Community legislation cannot be extended to cover abusive practices, that is to say, transactions carried out not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages provided for by Community law [...].”

1236. ECJ, 17 July 1997, Case C-28/95 A. Leur-Bloem v Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2.
1237. Ibid. para. 42.
1238. Case C-321/05 Kofoed, para. 38. We will not discuss subsequent cases which dealt with the anti-abuse provision of the Merger Directive, as they are not directly relevant to our question, i.e. whether the text of the provision itself and the interpretation that the Court gives to it implies an abuse test which includes both the subjective and the objective criteria of abuse. Zwijnenburg (CJ, 20 May 2010, Modehuis A. Zwijnenburg BV v Staatssecretaris van Financiendeal) concerned the question whether the Member States can counter the avoidance of taxes other than those covered by the Merger Directive by relying on Article 15(1)(a) of the Merger Directive. Foggia (CJ, 10 November 2011, Case C-126/10 Foggia – Sociedade Gestora de Participações Sociais SA v Secretário de
In this seminal paragraph, not only did the Court qualify the prohibition of abuse of rights as a general principle of EU law, it also stated that the anti-abuse provision in the Merger Directive is a reflection of that general principle. From this it follows that such provision has to be, at least broadly, in line with the general principle of prohibition of abuse. The definition that the Court gave to abusive practices under this provision, “transactions carried out not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages provided for by Community law”, brings the provision, indeed, closer to the doctrine of abuse developed in the context of the freedoms and VAT than the text of the provision itself. Although this is yet another formulation of abuse under the “general Community law principle that abuse of rights is prohibited” differing both from Halifax and Cadbury Schweppes, a broad correspondence between the various formulations can be found. The reference to ‘normal commercial operations’ can be understood as lack of artificiality, i.e. the objective condition, whilst the ‘obtaining of tax advantages’ as the sole purpose of the transaction constitutes the subjective condition. \(^{1239}\) The fact that in Kofoed, the Court did indeed try to converge the various definitions of abuse and show that a single general principle of prohibition of abuse of rights exists in EU law is evidenced by the reference not only to Cadbury Schweppes and Halifax but also to non-tax cases, inter alia, Centros. \(^{1240}\)

The interpretation by the Court of Article 15(1)(a) of the Merger Directive in Kofoed is a prime example of consistent interpretation or rather, an interpretation which entirely ignores the text of the provision itself. The Court defined ‘abusive practices’ although the provision does not use this term but rather ‘tax avoidance’. It gave a definition which has regard also to the ‘normal commercial’ character of the operations although the provision talks only about the purpose of the operations. Finally, it held that for an operation to fall under Article 15(1)(a) it has to be carried out ‘solely’ for the purpose of obtaining an advantage whilst the provision clearly says that what is required of such operations is that their ‘principal objective’ (or one of their principal objectives) is tax avoidance. Having regard to this one gets the impression that the Court in its endeavour to interpret Article 15(1)(a) \(^{Estado dos Assuntos Fiscais}\) focused merely on the interpretation of ‘valid commercial reasons’, therefore, just as Leur-Bloem, is not conclusive on the question whether or not the artificiality of the arrangement matters under Article 15(1)(a).

\(^{1239}\) Jiménez, supra note 1193, p. 281. Differently Petrosovich who considers that the objective test is that “individuals must not improperly or fraudulently take advantage of provisions of EU law” and the entire definition of abusive practices is the subjective test, see Petrosovitch, supra note 1193, p. 560.

\(^{1240}\) Weber, supra note 1193, p. 263; Englisch, supra note 1192, p. 44.
of the Merger Directive consistently with its general doctrine of prohibition of abuse forgot to read the provision. In any event, such interpretation, in our view, is contra legem.

The first question is whether the Court stretched the application of consistent interpretation to this extent because it considered that it was necessary for maintaining the validity of the provision. In other words, would Article 15(1)(a) of the Merger Directive be incompatible with any higher ranking norm of EU law if it was interpreted literally according to its words? The answer from the Court’s perspective is probably yes. If the prohibition of abuse of rights is a general principle of EU law and it has the meaning that the Court attributed to it in Halifax and Cadbury Schweppes, the anti-abuse provision under Article 15(1)(a) of the Merger Directive is incompatible with that principle and therefore its validity can be rightly questioned. In this light, the Court’s interpretation which aligned the meaning of the provision with the main outlines of the general principle of prohibition of abuse saved the provision from formal invalidation. On the other hand, if we reject the position that the prohibition of abuse is a general principle of EU law, then Article 15(1)(a) does not seem to conflict with any higher ranking norm of EU law. If the doctrine of prohibition of abuse merely functions as a principle of interpretation and it has a flexible content which can be adjusted to the specific context where it is applied the provision under Article 15(1)(a) must be considered as the specific expression of that doctrine in the field of application of the Merger Directive. In this light, Article 15(1)(a) is lex specialis in relation to the general doctrine according to which abuse of rights is prohibited. If it is so, the Court’s consistent interpretation in Kofoed, which in fact resulted in contra legem interpretation, is hardly explicable or justified as it set aside the meaning that the Union legislature attributed to that provision without it having been required by a higher ranking rule of Union law. This seems to be the view defended by Englisch who argues that there was no need for the Court to refer in the context of the Merger Directive to its unwritten doctrine of prohibition of abuse of Union law which was developed in areas where no specific provisions on abuse can be found.1241 Unlike those areas, i.e. the fundamental freedoms and VAT, the Merger Directive does have a specific anti-avoidance provision. Article 15(1)(a), in fact, constitutes the most detailed provision on tax avoidance amongst all the tax directives of the Union. On this ground Englisch considers that it was plainly wrong of the Court to hold in Kofoed that only those national anti-abuse rules are accepta-

ble under Article 15(1)(a) which target abusive operations the ‘sole’ purpose of which is to attain a tax advantage. The wording of Article 15(1)(a) clearly entails a broader scope for the Member State to counter tax avoidance in the field of application of the Merger Directive, as they can target transactions which have some commercial reasons but the principal objective of which is avoiding tax. In general, he concludes that “reconciliatory interpretation of Art. 15 (1) (a) MD and the general anti-abuse doctrine developed by the Court can only play a subordinate role. It must not be ignored that Art. 15 (1) (a) MD constitutes an explicit and specific statutory norm that should therefore inspire the case law on the unwritten “principle” of prohibition of abuse, rather than vice versa.”

As we emphasized above, we agree with the argument that Article 15(1)(a) is lex specialis in relation to the case law-based general abuse doctrine provided that this is defended on the ground that the prohibition of abuse of rights does not constitute a formal general principle of EU law. However, apparently, the Court’s starting point was precisely the opposite. In that light, the intention of the Court to bring the anti-abuse provision of the Merger Directive in line with the general principle of abuse is explicable; in this case, however, the wording of the provision deviates so much from the content of the general principle that it is highly questionable that consistent interpretation is a viable solution. An interpretation which is completely detached from the wording of the law contradicts legal certainty. Thus, in this case the invalidation of the provision might have been the best solution. This even more so taking into account that the invalidation of the provision would not have affected the Member States’ ability to fight abuse in the field of application of the Directive, as they could have directly relied on the general principle of prohibition of abuse in the absence of a specific anti-abuse provision under the Directive. Eventually, the outcome would have been the same as the Court’s solution under Kofoed – i.e. the Member States could combat abusive practices according to the criteria developed by the Court under the aegis of the general principle of prohibition of abuse – but legal certainty and transparency of Union law would have been better served.

In our view, the invalidation or, alternatively, the amendment by the Union legislature of Article 15(1)(a) of the Merger Directive is the preferable solution, also from a policy point of view. The subjective abuse test that the provision incorporates according to its wording is hardly an appropriate standard to define abusive operations and is clearly inferior to the case law-based abuse doctrine which is based on the combination of an objective

1242. Englisch, supra note 1192, p. 46.
and subjective criterion. A test which is based solely on the purpose of the transaction gives far too broad and vague a definition to abuse and does not sufficiently limit the scope within which Member States can fight abuse by denying tax benefits granted by EU law. We share the view with Jiménez that restructurings where tax motives are present or, even predominant, but the operation is not artificial – it attains the purpose of the Merger Directive as it constitutes a genuine merger (i.e. combination of companies with assets and activities that achieves a better allocation of resources), exchange of shares or division involving companies of different Member States – should not be excluded from the scope of the Directive.1243 To obtain this result, the Merger Directive should contain an abuse test which applies the objective and subjective criteria cumulatively meaning that tax avoidance purpose is not sufficient alone without artificiality in order for abuse to be established.

It is noteworthy that the Commission announced in its Action Plan of December 2012 that it will review the anti-abuse provisions of the direct tax directives.1244 The purpose of the review is to implement in the directives the general anti-abuse rule that the Commission recommends to the Member States to adopt in their domestic laws so that they can fight aggressive tax planning more effectively. This is a very welcome initiative that provides an opportunity not only for bringing in line with each other the anti-abuse provisions of the directives but also for replacing Article 15(1)(a) of the Merger Directive which is not only obsolete and outdated, but also incompatible with the case law-based doctrine of prohibition of abuse. The general anti-abuse rule that the Commission recommends to the Member States is the following:

“An artificial arrangement or an artificial series of arrangements which has been put into place for the essential purpose of avoiding taxation and leads to a tax benefit shall be ignored. National authorities shall treat these arrangements for tax purposes by reference to their economic substance.” 1245

The rule seems to be based on the Court’s doctrine of prohibition of abuse and as such, it represents an important step towards streamlining and reconciling the various anti-abuse rules existing in the Union both at national and European levels.

