

Article Summary

European Taxation – How successful are the institutions of the European Community in ensuring the smooth functioning of direct taxation in the European Internal Market?

Focus and scope

One of the main challenges facing the European Union, as identified by the European Commission in 1996, is what has become known as the smooth functioning of the Internal Market.

In this paper, John Marcarian examines how the European Union Institutions (EUIs), including the European Parliament, the Council of the European Union, the European Commission, the European Court of Justice and the European Council, play a role in the smooth functioning of the Internal Market, with a particular focus on direct taxation, and how effective they are in meeting this objective.

Background

The European Community Treaty states that the Internal Market should be “characterized by the abolition between Member states of obstacles to the free movement of goods, persons, services and capital.” It sets as the objective of the EUIs the abolition of obstacles to the fundamental freedoms to ensure a smooth functioning of the Internal Market.

In this paper, the author considers the objective of the smooth functioning of the Internal Market with a focus on direct taxation. The paper then considers the concepts of the “Internal Market” and “smooth functioning”. Then following a review of the primacy of European Union law and the function of each of the EUIs in pursuing the objective of the smooth functioning of the Internal Market.

It is the author’s view that the EUIs are not functioning effectively in pursuing the “smooth functioning” objective. This view is supported by reference to the following

points: smooth functioning problems identified by the Commission; uncertainty surrounding the current approach of the European Court of Justice; the push for a common consolidated tax base; the absence of a European Union Constitution; State aid and Double Tax Agreements; and calls for a European Union Model Agreement.

Impact

The author concludes that there are a number of serious problems that exist in the New Tax Order of Europe in relation to direct taxation. Furthermore, unless there is a seismic shift in the attitudes of both European citizens and the EUIs then the attainment of the 1996 objective of “smooth functioning of the Internal Market” will not be achieved in the foreseeable future.

Legislation, cases, rulings discussed

- European Community Treaty, Articles 1, 2, 3, 5, 7, 11, 14, 15, 43, 87, 93, 94, 99, 175, 190, 192, 197, 203, 205, 226, 230, 232
- United Kingdom-United States Double Tax Agreement, Article 10
- *Flamino Costa v ENEL* (1964) Case 6/64
- *NV Algemene Transport-en Expeditie Onderneming Van Gend & Loos/ Staatssecretaris voor Financien* (1963)
- *Lankhorst-Hohost GmbH v Finanzamt Steinfurt* C-324/00 (2002) ECR I – 11779
- *Marks & Spencer plc v David Halsey* Case C-446/03
- *Bosal Holding BV v Staatssecretaris van Financien* Case C-168/01 (2003) ECR – 9409

- *Hughes de Lasteyrie du Saillant v Ministere de L’Economie, des Finances et de l’Industrie* Case C-9/02 (2004) ECR I-2409
- *Bachmann’s case* Case C-2004/90
- *Futura Participations SA and Singer v Administration des contributions* Case C-250/95
- *Anneliese Lenz v Finanzlandesdirektion fur Tirol* Case C-315/02 (2004) ECR I – 7063
- *Petri Manninen* Case C-319/02 (2004) ECR I-7477
- *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt* Case C-324/00 (2002) ECR I – 11179
- *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* Case C-196/04
- *Test Claimants in Class IV of the ACT Group Litigation (Pirelli, Essilor and Sony), Test Claimants in Class IV of the ACT Group Litigation (BMW) v Commissioners of Inland Revenue* Case C-374/04
- *Rewe Zentralfinanz e Gals Gesamtrechtsnachfolgerin der ITS Reisen GmbH v Finanzamt KolMitte* Case C-347/04
- *Commission v UK* Case C-466/98
- *Commission v Denmark* Case C-467/98
- *Commission v Finland* Case C-468/98
- *Commission v Belgium* Case C-471/98
- *Commission v Luxembourg* Case C-472/98
- *Commission v Austria* Case C-475/98
- *Commission v Germany* Case C-476/98.



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European Taxation – How successful are the institutions of the European Community in ensuring the smooth functioning of direct taxation in the European Internal Market?

Over recent years there has been a deal of confusion as to the workings of EU Institutions and how they relate to each other. The objective of a unified ‘internal market’ has long been agreed but the manner in which this goal is being pursued has caused uncertainty in many quarters. The Article below will examine the EU Institutions and consider the smooth functioning objective from a number of perspectives.

INTRODUCTION

An appropriate place to commence a discussion of this question is in the picturesque town of Verona.

The reason might perplex even the most avid European tax historian though the answer is relatively simple.

In April 1996, unbeknownst to many of Verona's inhabitants a crucial gathering of the ECONFIN¹ took place.

At that meeting the European Commission² identified three main challenges for the EU.

These were:

1. the stabilization of Member States tax revenues;
2. the smooth functioning of the Internal Market³; and
3. promoting employment;

It is the aim of this article to comment on the second of the above points and to examine how the EU Institutions⁴ play a role in the smooth functioning of the Internal Market and how effective they are in meeting this objective.

This article will consider the objective of the “smooth functioning of the Internal Market” with a focus on direct taxation⁵. It will then consider the concepts of the “Internal Market” and “smooth functioning”.

At that point the article will present a review of the primacy of EU law and the function of each of the EU's in pursuing the objective of the smooth functioning of the Internal Market.

It is the author's view that the EU's are not functioning effectively in the “smooth functioning” objective.

This view will be supported by reference to the following points:

1. Smooth functioning problems identified by the Commission;

2. Uncertainty surrounding the current approach of the European Court of Justice;⁶
3. The push for a common consolidated tax base;⁷
4. The absence of an EU Constitution;
5. State aid⁸ and Double Tax Agreements;⁹
6. Calls for an EU Model Agreement;

The conclusion of this article is that there are a number of serious problems that exist in the New Tax Order¹⁰ of Europe in relation to direct taxation.

Furthermore unless there is a “seismic shift” in the attitudes of both European citizens and the EU's then the attainment of the 1996 objective of “smooth functioning of the Internal Market” will not be achieved in the foreseeable future.

The “Internal market” and “smooth functioning”

Prior to considering the term “Internal Market” let us note that the term “common market” is used in Article 2 of the ECT.¹¹ Furthermore a review of that Article will disclose that a “common market” is required to be established by the Community.

The term “Internal Market” first appears in Article 3(c) of the ECT. The term is not however defined in the ECT.

It is therefore curious that the term “common market” was not the term used in Article 3 of the ECT and instead the term “Internal Market” was used.

The author's view is that those who read the ECT are meant to view the term “common market” and “internal market” as interchangeable though the question of the exact relationship between the two terms is left unanswered.¹²

Article 3(c) of the ECT states that the Internal Market should be “characterized

by the abolition between Member states of obstacles to **the free movement of goods, persons, services and capital.**”¹³ The intention of the words “abolition...of obstacles” is clear enough.

It sets as the objective of the EU's the abolition of obstacles to the fundamental freedoms to ensure a “smooth functioning”¹⁵ of the Internal Market.¹⁵

It is also noted that Article 14(1) of the ECT imposes on the Community (through the EU's) the legal obligation to progressively establish the Internal Market.¹⁶

The theory can therefore be advanced that the ECT recognises that the smooth functioning objective will take some time to achieve.

Each of the EU's are required to play a role in achieving the objective set out in Article 3(c) of the ECT as they are part of the Community apparatus.¹⁷

Primacy of EU Law

Community law has a different structure from that of both national tax systems of the EU Member States and international treaties.

The primacy of EU law is reflected in the following quote:-

*“Although direct taxation is a matter for the Member States, they must nevertheless exercise their direct taxation powers consistently with Community Law.”*¹⁸

The relationship between EU law and national law has been subject to a great deal of analysis and discussion.