(iv) Assessment

In summary, when discussing consistent interpretation in connection with the concept of abuse we need to take into account the different areas of EU tax law where such concept is used and its different manifestations namely, the general unwritten doctrine of prohibition of abuse developed by the Court in its case law and the specific anti-abuse provisions included in the direct tax directives. Whether there is any requirement deriving from the principle of hierarchy of norms to interpret consistently the various manifestations of the concept of abuse depends on the status of the general doctrine of prohibition of abuse. The Court considers that it has the status of a general principle of EU law which qualifies it as primary law of a constitutional nature with which lower ranking norms of Union law must comply. Such status presupposes that it has a sufficiently definite content which can be applied uniformly to all areas of EU law. The Court has strived for interpreting and applying the doctrine of prohibition of abuse in a uniform way. On the basis of the case law concerning the fundamental freedoms in non-harmonized domains of direct taxation and the VAT Directive, it can be considered that the general contours of a uniform doctrine of abuse has emerged. In terms of this doctrine, an objective condition related to the artificiality of the arrangement and a subjective condition related to the purpose of the arrangement need to be met in order for abuse to be established. An arrangement is artificial if it frustrates the purpose of the law in spite of the fact that it formally observes the conditions thereof. Therefore, artificiality is linked to lack of economic reality or normal commercial context. The purpose of an artificial arrangement must be to obtain a tax advantage or to avoid a tax burden. The case law is not consistent on the point whether it has to be the sole or essential purpose of the arrangement. There are certain divergences in the Court’s application of this doctrine of prohibition of abuse in the area of the fundamental freedoms, on the one hand, and VAT, on the other. As long as the prohibition of abuse is a general principle of EU law, these divergences should be avoided by way of a consistent interpretation. However, if the doctrine of prohibition of abuse is not considered a general principle of EU law but rather a principle of interpretation with a flexible content, the differences in its application to the fundamental freedoms and to VAT cannot be objected. A differentiating approach can even be considered desirable to adjust the criteria of abuse to the specific context in which abusive arrangements are assessed. In our view, this latter approach to the doctrine of abuse is more sensible. As far as the specific anti-abuse provisions of the direct tax directives are concerned, the question whether they need to be interpreted consistently with the case law-based doctrine of prohibition of abuse is again dependent on the status of the latter doctrine.
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Taking the Court’s position means that these specific anti-abuse provisions laid down in secondary law must be in line, as a matter of normative hierarchy, with the general principle of prohibition of abuse which has the ranking of primary law. Even under the assumption that the case law-based abuse doctrine is a principle of interpretation, the specific anti-abuse rules of the direct tax directives should be interpreted consistently with the abuse doctrine applied to the fundamental freedoms. The direct tax directives are aimed at giving effect to the freedoms. If their anti-abuse clauses are interpreted more broadly than abuse under the fundamental freedoms – that is, the Member States are allowed to deny the benefits of the directives to a wide range of transactions – the directives cannot achieve the aim they pursue. Thus, whichever view is taken on the status of the general abuse doctrine, the anti-abuse clauses of the direct tax directives must be interpreted consistently with such doctrine. The difficulty with this statement is that the anti-abuse provision of the Merger Directive, the wording of which includes completely different criteria for assessing abuse from those implied by the general abuse doctrine, hardly permits such consistent interpretation. In the light of this, the anti-abuse provision of the Merger Directive should have been declared invalid by the Court. In the absence of such invalidation, the provision needs to be amended by the Union legislature to which effect the Commission has already made a proposal.

8.3.4.5. Reverse consistent interpretation

Consistent interpretation normally means interpreting secondary law in conformity with primary law as required by the principle of hierarchy of norms. The examples we have seen in this Section so far represented such conventional use of the technique of consistent interpretation. However, we have also discussed in Chapter 7 that sometimes the Court reverses the application of this method insofar as it interprets primary law in a way which reconciles its meaning and implications with what the Union legislature has laid down in secondary law. This was the situation in Förster, where the Court interpreted Article 18 of the Treaty prohibiting nationality-based discrimination in a way which reconciled it with Directive 2004/38 laying down restrictions on the rights of students to receive maintenance assistance in the Member State where they study. Primary law in that case had to be reconciled with secondary law, as the Court had previously interpreted the Treaty’s non-discrimination article to the effect of granting more rights to migrant students as regards maintenance assistance than those afforded by the provisions of the subsequently adopted secondary legislation. Thus, the later adopted secondary law was given effect in the face of the Court’s
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prior case law on primary law (see Section 7.3.4.2. (ii)). Such use of reverse consistent interpretation can be opposed on the basis of the principle of hierarchy of norms given that it effectively reverses the hierarchy between primary and secondary law. Nevertheless, examples of this interpretation technique can be found in the field of taxation as well, the most prominent of which are the first FII Group Litigation\textsuperscript{1246} case and Haribo and Salinen.\textsuperscript{1247}

In these cases, the issue was whether Member States can apply different methods of economic double taxation relief to domestic-source dividends and to foreign-source dividends. In particular, the domestic legislations at issue exempted domestic-source dividends and provided for an indirect credit for underlying corporate income tax for foreign-source dividends either initially or due to a switch-over from exemption to credit. The Court held that such a system does not contravene the fundamental freedoms provided that the tax rate applied to foreign-source dividends is not higher than the rate applied to domestic-source dividends and that the tax credit is not less than the tax paid by the distributing company in its Member State of residence within the limits allowed by the ordinary tax credit method.\textsuperscript{1248}

According to Wattel, the Court with this ruling endorsed a directly discriminatory treatment based on origin.\textsuperscript{1249} In his view, the Court probably meant to explain such deviation from established principles of the case law by referring to the Parent-Subsidiary Directive. Indeed, the Court in its reasoning pointed out that “Article 4(1) of Directive 90/435 expressly leaves it open to Member States to choose between an exemption system and an imputation system”.\textsuperscript{1250} While it is true that this provision offers a choice for the Member States between the exemption and the credit method for relieving economic double taxation of dividends, it does not, however, entitle them to choose different methods depending on the source of the dividends. This seems to follow from Bosal, which held with regard to another optional provision of the Directive that it can only be exercised in accordance with the freedoms.\textsuperscript{1251} Differently, in the first FII Group Litigation case and in Haribo and Salinen, the Court applied consistent interpretation in the reverse. It construed the freedom of establishment and the free movement of capital with a view to the Parent-Subsidiary Directive concluding that they do not preclude a differentiating tax treatment of domestic-source dividends.

\textsuperscript{1246} Case C-446/04 Test Claimants in the FII Group Litigation.
\textsuperscript{1247} CJ, 10 February 2011, Joined Cases C-436/08 and C-437/08 Haribo Lakritzen Hans Riegel Betriebs GmbH and Österreichische Salinen AG v Finanzamt Linz.
\textsuperscript{1248} Case C-446/04 FII Group Litigation, para. 57; Joined Cases C-436/08 and C-437/08 Haribo and Salinen, para. 86-90.
\textsuperscript{1249} Terra and Wattel, supra note 942, p. 904.
\textsuperscript{1250} Case C-446/04 FII Group Litigation, para. 44.
\textsuperscript{1251} Terra and Wattel, supra note 942, p. 905.
and foreign-source dividends. Wattel calls this form of reverse consistent interpretation ‘Follow-Secondary-EU-Law Approach’ and he points out that such approach can also be detected in the case law with regard to the OECD Model Convention and its Commentary.\textsuperscript{1252}

For the sake of completeness, it needs to be noted that in the meantime, the Court has considerably refined its approach to the equivalence of the credit method and the exemption method. In particular, in the second \textit{FII Group Litigation} case it clarified its first ruling specifically the question how to interpret the condition that the tax rate applied to foreign-source dividends cannot be higher than the rate applied to domestic-source dividends in order for the two methods to be equivalent.\textsuperscript{1253} Eventually, the Court held that the application of the exemption method to domestic-source dividends and the credit method to foreign-source dividends is in breach of the fundamental freedoms if it is established, first, that the tax credit on foreign-source dividends equals to the amount of tax actually paid in the other Member State on the profits underlying the distribution and, second, that the effective level of taxation of company profits in the Member State of the recipient of the dividends is generally lower than the prescribed nominal rate of tax.\textsuperscript{1254} This practically means that in most cases, the asymmetrical application of the exemption method and the credit method to domestic and inbound dividends will constitute a prohibited restriction on the freedoms unless a kind of ‘tax sparing’ credit is granted on foreign-source dividends based on the nominal rate of tax in the Member States of source instead of the tax actually paid.

Finally, it is interesting to point out that a kind of reverse consistent interpretation has been suggested in the academia to solve the problem of juridical double taxation under the freedoms. As discussed in Section 8.2.2.3. (ii) above, the Court’s position is that obstacles to free movement caused by the exercise in parallel of taxing jurisdiction by two Member States are not prohibited by the fundamental freedoms. The main reason for this is that the Court refrains from deciding which Member State should have a prior right to tax in the case of overlapping tax claims. In academic circles, it has been suggested that the Court should take guidance from the direct tax directives – for example, in the case of double taxation of dividends from the Parent – Subsidiary Directive – as regards allocation of taxing rights.

\textsuperscript{1252} Ibid.
\textsuperscript{1253} CJ, 13 November 2012, Case C-35/11 \textit{Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue, The Commissioners for Her Majesty’s Revenue & Customs}.
\textsuperscript{1254} Ibid. para. 65.
between the Member States in order to resolve juridical double taxation. This would mean interpreting the fundamental freedoms along the lines of secondary law. In this case, no objection could be raised against the “Follow-Secondary-EU-Law Approach”, as it would not lead to compromising the effect of primary EU law, i.e. the freedoms, but it would rather enhance their effectiveness by enabling them to tackle an impediment to the internal market which has not been resolved by other means. In fact, the Court did “find inspiration” from the Parent – Subsidiary Directive when it had to decide under the fundamental freedoms on the allocation of taxing rights between the Member State in the case of economic double taxation of dividends falling outside the scope of the Directive. In holding in the context of imputation systems that the Member State where the subsidiary distributing the dividends is resident cannot be obliged to give up its taxing jurisdiction the Court mentioned that:

“[...] in the case of shareholdings to which Directive 90/435 applies, Article 4(1) of that directive requires the Member State of the parent company which receives profits distributed by a subsidiary which is resident in another Member State, and not the latter State, to avoid a series of charges to tax [...]”

8.3.5. Review of legality of secondary law on taxation in the light of the fundamental freedoms

8.3.5.1. Recollections from Chapter 7

As concluded in the previous Chapter, the consequence of the fact that the Treaty rules on free movement are addressed not only to the Member States but also to the Union legislature is that the legality of Union measures, including secondary legislation, can be reviewed for its compliance with the rules on free movement. As regards the standard of review applied to Union measures under the fundamental freedoms, we have seen that the Court, in principle, applies the same broad restriction standard to Union acts as to Member State acts. As a result, not only those Union acts are prohibited which discriminate against intra-Union movements and transactions as compared to purely domestic situations but also those which create non-discriminatory obstacles to free movement (see Section 7.4.4.2.(ii)). The latter statement, however, needs to be seen in the light of the fact that

1255. Vanistendael, supra note 1028, Ch. 4.6.
1256. See reference by Wattel, Terra and Wattel, supra note 942, p. 905.
1257. Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation, para. 60.
the Court found each and every one of the non-discriminatory Union measures which were held to prima facie restrict the freedoms eventually justified. These conclusions are drawn from the general case law concerning non-tax matters. As far as the field of taxation is concerned, the situation is different as we demonstrated previously in this Chapter (see Section 8.2.2.4.). The fundamental freedoms prohibit only discriminatory national tax measures, although with regard to indirect taxes there is still a thin ground to argue that non-discriminatory national taxes may be caught by the prohibitions of the freedoms. In any event, setting out from the proposition that in the field of taxation the freedoms entail only a discrimination standard with regard to national measures, the same must be true in respect of Union measures. Thus, when the legality of secondary Union law governing the field of taxation is measured against the fundamental freedoms the only question that needs to be asked is whether the act of secondary law discriminates against cross-border situations as compared to purely domestic situations. The tax directives, most of which are aimed at reinforcing the fundamental freedoms in their respective fields of application, are generally not expected to cause such discrimination. Even if they do, it seems unlikely that the Court would find such a directive or, rather certain provisions of such a directive, to actually infringe the freedoms given that the proportionality of Union acts is measured by way of a substantially relaxed test which acknowledges a broad margin of discretion to the Union legislature in restricting free movement in pursuance of public interest objectives (see Section 7.4.4.2 (iv)).

In Chapter 7, we also showed that Union measures can produce obstacles to the internal market which do not occur in the case of national measures. In particular, first, an impediment to free movement may be caused by the incompleteness or imperfectness of harmonization in an area subject to such harmonization; second, the application of coordination rules may result in a particular disadvantage to cross-border movements. As regards the former, the Court considers that the decision whether to pursue harmonization gradually or in stages is at the discretion of the Union legislature and obstacles deriving from such decision do not constitute an infringement of the freedoms. As regards the latter, if a genuine coordination rule results in the application of the legislation of the Member State which is more burdensome for the ‘free mover’ the ensuing disadvantage flows from the disparities between the different legal systems of the Member States and not from a restriction on the freedoms imposed by the coordinating Union rule itself (see Section 7.4.4.2. (i)). As regards secondary law in the field of taxation, the conclusions regarding incomplete harmonization are of great relevance with respect to the direct tax directives which result only in fragmentary or ‘patchwork’ harmonization in their respective fields. The VAT Directive
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represents very comprehensive harmonization which, however, is still not exhaustive; therefore, in principle, the incompleteness of harmonization in this area can still lead to some obstacles to free movement. The same is true with regard to the Horizontal Directive on excise duty which introduces less comprehensive harmonization than the VAT Directive but certainly more than the direct tax directives. Similarly to classic coordination rules such as those included in Regulation No. 1408/71 concerning the application of social security laws to migrant workers, the tax directives can also cause, in principle, obstacles flowing from their function as coordination rules which are aimed at allocating taxing rights between the Member States.

The application of a discrimination standard under the fundamental freedoms in the tax field, a lenient proportionality test applied to Union measures restrictive on the freedoms and the fact that obstacles to free movement resulting from incomplete or imperfect harmonization do not formally constitute restrictions on the freedoms all point to the direction that the chance that a tax directive would be found to infringe the freedoms is very low. The probability of finding such infringement is further reduced by the fact that the optional provisions which the tax directives contain seem to leave sufficient room for discretion to the Member States. In case of the exercise of such options by the Member States, any potential ensuing infringement would not be attributed to the Union directive but to the national implementing law. To recall, the lesson from Socridis is:

“[...] directives do not infringe the Treaty if they leave the Member States a sufficiently wide margin of appreciation to enable them to transpose them into national law in a manner consistent with the requirements of the Treaty [...]”

In the forthcoming Sections, the above aspects and relations will be examined in the specific context of secondary law on taxation.

8.3.5.2. Incomplete harmonization

As far as the direct tax directives are concerned, the Court has dealt with the question of their compatibility with the fundamental freedoms only once, in a preliminary ruling procedure upon a question referred by a national court. In particular, in the Gaz de France case the validity of the Parent – Subsidiary Directive was questioned on the ground that its restrictive definition of the companies falling within its personal scope excluded from the benefits of the Directive distributions made to a French parent company of

1258. Case C-166/98 Socridis, para. 19.
a certain legal form.\textsuperscript{1259} The parent company took the form of a ‘société par actions simplifiée’ (SAS) which did not qualify as ‘a company of a Member State’ within the meaning of Article 2(a) of the Directive, as it was not included, before the 2003 amendment of the Directive, in the list of eligible French companies set out in the annex to the Directive. The SAS was not on the list, as it was introduced in French law after the adoption of the Parent – Subsidiary Directive. The SAS received dividend distributions from its German subsidiary which was denied of the withholding tax exemption laid down in the Directive on the basis that according to German law – which correctly implemented the Directive – the SAS was not a company of a Member State. The first question that the national court asked related to the interpretation of the Directive’s term ‘company of a Member State’ and specifically, whether a SAS could be regarded as such at the time when it was not explicitly included in the list of eligible entities. By its second question the national court asked whether or not the Parent-Subsidiary Directive infringed the Treaty’s free movement provisions due to the fact that it did not preclude a dividend distribution by a German subsidiary to a French parent company in the form of a SAS from being taxed by way of withholding tax whereas it precluded such taxation in the case of distributions to other French parent companies taking one of the forms listed in the annex to the Directive.