EU law¹⁹ forms an integral part of the national legislation of the Member States which their courts are bound to apply.²⁰ If there is a conflict between a national law and EU law then the latter has primacy.²¹

Sovereignty was moved from the level of Member States to that of the EU's in all fields regulated by the ECT. However there was no general transfer of power

but rather there was the granting of specific powers in order to achieve the policies of the EU.

Founders of the EU also made it clear that in principle Member States were not prevented from exercising their own rights to legislate in relevant fields of EU law.²²

There are no concurrent powers between Member States and the EUI's.

Acts by the EUI's prevail over Member States in order to ensure compliance with ECT.²³

However there are limits to the powers of the Community and these are contained in Article 5 of the ECT. These are:-

■ The Community shall have regard to the "principle of subsidiarity".

This means that under certain conditions Member States and not the EU shall legislate in a particular area.²⁴

■ The Community shall not go beyond what is necessary to achieve the objectives of the ECT.

This is known as the principle of proportionality. It means that public interference may not go beyond what is necessary in order to achieve the underlying aims of the interference.²⁵

It is relevant to note that the limitations of Article 5 do however present the EUI's with further challenges in achieving the goal of a "smooth functioning of the internal market".²⁶

The set of provisions related to fundamental freedoms represents the bulk of primary EU law on which the ECJ has built up the New Community Tax Order.

It is now time to consider the EUI's in further detail.

EUI's

The EUI's noted in Article 7 of the ECT are:

1. a Parliament;
2. a Council;
3. a Commission;
4. a Court of Justice;
5. a Court of Auditors;²⁷

To the above list may be added the European Council (which is different from the Council of the European Union referred to in point 2 above).²⁸

European Parliament²⁹

Since 1979 its members have been directly elected by the people they represent³⁰.

Parliament has three main duties:

1. *Passing European laws*³¹ (jointly with the Council in many policy areas³²).

Parliament also can initiate the development of new laws by asking the Commission "to submit any appropriate proposal on matters on which it considers that a Community act is required for the purpose of implementing this Treaty."³³

2. *Parliament exercises democratic supervision over the other EUI's.*

When a new Commission takes office, its members are nominated by the EU Member State governments but they cannot be appointed without Parliament's approval.³

Throughout its term the Commission remains politically accountable to the Parliament.³⁵

Parliament can also initiate or intervene in legal actions before the ECJ.³⁶

3. *Parliament decides jointly with Council on the EU's annual budget*

The EU's annual budget is decided jointly by Parliament and the Council.

The exercise of the "power of the purse" is thus another useful control instrument.³⁷

The Council of the European Union³⁸

The Council of the European Union³⁹ is the EU's main decision making body.⁴⁰

It represents the Member States, and its meetings are attended by one minister⁴¹ from each of the EU's national governments.⁴²

The relevant Council configuration for the purpose of this article is the ECOFIN⁴³.

The Council has four key responsibilities⁴⁴:

1. To pass European law – jointly with Parliament in many policy areas;
2. To co-ordinate the broad economic policies of the Member States;
3. To conclude international agreements between the EU and other countries or international organisations;

4. To approve the EU's budget, jointly with Parliament;

The Council votes either by simple majority⁴⁵, unanimity or by Qualified Majority Voting.⁴⁶ In particularly sensitive areas such as taxation Council decisions have to be unanimous.⁴⁷

The Commission

The Commission⁴⁸ is independent of national governments.

Its mandate is to act for and uphold the interests of the EU.⁴⁹

The Commission has four key responsibilities:

1. *To propose legislation to Parliament and the Council.*

The Commission has the right to initiate and it alone is responsible for drawing up proposals for new EU legislation which it presents to Parliament and the Council.

2. *To manage and implement EU policies and the annual budget;*

As the EU executive body, the Commission is responsible for managing and implementing the EU budget.⁵⁰

3. *To enforce European law (jointly with the Court of Justice);*

The Commission is widely referred to as the "guardian of the Treaties" and one can refer to Article 226 to witness the significant power it can wield in this area⁵¹.

4. *To represent the EU on the international stage by negotiating agreements between the EU and other countries;*

European Court of Justice

Based in Luxembourg, the ECJ was set up in 1952.

Its task is to make sure that EU legislation is interpreted and applied in the same way in all EU countries so that the law is equal for everyone⁵².

The ECJ reviews the legality of:

- Acts adopted jointly by the Parliament and the Council;
- Acts of the Council, of the Commission and of the European Central Bank, other than recommendations and opinions; and
- Acts of the Parliament intended to produce legal effects vis-à-vis third parties.

Thus importance of the ECJ cannot be overstated.

The ECJ applies its legal method differently from the legal methods applied by national courts.⁵³

European Council

The primary function of the European Council⁵⁴ is to give the general impetus and social, economic and political guidance in all areas of European Union activities at both European and national levels⁵⁵.

The European Council meets at least once every six months under the chairmanship of the Head of State or Government of the Member State which holds the Presidency of the Council of the European Union, which rotates twice a year.⁵⁶

However, the European Council has a number of weaknesses that hinder its efforts to pursue the smooth functioning objective.

Specifically these are:-

- That its competencies are not specified and it has no decision-making powers or powers of constraint vis-à-vis the other EUI's;
- That its guidelines and declarations are not legally binding;⁵⁷
- That it is not subject to the jurisdiction of the ECJ;

The shortcomings of the European Council are also highlighted in the following quote from Bermann⁵⁸ when in considering how

It is submitted that the failure to ratify an EU Constitution seriously inhibits the ability of the EUI's to pursue the objective of the smooth functioning of the Internal Market.

Let us now turn to some specific "smooth functioning" problems.

Functioning problems – Unanimity et al

One need only review some of the Commission's Communication bulletins to understand its level of dissatisfaction with its progress in meeting the smooth functioning objective of the Internal Market.⁵⁹

A number of problems exist in the direct tax field.

These include:

- the unanimity requirement in tax matters;
- the lack of political will;
- the lack of a common consolidated tax base;⁶⁰
- problems with infringement proceedings;⁶¹

A brief review of the Communications will highlight these points.

Unanimity requirement in tax matters

COM (2004) 22

In relation to direct taxation the Communication states on page 12 that:-

introduced in the ECT which would cover all aspects of taxation.

Although the delegations identified a number of matters as being suitable for adoption by qualified majority voting⁶³ it was the conclusion of the Intergovernmental Conference to retain the unanimity requirement for all Treaty provisions relating to taxation due mainly to political difficulties⁶⁴.

COM (2003) 726

On page 3 it was noted that:

*"The prospect of a continued **unanimity requirement** for decision-taking in EU tax matters will obviously also affect the scope for further progress, particularly when enlargement is taken into account"(emphasis added)*

It is therefore clear that the Commission believes that limited progress in direct tax matters will be made until QMV on tax matters is adopted by the Council.

Lack of political will

COM (2001) 260

At page 8 this Communication notes that *"the Commission is examining whether more can be done to tackle direct tax obstacles to the Internal Market, notably in the field of company taxation... Certainly, further **co-ordination of national tax systems** in the area of company taxation would help to eliminate situations of double taxation"* (emphasis added).

At page 9 the Communication states that: *"Eight years after the target date for completion of the Internal Market, it is **unacceptable that many obstacles remain to the attainment of Community objectives**"* (emphasis added).

The Communication, in making the above points about the lack of political will to resolve obstacles, suggests that the Community should consider a number of alternative instruments as a basis for initiatives in the tax field.⁶⁵

However the Commission is not optimistic about the outlook for positive developments in this area when it states at page 21 of the Communication that:

*"Although the Communication notes that ... such discussions are helpful it is the **insufficient political will combined with the unanimity requirement** rather than the existence of one body or another that are the main obstacles to progress"* (emphasis added)

The failure of the Member States to ratify an EU Constitution is lamentable.

the European Council would have been "improved" had the draft EU Constitution been adopted he states:-

*"The European Council would not only be made into a **conspicuously integral institution** of the Union but its functions would finally be codified ... **enhancing the European Council's efficiency**"* (emphasis added).