As regards the first question, when interpreting the term ‘company of a Member State’ the Court took account of the wording of the provisions at issue as well as the objectives and the scheme of the Parent-Subsidiary Directive. Having regard to the wording of the relevant provisions, especially that of point f) of the annex, and the scheme of the Directive the Court stated that in the case of France, the eligible forms of companies were defined in an exhaustive manner. Although the extension of eligible companies beyond those expressly listed in the annex would have corresponded to the objective of the Directive, the Court recognized that the Directive did not seek to introduce a common system of dividend taxation for all companies of the Member States and for all corporate holdings of any size. With this, the Court probably meant to stress that the Directive, by defining its subjective and objective scope, clearly delineates the situations which fall within its ambit and those which do not. In this regard, it pointed out that situations where the shareholding of the parent company in the subsidiary does not reach the minimum holding required by the Directive also fall outside the scope of the common system envisaged by the Directive. Outside the scope of the Directive, it is in the power of the Member States to decide

\textsuperscript{1259}. Case C-247/08 \textit{Gaz de France}. 
whether and to what extent they alleviate economic double taxation of dividends, as long as they do not discriminate cross-border dividend payments compared to domestic dividend payments. Thus, the Court emphasized that the Member States’ power to tax is restricted by the Directive only within a limited sphere. The boundaries of that sphere cannot be stretched by way of extensive interpretation of Article 2(a) and point f) of the annex. According to the Court, such extensive interpretation is precluded by the fundamental principle of legal certainty.1260

The relevant question from our point of view is the second one which is rather ironic in view of the fact that, most probably, it was the wrong question for the national court to ask.1261 Instead of inquiring about the validity of the Parent-Subsidiary Directive, it would have been more useful – at least for the taxpayer – to ask about the compatibility of the national law at issue with the fundamental freedoms. Although under the German imputation system which was in force at the time of the case dividend distributions to a German parent company were formally also subject to a withholding tax, therefore, there was no apparent discrimination between the tax treatment of domestic distributions and distributions to a French SAS, in substance, such legislation entailed a less favourable treatment of the latter.1262 As we have discussed above, situations which fall outside the scope of harmonizing secondary law remain to be subject to the fundamental freedoms. This was reiterated by the Court in the context of the second question too:

“The Court has already held that, in respect of shareholdings which are not covered by Directive 90/435, it is for the Member States to determine whether, and to what extent, economic double taxation of distributed profits is to be avoided and, for that purpose, to establish, either unilaterally or by conventions concluded with other Member States, procedures intended to prevent or mitigate such economic double taxation. However, that does not of itself allow them to impose measures that are contrary to the freedoms of movement guaranteed by the Treaty [...].”1263

Therefore, the German law which prescribed a withholding tax on dividend distributions to a company resident in another Member State falling outside the scope the Parent-Subsidiary Directive could have been reviewed in the light of the freedoms. The Court, in the absence of a question to that effect,

1260. For a criticism of this restrictive interpretation and the interpretation methods used by the Court, see Dourado, supra note 641, p. 180 and Boulogne and Geursen, supra note 1121, pp. 131-134.
1262. Ibid. 331.
1263. Case C-247/08 Gaz de France, para. 60.
did not examine this issue. It discussed only the question whether Article 2(a) of the Directive in conjunction with the annex, which defined the scope of the Directive in a way that it excluded – from the outset – companies which might be created in accordance with national law subsequent to the entry into force of the Directive, was invalid on account of infringing the freedoms. In this respect, the CJ first reiterated the principle, which we know from the non-tax case law as well as from Socridis, that Union institutions are free to introduce harmonization gradually:

“The Court has consistently held that the Community institutions are free to introduce harmonisation gradually or in stages. It is generally difficult to implement such measures because they require the competent Community institutions to draw up, on the basis of diverse and complex national provisions, common rules in harmony with the aims laid down by the EC Treaty and approved by a qualified majority of the Members of the Council, or even, as is the case in fiscal matters, their unanimous agreement [...]”

Then it spelled out that as long as the Directive does not authorize a Member State to discriminate against cross-border dividend distributions which fall outside its scope as compared to domestic distributions it does not infringe the fundamental freedoms. Thus, the Union legislature is free to leave certain segments of the field subject to harmonization outside the actual scope of harmonization measures. However limited the scope of a directive is, it does not, in itself, make the directive incompatible with the fundamental freedoms. As a dividend distribution by a German subsidiary to a French SAS falls outside the scope of the Parent-Subsidiary Directive, the only effect the Directive has on such distribution is that it does not prevent it from being subjected to a withholding tax. If it is subjected to withholding tax by the Member State and it is done so in a discriminatory manner the ensuing infringement of the freedoms is imputable to the Member State and not to the Directive. This would only be otherwise if the Directive expressly authorized the Member State to discriminate dividend payments falling outside its scope by a clear-cut provision which leaves no discretion to the Member State. This is consistent with the conclusion that we have drawn in Section 8.3.2.2. Hence, although the Court’s narrow, literal interpretation of the Directive under the first question can rightly be criticized, its conclusion that the Directive does not infringe the fundamental freedoms due to its restricted scope is in accordance with established principles of the case law. Still, as voiced by academic commentators, the Court could have scrutinized from another angle the exclusion by the Directive from its application.

1265. Case C-247/08 Gaz de France, para. 52.
1266. Ibid. para. 59.
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scope a company form which is fully equivalent to capital companies of the type included in the annex of the Directive. 1267 Indeed, the differentiation between the SAS and the other company forms which existed under French law and were included in the annex of the Directive (e.g. SA) may not be relevant for the purposes of the fundamental freedoms, as it is not based on the place where the company is established but it may well be relevant from the point of view of the principle of equality, a general principle of EU law with which secondary legislation must comply. While a differential treatment between a distribution to a SAS and a distribution to a German parent company is attributable to German domestic law and does not as such affect the validity of the Directive, the differential treatment between distributions to a SAS and to an SA – both being French companies with essentially similar characteristics – is attributable to the Directive and thus it may be questioned in the light of the equality principle.

Gaz de France is the only case where the Court has dealt with the validity of one of the direct tax directives from the point of view of their compatibility with the fundamental freedoms despite the fact that the directives offer ample opportunities for potential challenge. An obvious candidate is the permanent establishment requirement of the Merger Directive. We have discussed above (see Section 8.3.3.2.) that this problem could be solved by applying the tenet that outside the scope of secondary law the fundamental freedoms apply and prohibit domestic legislation which would restrict the freedoms by levying an immediate exit tax, without at least offering the choice to defer the tax, on reorganizations that do not meet the permanent establishment requirement. However, the question can be raised whether the legality of the Merger Directive could be challenged on the ground that by virtue of the permanent establishment requirement it disproportionately restricts the freedom of establishment. Taking into account the Court’s conclusions in Gaz de France with regard to the Parent – Subsidiary Directive and the Court’s general endeavour to maintain the validity of Union legislation, it is highly unlikely that the Court would consider the provisions of the Merger Directive laying down the permanent establishment requirement invalid. As the Union legislature is entitled to decide on the pace and extent of harmonization, the fact that the tax neutrality regime laid down in the Merger Directive is greatly limited by the latter requirement would not be considered in itself as an infringement of the freedom of establishment. The Court would probably point to the fact that outside the limited scope of the Directive the freedoms are fully effective and they preclude immediate exit taxation on corporate reorganizations irrespective of the fact whether

a permanent establishment is left behind or not. In addition, the Merger Directive neither requires nor authorizes the Member State to restrict the freedoms outside its scope. It is silent on the issue how reorganizations which do not fulfil the substantive prerequisite of leaving a permanent establishment in the exit State should be treated. Such reasoning would be a typical instance of consistent interpretation by which the Directive could be reconciled with the prerogatives of the primary law freedoms while its validity being preserved in accordance with the premise that a “Union act must be interpreted, as far as possible, in such a way as not to affect its validity.”

Having regard to the various derogations and transitional arrangements granted for certain Member States in the context of some of the direct tax directives it is worth recalling some further conclusions that we arrived at in Chapter 7 regarding coordination rules. In particular, coordination rules which introduce special tailored-made arrangements for certain Member States and thereby derogate from the general rule designating the applicable legislation in a certain situation may be capable of infringing the fundamental freedoms. This is because such rules increase the disparities flowing from the differing laws of the Member States and differentiate between persons and situations in different Member States. As held by the Court in Pinna:

“[the] objective [of securing free movement for workers] will [...] be imperilled and made more difficult to realize if unnecessary differences in the social security rules are introduced by Community law. It follows that the Community rules on social security introduced pursuant to [Article 48 TFEU] must refrain from adding to the disparities which already stem from the absence of harmonization of national legislation”1268

Applying this accordingly to the direct tax directives or even to the VAT Directive, which are also in the nature of coordination rules insofar as they designate which Member State can exercise its taxing right and which must give up such right, some of the derogations and transitional rules applied within their context could be questioned. The prime example is the special arrangement for Austria and Luxembourg in the context of the Savings Directive which allows them to withhold tax on interest income paid to individual beneficiaries instead of exchanging information with the other Member States. These special arrangements clearly and significantly distort competition in the internal market and as such, should not be regarded as being much different from coordination rules which enhance disparities. According to Pinna, the latter rules could not be employed in the context of a measure which was based on a Treaty provision allowing the adoption of

1268. Case 41/84 Pinna, para. 21.
Union acts for the sake of promoting the free movement of workers. With similar reasoning, a measure based on Article 115 TFEU which allows the adoption of harmonization measures aimed at facilitating the functioning of internal market should not contain rules which significantly distort competition in the internal market. Similarly, the set of transitional rules under the Interest and Royalties Directive which allowed numerous Member States to apply withholding taxes at various rates and for differing periods of time on interest or royalty payments or both could also be mentioned in this context. Admittedly, these rules are or have been applicable for a limited period of time which differentiates them from the rule condemned in Pinna which introduced a permanent exception for France from the general rule designating the law under which family benefits had to be granted to migrant workers. In addition, as we pointed out in Chapter 7, in Pinna the Court found that the deviating rule discriminated migrant workers compared to French workers which undoubtedly weighted greatly in the condemnation of the rule. Therefore, as long as the transitional arrangements under the direct tax directives do not entail discrimination they do not seem to be at risk of being found invalid even if they result in disparities or distortions of competition. It is likely that the Court would employ its ‘harmonization-in-stages’ reasoning if it were to assess the validity of these arrangements, as transitional rules are the most typical symptoms of a harmonization process which progresses gradually and in stages. The Court may be reluctant to substantively review the legality of these arrangements also for reasons of judicial policy, as they represent the necessary and unavoidable compromise between the Member States reached in the legislative process without which no harmonization could be achieved in the field of EU tax law.

In addition to the transitional arrangements, there is another aspect of the Interest and Royalties Directive which could raise question as regards its compatibility with the fundamental freedoms or, at least, its ability to achieve its objective of facilitating the exercise of the freedoms by eliminating double taxation on interest and royalty payments between associated companies and removing the administrative burdens which may be entailed by other relief mechanisms under domestic law or tax treaties. Namely, the numerous formalities which the Directive allows for the Member States to prescribe as a condition for granting the exemption from tax at source pose serious questions as regards the effet utile of the Directive. The source

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1269. Most of these transitional derogations have expired by now, see Article 6 of the Savings Directive and Council Directive 2004/76/EC of 29 April 2004 amending Directive 2003/49/EC as regards the possibility for certain Member States to apply transitional periods for the application of a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.
State can require not only an attestation proving that all requirements for the exemption are met with regard to each single contract under which interest and royalty payments are effected, it can also make the exemption conditional on an administrative decision that must be separately adopted to such effect. The attestation must contain a whole series of information substantiating the fulfilment of the requirements. If the attestation is not provided at the time of payment, the source State may require withholding at source by the payer and in such case the recipient of the payment has to claim repayment of the tax withheld by providing the attestation mentioned above. The source State can prolong the repayment up to one year. The fact that the Directive allows the maintenance of such highly burdensome formalities is especially conspicuous in the light of its express objective to reduce administrative burdens and cash flow problems for companies connected with obtaining double taxation relief on intercompany interest and royalty payments. However, were the Directive to be challenged on the ground that these excessive administrative requirements instead of facilitating rather hinder the exercise of the freedoms, the answer of the Court would, in all likelihood, be that the Union legislature is entitled to introduce harmonization in stages and the fact that the exemption is conditional on procedural and administrative formalities is a consequence of such gradual harmonization.

The ‘harmonization-in-stages’ reasoning is sometimes used by the Court to shield clearly and blatantly discriminatory provisions laid down in secondary law and/or national law based on the mere fact that such provisions are transitional in nature. Such was the case in Idéal Tourisme, which concerned a transitional VAT exemption under the Sixth Directive. The Sixth Directive authorized Member States to continue to apply during a transitional period certain exemptions which were provided for in their legislation before the entry into force of the Directive. Pursuant to this, Belgium maintained a VAT exemption (with the right to deduction) of international air passenger transport under its laws whilst it subjected to VAT international passenger transport by coach. Having regard to the fact that coach transport and air transport undertakings were in direct competition with each other on intermediate distances, the exemption was clearly in breach of the principle of equality. The exemption would also have constituted State aid for air transport operators if it had originated from national law. The Court, instead of examining the question whether the aid was attributable to the Member State or the Union, dismissed the claim regarding State aid with almost no

1272. ECJ, 13 July 2000, Case C-36/99 Idéal Tourisme SA v Belgian State.
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As regards the principle of equal treatment, the Court first seems to have reasoned on the line that a potential breach of such principle is attributable to the Sixth Directive. It mentioned that the Directive clearly and unambiguously authorized the Member States to continue certain exemptions and that the Directive would not allow the Member State to extend the exemption to coach operators; thus, if the Member State wanted to remedy the unequal treatment, it could only do so by taxing air transport as well. These statements point to the direction that the Sixth Directive has not left any margin of discretion to the Member State in implementing the authorization. However, instead of declaring that the Sixth Directive infringed the principle of equal treatment the Court ruled that:

“[...] the Community system of VAT is the result of a gradual harmonisation of national laws in the context of Articles 99 and 100 of the EC Treaty [now Articles 113 and 115 TFEU]. As the Court has repeatedly stated, this harmonisation, as brought about by successive directives and in particular by the Sixth Directive, is still only partial [...]”

Emphasizing the gradual and partial nature of harmonization seems to refer to the fact that the exemption was, in the end, laid down in national law before the adoption of the Directive and the Directive merely authorized its maintenance. However, national law cannot also be held responsible for the unequal treatment, as it merely made use of the authorization, which does not amount to actual transposition. With this full circle, the Court arrived at the conclusion that the infringement can be attributed neither to the Directive nor to national law. Eventually, it left the problem to be fixed by the Union legislature:

“With respect to such a situation, it is for the Community legislature to establish the definitive Community system of exemptions from VAT and thereby to bring about the progressive harmonisation of national VAT laws [...]”

It is submitted that the ‘harmonization-in-stages’ argument should not be used to exempt both the Member State and the Union from observing

1273. The Court’s statement that the proceedings related to the question whether the transactions carried out by the applicant, a coach operator, were subject to VAT or not seems to hint at the fact that a VAT exemption cannot be requested if the claim is based on the State aid rules, as that would mean the extension of the aid instead of its recovery from the beneficiary, see Case C-36/99 Idéal Tourisme, para. 28.
the basic requirements of primary Union law and allowing discriminatory exemptions, even if they are of a transitional nature, to remain in place in a harmonized Union system.

8.3.5.3. More lenient proportionality standard for secondary law

To demonstrate the use of a more lenient proportionality standard in the review of secondary law concerning taxation than in the review of national tax law we need to return to the Schmelz case. In this case, the Court reviewed the small undertakings scheme under the VAT Directive in the light of the freedom to provide services. It found that the scheme which grants a VAT exemption only to small undertakings established in the territory of the Member State where the VAT is due restricted such freedom prima facie. Then the Court examined, through a detailed analysis, whether the restriction could be justified on the ground of the need to guarantee the effectiveness of fiscal supervision. First, it pointed out that restricting the exemption to small undertakings established in the territory of the Member State granting the exemption was appropriate to ensure the effectiveness of fiscal supervision, as it enabled the verification whether the conditions for the exemption were met. This is so because undertakings generally keep the documents relating to their economic activities in the place of establishment. Furthermore, the secondary law instruments on administrative assistance cannot ensure useful exchange of data in this respect. As the small undertakings scheme aims at reducing the administrative charges on such undertakings, the latter are exempted from administrative tax formalities by the scheme. They do not even have to obtain a tax identification number in the Member State of establishment. Therefore, the latter Member State does not have data on their turnover or any other information that they could exchange with the authorities of the other Member State where the exemption is claimed. The lack of data and information could only be remedied by the introduction of formalities for small undertakings which would be contrary to the aim of a scheme that is specifically designed to spare small undertakings and the tax authorities from such formalities. The Court added that:

“[...] limiting the benefit of the VAT exemption solely to those taxable persons established in the Member State which has adopted such an exemption avoids a situation in which taxable persons pursuing activities in a number of Member States, without being established in them, can escape – altogether or to a large
degree – taxation of their activities, under the cover of exemptions in force in those Member States, even though those activities, taken as a whole, would objectively exceed a small undertaking’s level of activity. [...]”

Thus, the Court’s concern is that small undertakings could accumulate the benefit of the exemption scheme in several Member States even where their aggregate Union-wide turnover exceeds the limit that would qualify them as small. Given that exchange of information between the Member States cannot ensure that non-established small undertakings only benefit from the exemption scheme if they meet the conditions – in particular, the turnover threshold – thereof, their exclusion from the scheme was held to be a proportionate measure. As the Court put it:

“[...] at this stage in the evolution of the VAT system, the objective which consists in guaranteeing the effectiveness of fiscal supervision in order to combat fraud, tax evasion and possible abuse and the objective of the scheme for small undertakings, which is to support the competitiveness of such undertakings, justify, first, limiting the applicability of the VAT exemption to the activities of small undertakings established in the territory of the Member State in which the VAT is due and, second, the annual turnover generated to be taken into account being that generated in the Member State in which the undertaking is established.”