The failure of the Member States to ratify an EU Constitution is lamentable.

"Tax obstacles significantly hinder the functioning of the Internal Market and generate unnecessary compliance costs for business ... the Commission continues to hold the view that qualified majority voting will have to replace unanimity in the Council for tax matters which are essential for the functioning of the Internal Market." (emphasis added)

The Treaty of Nice

The 2000 Intergovernmental conference proposed a new single article to be

COM (2005) 330

At page 3 it is noted:-

*"One important element of the Lisbon re-launch is the overhaul of its governance structure to define more clearly the respective responsibilities at the national and the Community level in order to better match tasks and competencies. **The Commission must complement the efforts of Member States.**" (emphasis added)*

Such introspection by the Commission of its own need to do more is to its credit .

An example of the Commission doing more can be seen in the corporate tax field at the level of Commission Working Groups.

At the Commission Working Group level there was tentative discussion of the consequences of the ECJ decision in the "Lankhorst-Hohorst"⁶⁸ case which concerned thin capitalization issues.

Unfortunately though, even when faced with clear guidance by the ECJ, some Member States were still reluctant to go down the path of co-ordination of their approaches.

The lack of political will has also been noted by the respected commentator Malcolm Gammie⁶⁹ as a serious problem that exists in the direct tax field in the EU.

It should also be noted that the lack of political will is not limited to actions between the Member States.⁷⁰

Lack of a Common Consolidated Tax Base

COM (2003) 726

This Communication raises the absence of a CCTB as a weakness hindering the smooth functioning of the Internal Market when at page 5 it states:

*"The Commission nevertheless remains convinced that, as a measure designed to improve the Internal Market, the **common tax base** is necessary and should ideally be decided on a qualified majority voting basis"(emphasis added).*

Commentators have also highlighted this problem as a most serious obstacle to be addressed by the EU's.⁷¹

The fact that there is no CCTB has led the Commission to propose a pilot project in relation to Home State taxation as a way forward for small and medium size enterprises⁷².

Problems with infringement proceedings

COM (2001) 260

This Communication notes that infringement proceedings need to be launched on a more pro-active basis⁷³ although it is noted that they are slow and expensive to prosecute.

The Communication identifies the problem of "asymmetrical effects" from the decisions of the ECJ in infringement proceedings.

This term means that the ECJ's rulings involving one particular country are not always clear and therefore each Member State usually revises its national rules in different ways which are not necessarily favourable to the smooth functioning objective of the Internal Market.

Uncertainty surrounding the current approach of the ECJ

Observers of European tax will have noted the recent developments concerning the judgments of the ECJ.

The author views these recent developments with concern due to the uncertainty that prevails in relation to the ECJ's current approach.

Uncertainty at the level of the ECJ negatively impacts on the smooth functioning of the Internal Market because it makes the structuring of commercial transactions and their associated tax consequences all the more difficult to predict.

The decision in Marks & Spencer⁷⁴ has significantly added to this uncertainty.⁷⁵

In 2003 and 2004⁷⁶ the ECJ delivered some noteworthy decisions in relation to restrictions regarding cross-border establishments of businesses and flows of income.

Vanistendael noted that:-

"The Court appeared to have unleashed an unstoppable flood moving towards the full integration of national tax systems within the framework of the fully integrated Single Market...however in 2006 the tidal wave threatening to wash away all sovereign tax systems is clearly receding."

The recent decision in Marks & Spencer appears to break new ground and it has

caused some commentators to question whether the ECJ is heading in a new direction.⁷⁸

The question which is relevant at this point is whether the ECJ is changing its approach and if so how will this changed approach affect the smooth functioning of the Internal Market?

Before considering this question it is worth noting some principles of the established ECJ case law.

Current Established Position of ECJ Case Law

As stated earlier the power of direct taxation rests with Member States but those Member States need to conform to the requirements of the ECT.

The fundamental freedoms have been interpreted to mean that to establish discrimination on the basis of residence, a resident and the non resident need to be in comparable situations.⁷⁹

Discrimination cases are usually based on a comparison between an economic agent operating inside the Member State and one operating in the Single Market, ie moving his economic activity or his investment from his home Member State to another Member State.

A breach of the fundamental freedoms is established if the outbound situation is treated less favourably than the domestic situation, without adequate justification.⁸⁰

The ECJ has in the past decided that, a justification for a breach of one of the fundamental freedoms is acceptable if it is due to one of the following grounds:-

- based on grounds of the cohesion;⁸¹
- effectiveness of fiscal supervision;⁸²
- the requirement to counter tax evasion and avoidance.

In recent cases⁸³ the concept of cohesion has been extended in an economic sense to include two different taxpayers, two different taxes and even two different tax systems, provided that the benefits and burdens are closely linked⁸⁴.

The economic rationale⁸⁵ for allowing a tax benefit has also been extended to taxpayers who have been subject to taxes in other Member States.

In addition the instruments to counter tax evasion and avoidance have been interpreted strictly by the ECJ on the basis that such legislation has the "specific

“The Commission continues to hold the view that qualified majority voting will have to replace unanimity in the Council for tax matters...”

*purpose of preventing wholly artificial arrangements, designed to circumvent...tax legislation”.*⁸⁶

Hence the main conclusion of the recent ECJ decisions up to Marks & Spencer is that the Court is deciding on the position of the taxpayer from the point of view of operations in a fully integrated Single Market.⁸⁷

Marks & Spencer a new direction to smooth functioning?

This case has been one of the most widely commented upon in recent years.⁸⁸

The case concerned the ability of a UK parent company to access losses of a subsidiary in a Member State after that subsidiary had ceased business operations.⁸⁹

In Marks & Spencer a number of justifications for the domestic rule were advanced by the UK authorities to support the rejection of a claim for tax relief by the UK parent company.

The ECJ stated that:-

*“In the light of these **three justifications taken together** it must be observed that restrictive provisions such as those at issue in the main proceedings pursue legitimate objectives which are compatible with the Treaty and constitute overriding reasons in the public interest...”*⁹⁰ (emphasis added)

This was seen as an extraordinary development.

It is important to note that although the justifications “taken together” were accepted by the ECJ the taxpayer succeeded in its action to claim the losses by virtue of the proportionality argument.⁹¹

Justifications taken together

For the first time the ECJ did not refer to one single ground of justification but it stated that the three justifications⁹² had to be “taken together”.

These justifications were:

1. the balanced allocation of the power to impose taxes between Member States;

2. the danger that losses would be used twice; and
3. the risk of tax avoidance;

It has been said that the result of this approach very much favours Member States.⁹³

If the ECJ's line of reasoning is developed further then this is likely to inhibit the smooth functioning of the Internal Market.

It stands to reason that if the learned Advocate General Poiras Maduro can have his view of “justification” and “tax avoidance” overturned⁹⁴ then the task facing a client advisor becomes a Herculean one!

Risk of tax avoidance

The need to counter tax avoidance is a well known ground of justification.

However the ECJ decision in Marks & Spencer was a landmark one in this respect.

In other judgments the ECJ was willing to accept an infringement of a fundamental freedom on the grounds of preventing “tax avoidance” only if it was proportional.

In Marks & Spencer this “qualification” was omitted.⁹⁵

Accordingly the exclusion of group relief for losses incurred by non-residents was justified if they could not be used in the Member State of the subsidiary – at least when taken together with the other justifications.

The ramifications of this approach should send alarm bells to all international tax advisors.

If this approach is followed by future ECJ's it could signal that the justification of preventing “tax avoidance” per se is acceptable and not only those tax avoidance arrangements that are “wholly artificial”.

Marks & Spencer & beyond

It has been suggested that the recent

Opinions of Advocate General Geelhoed depart from accepted ECJ doctrine and that this would if accepted by the ECJ lead to a major reversal of established ECJ law.⁹⁶

These Opinions are said to advance theories built on Marks & Spencer.⁹⁷

In a recent decision, Advocate General Geelhoed indicates his disagreement with important earlier decisions.⁹⁸

More significantly he denies the comparability of the situation of a domestic parent with a subsidiary taxable in that Member State and a domestic parent with a subsidiary taxable in another Member State.⁹⁹

This remarkable statement would mean that Marks & Spencer would have been outside the ECT, which would therefore contradict the entire holding by the ECJ in its judgment!

Hence one may question if Marks & Spencer, which was seen as favourable to Member States, is in fact the tip of the iceberg?¹⁰⁰

It therefore seems reasonable to advance the view that the uncertainty surrounding the ECJ in view of Marks & Spencer and the Advocate General's new theory has the potential to inhibit the smooth functioning of the Internal Market.

Marks & Spencer as an aberration

The alternative view of Marks & Spencer is that it was a “one-off” and that since it was delivered the ECJ and a number of the Advocates General have attempted to limit the effects of that decision.¹⁰¹

The case of Cadbury Schweppes¹⁰² lends support to this proposition.

In that case, when considering tax avoidance, Advocate General Leger refers to “wholly artificial arrangements” and he tries to explain what that term means to him.¹⁰³

In the recent decision on 12 September 2006 the full court of the ECJ delivered its opinion in the Cadbury Schweppes case.¹⁰⁴

The Court fully supported the view in relation to “tax avoidance” as stated by Advocate General Leger where it said at para 69:

“... as pointed out by the Advocate General in point 103 of his Opinion, the fact that the activities which correspond to the profits of the CFC could just as well have been carried out by a company established in the territory

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of the Member State in which the resident company is established does not warrant the conclusion that there is a wholly artificial arrangement..”

It is significant that when faced with an opportunity to agree with the ECJ's approach in Marks & Spencer the ECJ in Cadbury Schweppes did not do so.

Additional support for the view that Marks & Spencer was a “one off” can be seen from the decision of Advocate General Poiares Maduro in Rewe¹⁰⁵ when he considered the “taken together” approach of the justifications.

The Advocate General suggested that the balanced allocation of taxing powers between Member States cannot exist on its own and it is unable to be separated from the other two justifications, namely the risk of tax avoidance and the double use of losses.¹⁰⁶

It can be seen that Advocate General Maduro was implicitly critical of the “taken together” justification approach and he certainly viewed it as unnecessary to consider the “balanced allocation” justification.

It is the author's view that the uncertainty caused by the ECJ's approach in Marks & Spencer is not likely to be sustained over the longer term.

Nonetheless this uncertainty should be explicitly removed¹⁰⁷ in order to eliminate any real or perceived obstacle to the smooth functioning of the Internal Market.

The push for a Common consolidated tax base

The continued push for a CCTB is clear evidence that the Commission does not believe the smooth functioning objective can be satisfied until this is achieved.

In October 2005 the Commission clarified that in the face of persistent opposition by some Member States¹⁰⁸ the CCBT could be brought in by way of enhanced co-operation under Article 43 (f) of the Treaty on the European Union (TEU) amongst those Member States accepting the CCBT.

This position was made clear by the EC Commissioner for Taxation and Customs Union when the Commission set out actions to encourage EU competitiveness.¹⁰⁹

The absence of an EU Constitution

At the debates on the draft European Constitution the convenors of that convention were focused on achieving the following objectives:¹¹⁰

- To maintain a credible system of checks and balances
- To maintain a system of “multi-level” or vertical constitutionalism
- To present a more visible and effective face to the external world
- To project a reasonably simpler and more coherent institutional design

It is worth considering the following comment from the President of the Convention, Valerie Giscard D'Estaing when at page 4 of the report he states that:-

“The Union's competencies have been clarified, categorized and stabilized and its range of legal instruments reduced in the interests of ...more effective action between the roles of the Union and of the Member States...the Convention is convinced that these reforms will substantially improve the Union's effectiveness” (emphasis added)

That the President of the Convention felt bound to offer such a frank assessment of what the new Constitution **would do** supports the author's contention that the EU's are not yet operating effectively in their pursuit of the smooth functioning objective.

State Aid and DTA's

Another example of a problem area not dealt with satisfactorily by the EU's is the case of the State aid provisions and their interaction with DTA's.¹¹² It is usually considered that aid must be imputable to the State and be financed through state resources (ie it must entail some form of financial burden).

The Commission has however taken the view that a loss of tax revenue is equivalent to the consumption of state resources in the form of fiscal expenditure.¹¹³

The prohibition of State aid is enshrined in Art. 87(1) of the ECT.¹¹⁴ The key words of Article 87(1) of the ECT are “aid granted by a Member State or through State resources”.

In this brief analysis we will consider the DTA between the United Kingdom¹¹⁵ and the United States of America.¹¹⁶ Article 23(1) of the UK/US DTA contains a limitation on benefits clause.¹¹⁷

Let us now consider the UK/US DTA where the exemption from dividend withholding taxes is granted by US tax authorities under Article 10(3) an excerpt of which is the following:-

“Notwithstanding the provisions of paragraph 2 of this Article, dividends shall not be taxed in the Contracting State of which the company paying the dividends is a resident if the beneficial owner of the dividends is a resident of the other Contracting State...”

The question that presents itself is whether or not the above article is in breach of the State aid provision contained in Article 87(1) of the ECT?

The case of Germany v the Commission provides an answer as it was held that “indirectly conferring” an aid on undertakings was an aid that fell foul of Art. 87(1) of the ECT. The Open Skies line of cases¹¹⁸ also provides clear support for the idea of indirect blameworthiness, albeit in the context of the fundamental freedoms.¹¹⁹

What is important for present purposes is that the ECJ found that the breach of Art 43 of the ECT consisted in the “granting by the UK” to the US a particular “right” under a treaty.

The ECJ held that “by concluding and applying” this agreement, it was the UK that had breached its Community obligations.¹²⁰

A direct comparison can therefore be made to the UK/US DTA.

By entering into a new tax treaty with the US¹²¹, the UK indirectly confers a benefit to these companies as opposed to UK resident companies owned by non-UK EU residents.¹²²

Thus under Community law an aggrieved party not able to benefit from the US/UK DTA could seek repayment of the illegal aid.¹²³

It is worth noting that pursuant to Article 96 of the ECT, the Commission and the Council are empowered to override the DTA.¹²⁴

However given that the article has raised, treaty override, damages and repayment of illegal aid merely confirms that the EU's have a long way to go to satisfy the

objective of “smooth functioning of the Internal Market” so far as ECT/DTA's are concerned.

An answer that has been mentioned as a possible solution to the above problem (from an EU perspective) is the conclusion of an EU model agreement and this will be considered below.

Calls for an EU Model Agreement

It has long been recognized that Community Law and DTA's do not operate efficiently with each other¹²⁵ (as indicated above in the case of State aid and DTA's) and that serious problems remain to be solved.

Pistone supports the author's contention in relation to State aid and the UK/US DTA conflict when he notes¹²⁵ that the “most relevant example of friction between tax treaties and Community law in this framework is ...the limitation on benefits clauses.”

Maisto¹²⁷ also calls for the drafting and implementation of an EC Model agreement as the most appropriate solution to clashes between EU law and tax treaties.