As it appears, the Court accepted the territorial limitation of the small undertakings scheme on the basis of arguments relating to administrative difficulties which would accompany the application of the scheme if it was extended to non-established undertakings. Traditionally, when the Court reviewed national measures in the light of the fundamental freedoms it did not accept the attempt to reduce administrative or practical difficulties as a justification for a restriction on the freedoms. However, we submit that in Schmelz, the Court relied on a justification which goes beyond merely reducing administrative difficulties; namely, ensuring effective fiscal supervision in order to combat fraud, tax evasion and abuse. The Court painstakingly reasoned to show that exchange of information in this case does not enable the Member State which grants the exemption to check whether the taxpayer indeed satisfies the condition for the exemption so that it can prevent the small undertakings scheme from being abused. In this regard, we see a

1276. Case C-97/09 Schmelz, para. 70.
1277. Ibid. para. 71.
1278. Englisch, supra note 1274, p. 480 referring to ECJ, 4 March 2004, Case C-334/02 Commission v France, para. 29; ECJ, 14 September 2006, Case C-386/04 Centro de Musicologia Walter Stauffer v Finanzamt München für Körperschaften, para. 48; CJ, 1 July 2010, Case C-233/09 Gerhard Dijkman, Maria Dijkman-Lavaleije v Belgische Staat, para. 60.
recent trend in the case law that the Court is more sensitive in its proportionality analysis to arguments which contend that an alternative means which is supposed to be less restrictive than the measure under review is actually less effective or causes at least as much or, even more, burden on the exercise of the freedom than the measure under review. This trend can be detected in the case law regarding national measures; for example, in National Grid Indus where the Court accepted the argument that in certain situations, the cross-border tracing of assets and the reporting obligations for the taxpayer which accompanies the tax deferral granted upon the transfer of seat of the taxpayer can be more burdensome than the immediate payment of an exit tax.\textsuperscript{1279} In \textit{X NV}, the question was whether the obligation on a service recipient to withhold tax on remuneration paid to a non-resident service provider and the attached liability risk is a proportionate restriction on the freedom of provision of services justified by the need for effective collection of taxes.\textsuperscript{1280} The Court held that reliance on the Mutual Assistance Directive for the recovery of tax claims in order to collect the tax directly from the non-resident service provider would not necessarily be less restrictive from the point of view of the service recipient than the obligation to withhold tax. The former method would also entail administrative obligations for the service recipient insofar as the Member State would be likely to require the service recipient to report the fact that it received services from a non-resident provider. In addition, the recourse to administrative assistance would also be more burdensome than the withholding of the tax for the non-resident service provider who would have to file a tax return in a foreign country as well as for the tax administration of the Member State where the service is provided. In the end, the Court held that the collection of the tax directly from the non-resident service provider and the recourse to mutual assistance for the recovery of the tax would not necessarily constitute a less severe means than the withholding at source and therefore the latter was a proportionate restriction on the freedom of services.\textsuperscript{1281}

In \textit{Schmelz}, the reasoning was in a way similar to that in \textit{X NV} or \textit{National Grid Indus} in that the Court assessed in detail the feasibility and effectiveness of exchange of information which represented an alternative to limiting the exemption scheme to small undertakings established in the territory of the Member State where the VAT is due. Thus, the fact that in \textit{Schmelz}, the Court balanced the effects of alternative means through a detailed analysis does not, in itself, represent a difference in approach as compared to the examination of the proportionality of Member State measures. Yet, there

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\item \textsuperscript{1279} Case C-371/10 \textit{National Grid Indus}, paras. 69-71.
\item \textsuperscript{1280} CJ, 18 October 2012, Case C-498/10 \textit{X NV v Staatssecretaris van Financiën}.
\item \textsuperscript{1281} Ibid. paras. 43-52.
\end{itemize}
is one relevant difference between Schmelz and the other cases concerning national measures. Namely, in the case of national measures when the Court balanced the alternative means against each other it did so also – or rather mainly – from the point of view of the taxpayer. (The Court asked: is it better for the taxpayer to pay immediate exit tax upon the transfer of its seat or to obtain a tax deferral with a corresponding tracing and reporting obligation? Is it better for the taxpayer to withhold tax at source or to report to the tax administration the fact that it received services from a non-resident service provider?). Although the administrative burden on the tax authorities was also considered in these cases, the main concern for the Court was certainly the taxpayer. In contrast, in Schmelz, the Court entirely ignored the point of view of the taxpayer in holding that the territorial limitation of the small undertakings scheme was a proportionate restriction on the freedom to provide services. Admittedly, it can be argued that in the eyes of the Court, exchange of information was not an alternative at all because it did not help exclude the possibility of abusing the small undertakings scheme and this is why the Court did not engage in a real balancing of alternative means taking into account both the taxpayer’s and the Member State’s perspective. In our view, however, the fact that the Court neglected the taxpayer’s point of view in the analysis is a sign that the Court measures the proportionality of a restrictive provision of a tax directive with a different standard from that applied to a restrictive national tax provision. This is all the more clear if we consider that in the case at hand, Mrs Schmelz had no economic activity at all in her Member State of residence or in a Member State other than Austria; therefore, the risk that she would take advantage of more exemption schemes in several Member States was non-existent. This was precisely the reason why the Advocate General considered the measure disproportionate to the aim pursued:

“It would go beyond what is necessary for reasons of fiscal supervision to exclude the exemption also in a case where the concession should clearly apply, according to its spirit and purpose, and the taxable person is not given an opportunity to show that he generates taxable turnover only in the Member State in question.”

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Although the standard of proportionality applied to Member State measures, on the one hand, and Union measures, on the other, may still differ, it is obvious that the Court has abandoned the ‘manifestly inappropriate’ test that it had previously used for analysing the proportionality of Union acts

(see Section 7.4.4.2. (iv)). Now it strives for conducting a detailed analysis of the elements of proportionality, especially that of necessity, approximating, at least, the method of analysis to that of Member State measures.

Another example which shows that the Court applies different proportionality standards to national tax measures, on the one hand, and to the Union tax directives, on the other, is the different assessment of admissibility of anti-abuse measures containing a general presumption of abuse. In the Leur-Bloem case, the Court stated with regard to a national anti-abuse rule adopted in implementation of the anti-abuse clause of the Merger Directive that the laying down of a general rule automatically excluding certain categories of operations from the tax advantage offered by the Directive is disproportionate to the aim of combating abuse. It was also held that in order to determine whether an operation has tax avoidance as its objective, the national authorities cannot confine themselves to applying predetermined general criteria but must subject each particular case to a general examination. In the specific context of the case, the Court expressly stated that a merger by exchange of shares with the aim of creating a specific structure for a limited period of time and not on a permanent basis may have valid commercial reasons. This is consistent with what the Court held later with regard to national anti-abuse rules concerning non-harmonized direct taxes when reviewing the compatibility of the latter with the fundamental freedoms. The Court considers such rules proportionate only when they specifically target wholly artificial arrangements. On the other hand, the Court has endorsed Article 3(2) of the Parent – Subsidiary Directive, which has an equivalent in the Interest and Royalties Directive (Article 1(10)), allowing the Member States to set a minimum holding period of up to two years as a condition for granting the benefits of the Directive. The Court described this provision as being aimed at countering abuse whereby holdings are taken in the capital of companies for the sole purpose of benefiting from the tax advantage of the Directive and which are not intended to be

1283. Case C-28/95 Leur-Bloem, para. 44.
1284. Ibid. para. 41.
1285. Ibid. para. 42.
1286. Case C-196/04 Cadbury Schweppes, para. 50; Case C-524/04 Thin Cap Group Litigation, para. 74.
1287. A relatively recent tendency in the Court’s case law is that generalizing anti-avoidance rules are accepted as long as the justification of prevention of tax avoidance is coupled with the need to preserve the balanced allocation of taxing rights, see ECJ, 18 July 2007, Case C-231/05 Oy AA, para. 63; CJ, 21 January 2010, Case C-311/08 Société de Gestion Industrielle SA (SGI) v État belge, para. 66.
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The provision obviously incorporates a general presumption of abuse to the extent that it assumes that all shareholdings which are held for less than the minimum period have been obtained for the sole purpose of abusing the Directive. The requirement for a minimum holding period is also at odds with the express statement of the Court in *Leur-Bloem* that the creation of a specific structure for a limited period of time may have valid commercial reasons. The fact that the Court has not found anything objectionable in this provision of the Parent – Subsidiary Directive shows that generalizing rules that exclude certain categories of transactions, holdings or groupings from the tax advantages granted under Union law are regarded as proportionate when employed by the Union legislature. Thus, there is apparently a double standard of proportionality; what is regarded as proportional instruments in the hands of the Union legislature becomes disproportional in the hands of national lawmakers. The fact that the Court accepted a national provision laying down a minimum holding period in the context of VAT as a condition for being eligible for an optional mechanism simplifying VAT declarations and payments could, in theory, indicate that the Court does not, in fact, apply a double standard but it is simply inconsistent. It found a generalizing national anti-abuse rule disproportional in the context of the Merger Directive while in the context of VAT it considered a similar national measure compatible with the principle of prohibition of abuse of rights and thus obviously proportional. However, such a difference in approach may as well be considered justified taking into account that VAT is a comprehensively harmonized system where the application of a generalizing anti-avoidance rule, which is aimed at limiting the use of an optional derogating regime, tends to enhance the objectives of harmonization and the uniform application of the harmonized rules rather than frustrate the latter aims. Even if the Court’s differentiating approach makes sense in this respect, the different assessment of generalizing anti-abuse rules in the context of the Merger Directive, on the one hand, and the Parent-Subsidiary Directive, on the other, can hardly be explained with the difference of the context. According to the Court, an anti-abuse rule in the context of the Merger Directive which defines abusive transactions in a generalized way in the interest of legal certainty and administrative efficiency is disproportional, whereas a similar rule in the context of the Parent-Subsidiary Directive is proportional. As the only difference between the two scenarios is that the first rule was laid down in the implementing national law.