This fact is recognized also by the Commission when at page 14 of COM (2001) 582 the Commission specifically considers that “the most promising way forward is an EU version of the OECD Model Convention and commentary... which meet the specific requirements of EU membership. This would leave intact existing bilateral treaties”

The continued absence of an EU Model Agreement highlights the work that remains to be done in resolving these problems.

The calls by respected commentators for an EU Model support the view that the EUI's in the absence of such a methodology are not likely to achieve smooth functioning in the Internal Market in the field of direct taxation and DTA's.

Conclusion

European integration has delivered more than 50 years of stability, peace and economic growth.

It has significantly improved the quality of life of its citizens and it has built an Internal Market that has fostered the development of the EU's voice in world affairs.

It is sadly the case though that despite these many achievements the majority of Europeans “feel alienated from the Union's work ...and this feeling is not confined to the European Institutions”.¹²⁸

Such feelings apply to politics and political institutions the world over.

However in the EU the feelings of uncertainty and cultural tensions are palpably evident and these are affected by the collective inefficiencies of the EUI's.

In relation to the EUI's the Commission notes:-

“Many people do not know the difference between the Institutions. They do not understand who takes the decisions that affect them and do not feel the Institutions act as an effective channel for their views and concerns.”¹²⁹

This emphasizes the author's view that the EUI's, despite their intentions, are not operating effectively in pursuing the smooth functioning objective of the Internal Market.

That this may be the case due to some circumstances beyond their control is unfortunate but also irrelevant.

It is wholly within the power of the EUI's, most notably the European Parliament to bring about the required change through a variety of techniques¹³⁰ and this must be done before the Verona objective of “smooth functioning in the Internal Market” can be satisfied.

This article has identified a number of problems that exist in the field of direct taxation ranging from the unanimity requirement in taxation matters to the lack of an EU Constitution.

The continued existence of these problems will force the ECJ to continue being the “workhorse” for change and this is both costly and time consuming.

There is also another disadvantage in using the ECJ as an instrument of change.

Namely, ECJ decisions that create “uncertainty” also create negative tensions in the affected Member States and this can exacerbate smooth functioning problems both inside and outside the areas of direction taxation.¹³¹

It is the author's sincere hope that a real sense of EU identity will emerge and that this will lead to positive developments such as the adoption of QMV in tax matters, the development of an EU Model Agreement and belatedly an EU Constitution¹³².

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Reference notes

- 1 The ECONFIN is the Economic and Financial Affairs arm of the Council of the European Union.
- 2 Hereafter referred to as the Commission. The function of the Commission to be discussed further below is primarily to act for and uphold the mandates of the European Union.
- 3 The Internal Market was formed under the Treaty of Rome in 1957. Subsequent amendments to this treaty were made and in this article the term ECT is used instead of the long form European Community Treaty.
- 4 The EU Institutions primarily discussed are listed in the ECT and they include the European Parliament, the Council of the European Union, the European Commission and the European Court of Justice. In addition to this another EU institution is the European Council and this was formed under the Single European Act as discussed further below. This article will refer to these institutions collectively as EU's.
- 5 This article will not analyze all direct tax problems. Further reference though could be made to the report from the Commission concerning Company taxation in the Internal Market. SEC (2001) 1681 identified a number of obstacles some of which are beyond the direct taxation focus of this article.
- 6 Hereafter referred to as the ECJ.
- 7 A common consolidation tax base would allow multinational companies with subsidiaries and branches throughout the EU to calculate their tax base under a new set of common rules rather than under different national ones.
- 8 There is a general prohibition under the ECT on the provision of State aid which essentially is any aid granted by an EU Member State or through its resources which does or has to the potential to distort competition.
- 9 Hereafter referred to as DTAs.
- 10 This expression was first used amongst scholars several years ago, in particular see Vanistendael F., "The New Community Tax Order, in Common Market Law Review, 1994, p.293, to describe the dramatic change that European judges have caused to the existing Community law in the field of direct taxation since the mid 1980s by means of negative integration. Negative integration is the term used to describe the elimination of inter-state barriers for goods and factor flows without harmonization of economic institutions.
- 11 By way of background the following should be noted. The Treaty was first concluded in Rome, 25 March 1957, which established the European Community. It was amended by the Treaty on the European Union concluded in Maastricht on 7 February 1992 and entered into force on 1 November 1993. The Treaty was further amended by the Treaty on the European Union concluded in Amsterdam on 2 October 1997 and entered into force on 1 May 1999. The Treaty of Nice was adopted by the European Council and it made changes to the ECT not settled in Amsterdam. The ECT came into force on 1 February 2003. The ECT commences in Article 1 with the establishment by the contracting parties of a European Community. Article 2 then sets out the main tasks of the Community as including "establishing a common market and an economic and monetary union and by implementing common policies or activities..." This is significant as it can be seen that the Verona objective of 'smooth functioning of the Internal Market' is wholly consistent with this Article.
- 12 Were the terms not interchangeable I would find it difficult to conceive of a situation of the four freedoms having application in two legally distinct markets!
- 13 In this article these freedoms will be referred to as the fundamental freedoms.
- 14 The word 'smooth' is not used exist in the ECT. The word functioning though is used in Article 15.
- 15 It has been said that "Both the common market and the internal market aim at letting the market mechanism operate in the same way as in a domestic market so that the greatest possible economic advantage (efficiency, costs) is created" see Weber D, "Tax Avoidance and the EC Treaty Freedoms" Volume 11, Kluwer Law International London, 2005, p. 7
- 16 Article 15 of the ECT requires the Commission to take into account the extent of the effort that certain economies showing differences in development will have to sustain during the period of establishment of the internal market. Furthermore Article 14(3) of the ECT recognises "that Council acting on a qualified majority on a proposal from the Commission, shall determine the guidelines and the conditions necessary to ensure balanced progress in all the sectors concerned" (emphasis added).
- 17 It is worth noting that the Commission did in its landmark Communication of October 2001, COM (2001) 582 "Towards an Internal Market without tax obstacles" Brussels 23 October 2001, present a 'two track strategy' aimed at tackling tax-related inefficiencies and obstacles to cross border economic activity.
- 18 ECJ, Schumacker, in ECR, 1995 at I-225, para. 21.
- 19 At this point it is sufficient to note that EU law is implemented by way of the following techniques (1) Regulations – these are binding and are directly applicable in all Member States without the need for further legislation (2) Directives – these have direct effect on Member States and are binding but as stated in Article 249 of the ECT the national authorities shall decide on their choice of form and method in satisfying the directive (3) Decisions – pursuant to Article 249 a decision is binding to the State that it is addressed to, however it is not intended to have general application (4) Recommendations – have no binding force & (5) Opinions – have no binding force.
- 20 National courts of the Member States are obliged to interpret national law as far as possible in conformity with Community law. Furthermore if a national court finds that there is a conflict between Community law and a national provision, the court shall disregard the national provision. This is known as the doctrine of direct effect.
- 21 The ECJ declared this in 1964 in Case 6/64 Flaminio Costa v ENEL.
- 22 Although primary law is the axe of Community law, the allocation of powers between Member States and EU institutions was substantially affected in 1992 by the introduction of Article 3B (now Article 5 of the ECT) into primary EU law through the Treaty of Maastricht. While reaffirming in paragraph 1 of Article 5 that there is no general power at EU level, this Article strengthens Member States powers in its following paragraphs, by limiting EU action through the principles of subsidiarity and proportionality.
- 23 The primacy of EU law was stated by the ECJ since its first judgements. In this regard see NV Algemene Transport-en Expeditie Onderneming Van Gend & Loos/Staatssecretaris voor Financien in ECR, 1963.
- 24 The Community shall therefore only take legislative action if the objectives of the proposed action cannot be sufficiently achieved by Member States or by reason of the scale or effects of the proposed action, the Community can better achieve these objectives.
- 25 The ECJ has referred to the principle by applying the phrase "appropriate and necessary". Further reference can be made to Dahlberg, Matthias "Direct taxation in relation to the Freedom of Establishment and the Free Movement of Capital", Kluwer Law International, 2005 p. 30.
- 26 For example a national law in particular area may still need to be modified and amended to comply with EU law even though the Member State had the general power to legislate in that area. There are numerous examples of this including CFC legislation, transfer pricing legislation and the entry into tax treaties. An example of the conflict between ECT and a DTA will be considered below.
- 27 The Court of Auditors was set up in 1975. It is based in Luxembourg. The main task of the court is to check that the EU's revenue is properly collected and that those funds are spent legally, economically and for their intended purpose. This article will not discuss this EUI further due to its limited role in matters affecting direct taxation.
- 28 In addition to the above there exists the Economic and Social Committee, a Committee of Regions, the European Central Bank, a European Investment Bank and various other statutory creations such as the European Ombudsman, the European Data Protection Supervisor and the European Personnel Selection Office. While these other bodies and committees exist further focus on them will not be made in this article, though it is recognised however that they assist the above institutions in their efforts to achieve a smooth functioning of the Internal Market.
- 29 The origins of the European Parliament can be traced to the "The European Coal and Steel Community" (ECSC) which established a 'Common Assembly' in September, 1952. This was expanded in March 1958 to also cover the European Economic Community and the European Atomic Energy Community. The name European Parliamentary Assembly was adopted. The body was renamed to the European Parliament in 1962.
- 30 Its elections are held every 5 years and every EU citizen who is registered as a voter is entitled to vote.
- 31 The most common procedure for passing EU legislation is 'codecision'. In the codecision procedure, Parliament does not merely give its opinion it shares legislative power equally with the Council. If Council and Parliament cannot agree on a piece of proposed legislation, it is put before a conciliation committee, composed of equal numbers of Council and Parliament representatives. Once this committee has reached an agreement, the text is sent once again to Parliament and the Council so they can then adopt it as law. There are a number of standing committees that deal with legislative proposals. Article 99(4) of the ECT recognizes the roles of these committees. In particular this is confirmed by the following sentence in Article 99(4) "The President of the Council and the Commission shall report to the European Parliament on the results of multilateral surveillance. The President of the Council may be invited to appear before the competent committee of the European Parliament if the Council has made its recommendations public".
- 32 In the area of taxation unanimity within Council is required – see Article 190(5) of the ECT.
- 33 Article 192 of the ECT.
- 34 Parliament interviews each of them individually including the candidate for Commission President. Parliament then votes on whether to approve the Commission as a whole.
- 35 Parliament has the power to pass a motion of censure calling for the Commission's mass resignation. This is a powerful control mechanism. More generally though the Parliament exercises control by regularly examining reports sent to it from the Commission. Members of Parliament also regularly ask questions of the Commission which the Commissioners are legally obligated to answer pursuant to Article 197 of the ECT. While Parliament cannot question the European Council or implement sanctions against the Council of the European Union or the European Council it does have the power to investigate breaches of Community Law and maladministration.
- 36 See Article 232 of the ECT.
- 37 Parliament debates the annual budget in two successive readings, and the budget does not come into force until it has been signed by the President of the Parliament.
- 38 The Council of the European Union should be distinguished from the European Council, which meets four times a year in what is informally known as the 'European Summit' (EU summit), and is a closely related but separate body, made up with the heads of state and government of the member states, whose mission is to provide guidance and high level policy to the Council. It is also to be distinguished from the Council of Europe which is a completely separate international organisation, not an EU.
- 39 Hereafter referred to as the Council.
- 40 Similar to the Parliament the Council was established in the 1950's.
- 41 Which ministers attend which meeting depends on what subjects are on the agenda.
- 42 See Article 203 of the ECT which states that "The Council shall consist of a representative of each Member State at ministerial level, authorized to commit the government of that Member State."
- 43 Refer to Note 1.
- 44 Other responsibilities include to develop the EU's common foreign and security policy based on guidelines set by the European Council and to co-ordinate co-operation between the national courts and police forces in criminal matters.
- 45 See Article 205 of the ECT. Matters which may be decided by simple majority include a request to the Commission to undertake studies to achieve an ECT objective.
- 46 Hereafter referred to as QMV. Article 11(2) of the ECT is an example of QMV where the Council has the power to establish enhanced cooperation between Member States after consulting the European Parliament. A qualified majority is reached if a majority of Member States (in some cases a two thirds majority) approve and if a minimum of 232 votes is cast in favour which is 72.3% of the total. In addition a Member State may seek confirmation that the votes in favour represent at least 62% of the total population of the EU otherwise the decision will not be adopted. The voting system used for a given decision depends on the policy area to which that decision belongs.
- 47 Other areas include common foreign and security policy and asylum and immigration policy.
- 48 The Commission originated in the High Authority of the European Coal and Steel Community which was established in 1951 under the terms of the Treaty Establishing the European Coal and Steel Community. In 1958 two further bodies were established under the terms of the Treaties of Rome. These were the Commission of the European Economic Community and the Commission of the European Atomic Energy Community. In 1967, three bodies merged to form the Commission of the European Communities, established under the terms of the Merger Treaty and this is the body that continues to exist to this day.
- 49 It is also responsible for implementing the decisions of Parliament and the Council which in effect means managing the day to day business of the EU implementing its policies, running its programmes and spending its funds.
- 50 However most of the actual spending is done by national and local authorities. The Commission is responsible for supervising it under the Court of Auditors. Only if satisfied with the Court of Auditors annual report does the Parliament grant the Commission discharge for implementing the budget.
- 51 Article 226 of the ECT states "If the Commission considers that a Member State has failed to fulfil an obligation under this Treaty, it shall deliver a reasoned opinion on the matter after giving the State concerned the opportunity to submit its observations. If the Member State concerned does not comply with the opinion within the period laid down by the Commission, the latter may bring the matter before the Court of Justice".
- 52 It ensures for example that national courts do not give different rulings on the same issues. The purpose of the ECJ is stipulated in Article 230 of the ECT.
- 53 Dahlberg, Matthias "Direct taxation in relation to the Freedom of Establishment and the Free Movement of Capital", Kluwer Law International, 2005 p. 13. The legal method of the ECJ emphasises the purpose and objective of different community acts. One explanation for this is said to be the lack of clarity of these acts. In the area of direct taxation, the Court has in a number of cases interpreted the meaning of the fundamental freedoms contained in the ECT. Perhaps by its nature as a frame-work treaty, the ECT is a legal instrument containing broad and sometimes vague provisions and it is the objective of the ECJ to fill those provisions with content when deciding specific cases.
- 54 It came into being in 1974 and was given formal status by the Single European Act. Its members are assisted by the Ministers for Foreign Affairs and by a Member of the Commission.
- 55 It also serves as a forum for top-level political discussion in crisis situations and it endeavours to resolve disagreements between Member States.
- 56 In practice, the European Council meets at least four times a year, and special European Councils are also organised as circumstances demand. Since 2000, in accordance with the Lisbon strategy, the March Council addresses economic, social and environmental issues.
- 57 For its declarations to be put into effect, they must follow the routine procedure for Community legal instruments: proposals from the Commission voted on by the European Parliament and Council of the European Union, followed where necessary by implementation at a national level.
- 58 Bermann, George "The Institutions Under the New Draft Constitution", Article posted on the website of the University of Lisbon <http://www.fd.unl.pt/je/> p.3.
- 59 See page 5 of COM (2004) 22 where it is stated that "...the Internal Market is still not functioning as it should. There are too many obstacles which continue to hold it back. There are also policy areas, such as services, which have barely been touched by Internal Market Policy".
- 60 Hereafter referred to as a CCTB.
- 61 An infringement proceeding is the term given to describe a legal proceeding brought by the Commission against a Member State that the Commission considers to have breached the ECT.
- 62 That subsequently became the Treaty of Nice identified a number of suggested changes that needed to be made to the European Parliament, the Commission, the Council and the ECJ that subsequently were enacted.
- 63 These included measures to prevent discrimination and double