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1289. See Case C-162/07 *Ampliscientifica*.
1291. Englisch, supra note 1192, p. 74.
law while the second is contained in the Directive itself, the conclusion that a double standard is applied for measuring the proportionality of anti-abuse measures depending on whether they are adopted by the national or the Union legislature is unavoidable.\textsuperscript{1292}

In summary, the conclusion that we drew in Chapter 7, that Union acts are measured by a lower standard of proportionality than national measures when they are reviewed for their compatibility with primary law holds true also with respect to Union acts adopted in the field of taxation. In Schmelz, the Court did not emphasize the broad scope of discretion of the Union legislature and it did not apply the ‘manifestly inappropriate’ test that we saw in many of the cases in the non-tax fields. This suggests that the Court does not consider the harmonized system of VAT an area in which the Union legislature has to make decisions involving “political, economic or social choices”. The Court – at least, formally – applied in the case the same proportionality test as to Member State measures. In particular, it examined the appropriateness and the necessity of the territorial limitation of the small undertakings scheme laid down in the VAT Directive through a detailed analysis in which it evaluated the effectiveness of a potentially less restrictive alternative. Although formally, the analysis did not differ from that of national measures, the outcome according to which the exemption can be denied to non-established small undertakings even if they do not carry out economic activity in any other Member State shows that the notion of a proportional restriction is understood much more leniently under the VAT Directive than with respect to national measures. This has been confirmed by comparing the Court’s approach to anti-abuse measures under national law and the specific, substantive anti-abuse provisions of the Union directives. The fact that generalizing anti-abuse rules are prohibited for the national legislature while allowed for the Union legislature proves the existence of a double standard.

8.3.6. Interim conclusions

In the second part of this Chapter, we examined concrete aspects of the relationship of the tax directives and various norms of primary law – predominantly the fundamental freedoms – returning to the same issues that we have discussed in Chapter 7 now examining them in the specific context of taxation. First, we observed that the tax directives contain a large number of authorizations, optional rules, special regimes and derogations which the

\textsuperscript{1292} Ibid. p. 75.
Member States may choose to exercise upon their discretion. As regards these types of rules we examined the question under what circumstances an infringement of primary law which results from the exercise of an option by a Member State should be attributed to the Member State or alternatively, to the Union. In the context of the tax directives the question of attribution of an infringement is relevant both from the point of view of the fundamental freedoms and the State aid rules. Applying the conclusions drawn from the previous Chapter to the tax directives, we looked at the degree of discretion left by the Union directives to the Member States in order to decide on the question of attribution. We distinguished three scenarios in this respect. The first is where a Member State implements a compulsory rule provided for by the tax directives and this leads either to an obstacle to free movement or a selective advantage to certain undertakings. In this case, the potential infringement of primary law will be attributable to the Union. Second, when the tax directives grant an authorization which leaves no discretion to the Member States as regards the way in which it can be exercised, the ensuing infringement must be imputed to the Union as well. This is in spite of the fact that the decision by the Member State to make use of the authorization necessarily implies an autonomous decision and thus a certain degree of discretion on its side. Third, an infringement of primary law is imputable to the Member State when the directive grants an option which leaves sufficient margin of discretion to the Member States to exercise it in a way which accords with the requirements of primary law.

As regards the fundamental freedoms, the decision on the attribution of their potential infringement does not affect the conclusion whether there is an infringement or not. In other words, where a restriction on free movement is imputed to the Union, it still remains an infringement of the fundamental freedom concerned. The prohibitions set out under the free movement provisions are addressed to the Union legislature just as much as to the Member States. The same is not true, however, in the context of the State aid rules. The definition of State aid requires that an aid must be granted by a Member State therefore Union aid is excluded from the scope of Article 107(1) TFEU. Thus, when it is established that a selective aid which results from the exercise of an authorization granted by a Union directive is attributable to the Union, no infringement of the State aid rules will follow. In brief, while a Union act may very well infringe the fundamental freedoms, the State aid rules exclude a priori the possibility that aid granted by a Union act could be in breach of Articles 107-108 TFEU. This strict position under the State aid rules raises the question whether the conclusion that a Union measure is incapable of being qualified as aid distorting competition is a consequence of a sound dogmatic approach or another proof of the
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Court’s aversion to a substantive review of Union legislation in the light of higher ranking primary law norms. From a dogmatic point of view, it can be argued that both the contextual and teleological interpretation of the State aid rules as well as the logic of the State aid procedure support the position that aid granted by a Union measure cannot be classified as ‘State’ aid. However, this stance should not lead to the conclusion that the distortions that Union legislative measures cause to the conditions of competition in the internal market are consequences of the choices of the Union legislature which ought to be accepted without any possibility for revision. In this respect, it is important to emphasize that Union acts which grant selective advantages and thereby create unequal competitive conditions in the internal market are liable to being reviewed in the light of the principle of equality as a general principle of EU law. The effectiveness of such review carried out by the Court is, however, questionable. The Court’s deference towards the Union legislature and its reluctance to interfere with the political, economic or social choices made by the latter even where they are in breach of basic primary law norms enables serious distortions to remain in place in the internal market. We have argued that the constitutional-type review of Union legislation should not be rendered a mere formality by the Court, as such review is necessary to remedy the consequences of the fact that distortive and selective advantages granted by Union acts cannot qualify as aid within the meaning of Article 107(1) TFEU.

Next, we examined the question whether and to what extent the fundamental freedoms apply in parallel with the tax directives to the effect of constituting an additional limit to national legislation adopted by the Member States in the exercise of the competences that they have retained in the field of taxation. In exhaustively harmonized areas the application of the freedoms is precluded by the harmonizing secondary law as long as the legality of the latter is not questioned in the light of those freedoms. However, the tax directives do not bring about exhaustive harmonization. Not even the VAT Directive, which achieves the most comprehensive harmonization amongst the acts of secondary law on taxation, covers exhaustively all the aspects of value added taxation. Therefore, at least in principle, the fundamental freedoms may apply to certain aspects of national VAT laws. The role of the freedoms is much more important in the field of direct taxation where only ‘patchwork’ harmonization exists. The scope of application of the freedoms is much broader here, as outside the narrow scope of the direct tax directives they are fully applicable to the effect of limiting the exercise of powers in taxation retained by the Member States. Even if a certain piece of national legislation concerns a subject-matter governed by one of the direct tax directives there is a good chance that besides the directive the fundamental
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freedoms will also apply to it. This will be the case if the national legislation exercises an option granted by the direct tax directives. The freedoms will also apply in cases where a certain situation falls outside the personal or material scope of a directive or where the transaction at issue does not fulfil a substantive precondition for the beneficial treatment provided for by the directive. The fact that the freedoms apply parallel with the directives is especially relevant in the context of the Merger Directive where this complementary application of the freedoms enables the Merger Directive to be interpreted consistently with the freedoms and thereby helps maintaining the validity of the Directive and specifically, its restrictive permanent establishment requirement. The condition under the Merger Directive that the assets transferred in a qualifying transaction must remain effectively connected with a permanent establishment in the exit State seems to contravene the freedom of establishment as interpreted by the Court in its recent case law on company exit taxation. In that case law, the Court held that the exit State cannot charge an immediate exit tax upon the transfer of seat of a company to another Member State; rather, it has to offer an option to defer the tax until the realization of the capital gains on the transferred assets irrespective of the fact whether or not a permanent establishment remains in the exit State. The logic of this case law requires that such deferral be granted on all the corporate reorganizations which fall under the scope of the Merger Directive even if the assets are physically moved out of the tax jurisdiction of the exit State. Although the permanent establishment condition apparently conflicts with what the freedom of establishment requires, taking into account the Court’s general reluctance to invalidate provisions of secondary law which are in conflict with higher ranking norms of primary law, it is very unlikely that this restrictive condition of the Merger Directive would be found to infringe the freedom of establishment if it were to be tested by the Court. Instead, the Court would interpret the Merger Directive consistently with the freedoms according to the premise that a “Union act must be interpreted, as far as possible, in such a way as not to affect its validity.” This would involve using the argument that a reorganization which does not fulfil the permanent establishment condition actually falls outside the scope of the Merger Directive and as such is governed by the freedoms, which do not allow an immediate exit tax to be charged. With such reasoning, it is possible to arrive at a result which is in accordance with the requirements of the freedom of establishment and does not affect the validity of the Merger Directive.

Apart from this interpretation of the Merger Directive, we have examined other examples of consistent interpretation of secondary law with primary law in the field of taxation. These examples show that the Court uses this
technique in relation to the tax directives for the same purposes as in the non-tax fields. When the purpose is to avoid the invalidation of a provision of a tax directive, the Court seems to use this technique without apparent limits. We saw cases where the text of the interpreted provision was open enough to accommodate a meaning consistent with primary law (Case 15/81 Gaston Schul). In other cases, reconciliatory interpretation led to rather unreasonable results (Case C-166/98 Socridis and the interpretation proposed by the Advocate General in Schmelz). The Court has also used consistent interpretation for the purpose of aligning the specific anti-avoidance rule of the Merger Directive with the general principle of prohibition of abuse of rights which it has developed in its case law concerning the fundamental freedoms and VAT (Case C-321/05 Kofoed). In this regard, consistent interpretation, in fact, resulted in contra legem interpretation.