- taxation, simplification and modernisation of the existing Community rules on VAT and excise duties (a protocol annexed to the treaty could describe in more detail which questions this covers), the fight against tax fraud and evasion of the rules, environmental taxation and administrative cooperation between tax administrations.
- 64 No change was therefore made to Article 93 of the ECT (current legal basis for indirect taxation measures), Article 94 of the ECT (current legal basis for measures in the field of direct taxation) or Article 175(2)(a) of the ECT (legal basis for tax measures with an environmental objective).
- 65 Directives and regulations, the creation of a new body to co-ordinate tax issues in the framework of the Council and the greater use of "soft legislation" which the Communication notes may be "an additional means of making progress in the tax field".
- 66 The Lisbon strategy is an action and development plan for the European Union. It was set out by the European Council in March 2000.
- 67 Also to its credit is the fact that the Commission in its 2001 Communications on Tax Policy and on Company Taxation did set out a plan to deal with this problem by way of a proactive co-ordination of those features of Member States' tax systems that are or are likely to be in conflict with EU law.
- 68 C-324/00 Lankhorst-Hohorst GmbH v Finanzamt Steinfurt (2002) ECR I – 11779.
- 69 Gammie, M. "The compatibility of 'national tax principles of the Member States' with a fully integrated market" A paper presented at the European Association of Tax Law Professors Congress 2004, 3 June 2004 – 5 June 2004, Sorbonne, Paris. "It is the failure by Member States to agree in the past that has driven taxpayers increasingly to challenge that tax rules adopted by Member States. That is unlikely to stop, and the pressure on Member States created by the Court's decisions is unlikely to diminish.", p.29.
- 70 In fact that Communication also highlights the problems of the Commission and the Council not working together on "cross-border loss relief" as an example of an obstacle to the smooth functioning of the internal market that could not be efficiently dealt with after more than a decade and reference should be made to COM (2003) 726 p. 9.
- 71 Gammie, M "The compatibility of 'national tax principles of the Member States' with a fully integrated market" A paper presented at the European Association of Tax Law Professors Congress 2004, 3 June 2004 – 5 June 2004, Sorbonne, Paris page 29 "Discussion of QMV, however merely masks the true nature of the problem. The Treaty requires unanimity for VAT measures and yet a great deal more progress has been made in establishing common VAT rules than has been made in the direct tax field. The reality is that most people have a clear view of the basic elements of such general consumption taxes. None of these things are true of taxes on capital, including company taxes. There is no common understanding of the tax base, which is why there are 25 versions of company tax within the single market alone". (emphasis added)
- 72 In COM (2005) 702 The Commission states that "... this concept could be usefully tested by interested Member States and companies in an experimental pilot scheme" p.3.
- 73 Page 22 of COM (2001) 260.
- 74 ECJ, 13 December 2005, Case C – 446/03, Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes) – hereafter referred to in this article as Marks & Spencer.
- 75 Lang, Michael "Direct Taxation: Is the ECJ Heading in a New Direction?", European Taxation, September 2006, International Bureau of Fiscal Documentation p. 426.
- 76 ECJ, 18 September 2003, Case C – 168/01, Bosal Holding BV v Staatssecretaris van Financiën (2003) ECR – 9409; ECJ 11 March 2004 Case C- 9/02, Hughes de Lasteyrie du Saillant v Ministère de l'Economie, des Finances et de l'Industrie (2004) ECR I-2409;
- 77 Vanistendael, Frans "The ECJ at the Crossroads: Balancing Tax Sovereignty against the Imperatives of the Single Market", European Taxation, September 2006 International Bureau of Fiscal Documentation, p. 413
- 78 Prior to Marks & Spencer the ECJ was subject to strong criticism and even political threats to curtail its role in tax matters during the debate on the EU Constitution. In this regard see Luc Hinnekens, "European Court goes for robust tax principles for treaty freedoms, What about reasonable exceptions and balances?", Vol. 13 EC Tax Review (2004) pp 65-67, Cristina Garcia-Herrera and Pedro Herra, "Is tax fairness in Europe under Siege? Spanish law and anti-avoidance provisions" Vol. 13 EC Tax Review (2004-2) p 57-64 and Lang, Michael "Direct Taxation: Is the ECJ Heading in a New Direction?", European Taxation, September 2006 International Bureau of Fiscal Documentation page 421 "Commentators saw a link between Marks & Spencer and the proposition, expressed during the debates leading up to the EU Constitution, to prohibit the ECJ from drawing any tax related conclusions whatsoever from the provisions of the EC Treaty relating to the fundamental freedoms..."
- 79 These freedoms also apply to situations in which nationals or residents exercise their fundamental rights to pursue employment, provide services, invest capital or establish a business in another Member State.
- 80 The ECJ has accepted an infringement of a fundamental freedom on the basis of a justification ground specifically referred to in the ECT and on those that have been developed by the ECJ. Note that the grounds in the ECT are unhelpful with regard to tax matters.
- 81 Cohesion was accepted as a justification in Bachmann's case (ECJ, 28 January 1992, Case C – 2004/90). The ECJ accepted the justification of "the need to safeguard the cohesion of a tax system" as a compelling reason of general public interest. Since Bachmann's case however, the Member States have been quite unsuccessful in using this ground for justification.
- 82 Fiscal supervision is, in essence, collecting taxes on cross border transactions. A useful case for further reference of this justification is Case C – 250/95 Futura Participations SA and Singer v Administration des contributions.
- 83 ECJ, 15 July 2004, Case C – 315/02 Anneliese Lenz v Finanzlandesdirektion für Tirol (2004) ECR I – 7063; ECJ, 7 September 2004, Case C 319/02, Petri Manninen (2004) ECR I-7477; and ECJ, Advocate General Poiares Maduro's Opinion, 7 April 2005, Case C 446/03, Marks & Spencer plc v David Halsey (HM Inspector of Taxes) paras. 65-81.
- 84 The concept of cohesion has been extended by the ECJ as applying to cross border situations if a taxpayer moves from one Member State to another and has refused to consider the budgetary aspects of cohesion.
- 85 For example, the avoidance of double economic taxation in ECJ, 7 September 2004, Case C – 319/02 Petri Manninen (2004) ECR I – 7477, paras. 46 and 48.
- 86 ECJ, 12 December 2002, Case C -324/00 Lankhorst-Hohorst GmbH v Finanzamt Steinfurt (2002) ECR I – 11179 and more recently, ECJ, Advocate General Leger's Opinion, 2 May 2006 , Case C- 196/04, Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, paras. 87 and 88: "the use of that formula, the language of which reproduces that of the doctrine of 'abuse or rights', may be understood as intended to prevent the counteraction of tax avoidance from being used as a pretext for protectionism. Application of Community law may be refused only when the company in question relies on it abusively because it has set up an artificial arrangement in order to avoid tax".
- 87 Hence restrictions and discriminations are decided not only on the basis of the effect of the rules in a single separate tax system but also on that of the interaction of both the residence and the source Member State tax systems.
- 88 Lang, Michael "Direct Taxation: Is the ECJ Heading in a New Direction?", European Taxation, September 2006 International Bureau of Fiscal Documentation page 421 states that "Numerous experts had anticipated that the ECJ would require the UK to allow group relief for cross-border situations in exactly the same way that group relief is applied domestically, without any 'ifs or buts'".
- 89 The ECJ held that foreign subsidiary losses could be offset against the UK parent company's income once all possibility of loss recovery had been exhausted in the source Member State.
- 90 ECJ , 13 December 2005, Case 446/03 Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes) para. 51.
- 91 The argument of proportionality referred to at note 25 was defined in Gebhard, Case C – 55/94.
- 92 It is noteworthy that the concept of fiscal cohesion was not raised in Marks & Spencer decision.
- 93 Lang, Michael "Direct Taxation: Is the ECJ Heading in a New Direction?", European Taxation, September 2006 International Bureau of Fiscal Documentation, p. 430.
- 94 See the Opinion of Advocate General Poiares Maduro delivered on 7 April 2005, Case C – 446/03 Marks & Spencer plc v David Halsey (HM Inspector of Taxes).
- 95 At para 49 of the judgment the ECJ stated that "the possibility of transferring the losses incurred by a non-resident company to a resident company entails the risk that within a group of companies losses will be transferred to companies established in the Member States which apply the highest rate of taxation and in which the tax value of the losses is therefore the highest"
- 96 Vanistendael, Frans "The ECJ at the Crossroads: Balancing Tax Sovereignty against the Imperatives of the Single Market", European Taxation, September 2006 International Bureau of Fiscal Documentation, p.417.
97. As above.
- 98 ECJ, Advocate General Geelhoed's Opinion, 23 February 2006, Case C – 374/04, Test Claimants in Class IV of the ACT Group Litigation (Pirelli, Essilor and Sony), Test Claimants in Class IV of the ACT Group Litigation (BMW) v Commissioners of Inland Revenue and ECJ, Advocate General Geelhoed's Opinion, 6 April 2006, Case C – 446/04, Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue.
- 99 ECJ, Advocate General Gellehoed's Opinion, 23 February 2006, Case – 374/04, Test Claimants in Class IV of the ACT Group Litigation (Pirelli, Essilor and Sony), Test Claimants in Class IV of the ACT Group Litigation (BMW) v Commissioners of Inland Revenue, Para. 63.
- 100 Certainly if the view espoused by Advocate General Geelhoed is an indication of things to come it would completely reverse the trend towards the integration of domestic tax systems that had been started by the ECJ.
- 101 Lang, Michael "Direct Taxation: Is the ECJ Heading in a New Direction?", European Taxation, September 2006 International Bureau of Fiscal Documentation, p. 430.
- 102 ECJ, Advocate General Leger's Opinion, 2 May 2006, Case C – 196/04, Cadbury Schweppes plc, Cadbury Schweppes Overseas Limited v Commissioners of Inland Revenue, paras. 112 - 114
- 103 The fact that post Marks & Spencer this Advocate General adopts a "pre-Marks & Spencer" concept of tax avoidance does lead one to suspect that the interpretation of tax avoidance in the Marks & Spencer case was an aberration.
- 104 ECJ, 12 September 2006, Case C – 196/04, Cadbury Schweppes plc, Cadbury Schweppes Overseas Limited v Commissioners of Inland Revenue.
- 105 ECJ, Advocate General Poiares Maduro's Opinion, 31 May 2006, Case C -347/04, Rewe Zentralfinanz e Gals Gesamtrechtsnachfolgerin der ITS Reisen GmbH v Finanzamt KolMitte, Para 36 et seq.
- 106 This view also has the support of form ECJ judge Wathelet and reference can be made to his article "Marks & Spencer plc v Halsey: lessons to be drawn", British Tax Review 2 (2006).
- 107 Ideally by the ECJ in express terms in future judgments or via some other mechanism.
- 108 Currently those opposing the CCBT are the Czech Republic, Estonia, Ireland, the Slovak Republic and the United Kingdom.
- 109 See European Commission Press Release IP/05/1352. See also COM (2005) 532 final, "The Contribution of Taxation and Customs Policies to the Lisbon Strategy" of 25 October 2005, p5 in which the Commission states its intention to present a Community legislative measure by 2008.
- 110 Bermann, George "The Institutions Under the New Draft Constitution" Article posted on the website of the University of Lisbon <http://www.fd.unl.pt/jel/>.
- 111 CONV 851/03 "Report from the Presidency of the Convention to the President of the European Council" Brussels, 18 July 2003.
- 112 Note the article will not consider the incompatibility with the fundamental freedoms but rather the fact that an LOB clause can be said to contradict the prohibition against State aid.
- 113 Commission Notice on the application of the State aid rules to measures relating to direct business taxation, OJ 1998 384/3, Sec 10b.
- 114 Article 87(1) of the ECT states the following "Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market".
- 115 The United Kingdom will be referred to as the UK. The United States of America will be referred to as the US.
- 116 On 24 July 2001 a new tax treaty was signed between the United Kingdom and the United States. The treaty was ratified by the UK parliament and it entered into force on 31 March 2003. It will be referred to as the UK/US DTA.
- 117 The clause states: "Except as otherwise provided in this Article, a resident of a Contracting State that derives income, profits or gains from the other Contracting State shall be entitled to all the benefits of this Convention otherwise accorded to residents of a Contracting State only if such resident is a "qualified person" as defined in paragraph 2 of this Article and satisfies any other specified conditions for the obtaining of such benefits."
- 118 Cases C – 466/98, Commission v UK; C-467/98 Commission v Denmark; C- 468/98, Commission v Finland; C-471/98, Commission v Belgium; C – 472/98, Commission v Luxembourg; C – 475/98, Commission v Austria; C – 476/98 Commission v Germany.
- 119 That case concerned air transport and in particular bilateral agreements between the US and several EU countries.
- 120 Id., para 52.
- 121 Whereby the treaty applies no withholding tax on the dividends flowing only to UK resident companies that are owned by UK residents.
- 122 While the direct benefit might, actually be conferred by the US tax authorities, it is the UK that has entered the agreement and would be responsible from the perspective of the ECJ. See the article by Panay, Christiana HJI, "Limitation on Benefits and State Aid" Feb/March 2004 European Tax Bulletin 2004 International Bureau of Fiscal Documentation p 90.
- 123 It may be the case the an individual could alternatively sue a Member State for damages due to the infringement of EU law.
- 124 This is permitted in order to eliminate distortions of competition occurring through provisions laid down by law, regulation or administrative action in Member States.
- 125 Pistone notes "Community law and the law of tax treaties in the field of direct taxation no longer operate in completely separate spheres but rather share the regulation of issues of common relevance and thus may be in conflict with each other...it is now time to ascertain whether principles long regulating international tax law are compatible with Community law." Pistone, Pasquale "The Impact of Community Law on Tax Treaties, Issues and Solutions", Kluwer Law International, 2002, p.1.
- 126 Id., para 7.
- 127 Maisto, Guglielmo "Shaping EU Company Tax Policy: The EU Model Tax Treaty" European Taxation, August 2002 International Bureau of Fiscal Documentation p. 304 "the Commission advocated an EU version of the OECD Model...[and] the action proposed by the Commission should be supported."
- 128 COM (2001) 428 p 7.
- 129 Id p.7.
- 130 These include – workshops, discussion forums and Member State level, conventions and referendums and lobbying at all levels, print and media campaigns until the message of change is accepted EU wide.
- 131 The Irish "no" was said to be a result of the impact of a number of problems including the complex systems of the EU's and the way they operate. The Commission was disappointed by the quality of the Irish debate on the EU constitution and the low voter turnout.
- 132 It is noted that in June 2006 the EU leaders decided to extend until 2008 the "period of reflection" that was started after the Dutch and French rejection of the draft Constitutional Treaty. It is expected that the German Presidency of the EU (starting from 1 January 2007) will try to pick up the pieces and prepare a salvaging operation for the EU Constitution, which could then be put into operation during the French EU presidency.