As regards consistent interpretation in the context of the concept of abuse, the main question is to what extent the specific anti-abuse provisions of the direct tax directives must be interpreted consistently with the general case law-based abuse doctrine. The answer to this question depends on the status of the latter doctrine. The Court’s position is that the prohibition of abuse of rights is a general principle of EU law. This qualification implies that it has the ranking of primary law of a constitutional nature meaning that secondary law must comply with it. Under this view, the specific anti-abuse provisions of the direct tax directives must be in line, as a matter of normative hierarchy, with the general principle of prohibition of abuse. We suggested that the general abuse doctrine should be considered a principle of interpretation rather than a formal general principle. This, however, does not affect the conclusion that the anti-abuse rules of the direct tax directives need to be interpreted in a way which reconciles them with the general doctrine of prohibition of abuse. Yet, there is a limit to such reconciling interpretation and that is the wording of the provisions at issue.

The anti-abuse rule of the Parent – Subsidiary Directive is not a substantive anti-abuse provision but a mere authorization for the Member States to apply their domestic law-based or tax treaty-based anti-avoidance rules within the scope of application of the Directive. Consistent interpretation of this provision with the general abuse doctrine is rather straightforward. The provision expressly includes the term ‘abuse’ which should be attributed the same meaning as that under the general abuse doctrine. From this, it follows that the provision authorizes the application of only such domestic anti-avoidance rules or principles which comply with the requirements of the general abuse doctrine. The matter is much more complicated with respect to the anti-avoidance rule of the Merger Directive. It is a
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substantive rule which contains the criteria according to which transactions can be qualified as abusive. The description significantly differs from that of the general doctrine of prohibition of abuse, which defines abuse as an artificial arrangement which is devoid of economic reality and the sole (or essential) purpose of which is to obtain a tax advantage. In contrast, the wording of the provision of the Merger Directive does not refer to artificiality (objective condition) but only to the tax avoidance purpose of the operation (subjective condition). Thus, the provision conflicts with the general abuse doctrine which, according to the Court, is a general principle of EU law of the status of primary law. The wording of the anti-abuse provision of the Merger Directive does not seem to leave scope for consistent interpretation, as it clearly deviates from the content of the general abuse doctrine. Despite this, the Court held in Kofoed that the anti-abuse provision of the Merger Directive is the reflection of the general principle that abuse of rights is prohibited and thus interpreted the provision along the lines of such principle and contrary to its wording. We submitted that the provision could have been declared invalid on the ground of infringing the higher ranking principle of prohibition of abuse. This would not have deprived the Member States of the right to combat abuse in the context of the Merger Directive, as they could have relied directly on the general principle of prohibition of abuse for such purposes.

The number of cases where the actual compatibility of the tax directives with the fundamental freedoms has been at issue is very low, which is due to the fact that (i) the tax directives are generally less likely to conflict with the fundamental freedoms than secondary legislation pursuing some non-internal market related objectives, and (ii) through the various techniques discussed above the Court has avoided addressing direct confrontation between the tax directives and primary law. We found and analysed two cases dealing with such issue, one concerning the VAT Directive (Case C-97/09 Schmelz) and the other one the Parent – Subsidiary Directive (Case C-247/08 Gaz de France). In neither of these cases did the Court find the directives incompatible with the freedoms. The reasoning in Gaz de France relied on the ‘harmonization-in-stages’ argument, that is, the incompleteness or imperfection of harmonization which a directive introduces does not lead, in itself, to an infringement of the freedoms. For such infringement to be established it is not enough that certain segments of the field to which harmonization relates are left outside the scope of the directive. Although incomplete coverage of the field may lead to inequalities insofar as comparable situations will be treated differently, for finding a breach of the freedoms, differential treatment must occur between a cross-border situation and a comparable domestic situation. A Union directive does not normally
provide for the tax treatment of purely domestic situations, therefore, it is rarely the case that a directive can infringe the freedoms in itself. The ‘cooperation’ of the Member States is also necessary insofar as the treatment of domestic situations is dependent on domestic law. If domestic law ‘contributes’ to the infringement in this way, the infringement will be attributed to it unless the directive grants a clear-cut authorization for the Member State to discriminate. This reasoning does not, however, exclude the possibility that the directive itself without the contribution of domestic law can infringe the principle of equality. In *Gaz de France*, the Court has omitted to scrutinize the directive in this respect which is hardly surprising in view of its reluctance to substantively review Union legislation. In *Schmelz*, the Court avoided the need to invalidate the contested provision of the VAT Directive by lowering the proportionality standard compared to the standard applicable to national measures. Formally, the Court applied the same test as to national measures without referring to the ‘manifestly inappropriate’ standard, which had often been used to measuring the proportionality of Union legislation in non-tax fields. This may indicate that, in principle, VAT is not an area where sensitive political, economic and social choices would need to be made, justifying the recognition of a wide margin of discretion to the Union legislature. On the other hand, we have also seen in Chapter 5 that the Court in its recent case law on fundamental rights has abandoned the ‘manifestly inappropriate test’. This trend may extend beyond the domain of fundamental rights signalling a change in the general approach of the Court to the analysis of proportionality in the judicial review of Union legislation. Although there might be a willingness on the side of the Court to approximate the standard of proportionality applied to secondary legislation to that applied to Member State measures, the actual outcome in *Schmelz* proves that there is still a difference between the two types of measures as regards the analysis of their proportionality when reviewing their compatibility with the fundamental freedoms.

### 8.4. Overview

In conclusion, the fact that to date, not a single provision of secondary legislation concerning taxation has been annulled or declared invalid by the Court on the ground of infringing primary law can be explained, on the one hand, by the nature of such legislation and, on the other, by the Court’s general reluctance to set aside validly adopted Union legislation. On the basis of the nature of the legislation, we have anticipated that the directives which govern substantive tax issues are likely not to come into conflict with the fundamental freedoms, as they are aimed at giving effect to those
very freedoms in the specific domains to which they apply. In addition, the technique of minimum harmonization in the case of the direct tax directives is not prone to generate similar problems to those we have seen in the case of some non-tax directives pursuing non-internal market related aims, such as consumer or environmental protection, where the prescription of stricter standards by the Member State than that laid down in a directive may easily impede the exercise of free movement rights. Finally, the tax directives which provide for numerous authorizations and options seem to leave sufficient margin of discretion for the Member States to transpose them in conformity with the Treaty in which case, no infringement of primary law can be imputed to the directive itself.

Nonetheless, the fact that direct conflicts between the tax directives and higher ranking primary law norms hardly come up in the case law is mostly due to the various techniques that the Court applies for avoiding such conflicts. First, in the case of authorization provisions set out in the directives the Court may attribute an eventual potential infringement of primary law to the Member State availing itself of the authorization even if the authorizing provision leaves no margin of discretion to the Member States as to the manner of exercise (Case C-166/98 Socridis). Second, selective aid granted by a Union act cannot by definition constitute State aid and thus infringe the prohibition of State aid under Article 107(1) TFEU (Case T-351/02 Deutsche Bahn, Case C-460/07 Puffer). Such selective aid is hardly ever found to be in breach of the principle of equality, as the Court either rejects that the differential treatment causing the selective advantage relates to comparable situations (Case C-460/07 Puffer) or it may even simply refer to the deliberate choice on the part of the Union legislature to introduce unequal treatment (Case C-269/00 Seeling, see Section 5.1.2.4.). Further, the Court employs the technique of consistent interpretation extensively in order to avoid the need for finding an incompatibility of the secondary law with primary law. In this effort, consistent interpretation may reach the point of contra legem interpretation (Case C-321/05 Kofoed) or may even be reversed to the effect that the interpretation of primary law is aligned to what is required by secondary law (Case C-446/04 first FII case). If through these techniques the Court has not managed to sidestep the question of compatibility of secondary law with primary law, there are further arguments that can be used in the actual review of legality of secondary law in order to avoid a declaration of invalidity. By the ‘harmonization-in-stages’ argument the Court tends to reject that obstacles or barriers that follow from the incompleteness of harmonization can constitute a restriction on the fundamental freedoms. By this, not only secondary legislation, the scope of which is too narrowly drawn, can be saved from potential invalidation (Case C-247/08
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Gaz de France) but also discriminatory transitional arrangements authorized by secondary legislation can be maintained (Case C-36/99 Idéal Tourisme). Finally, the last tool which is available for the Court to escape from having to invalidate a piece of secondary legislation is the relaxation of the proportionality test which allows restrictive secondary law to be justified under conditions in which national measures could not be justified (Case C-97/09 Schmelz). As it appears, the use of these techniques by the Court in the field of taxation is not different from what we have seen in the non-tax fields.

The motivation of the Court not to interfere with the Union legislative process under the delicate circumstances of supranational lawmakers and not to upset the institutional balance within the Union constitutional construct clearly transpires from the case law analysed in this Chapter. Admittedly, the Court’s attitude can be perceived as being an incentive for the Member States to agree on the harmonization of their tax systems by suggesting that if they do so the outcome of their agreement will not be scrutinized as rigorously as their national laws. Nevertheless, the Court’s reluctance to carry out an effective constitutional review of Union legislation enables a ‘cartel of Member States’ – or for that matter, even one single renegade Member State that is willing to abuse the unanimity requirement applying to the field of taxation – to exploit the Union legislative process for promoting their own interests, thereby jeopardizing the achievement of the aim of a genuine internal market that is free of obstacles to free movement and distortions of competition.

1294. Englisch, supra note 975, Ch. 1.3.1.4.