THE CJEU'S APPROACH TO MATTERS OF DIRECT TAXATION: A CRITICAL ANALYSIS

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ABSTRACT

Historically, the Court of Justice of the European Union has been eager to strike down any obstacle to trade which might compromise the fundamental freedoms and hinder progression towards the ultimate goal of the Union; the creation of a Single Market. One obstacle which the Court is not permitted to strike down per se is the Direct Taxation law of a Member State. If such direct taxes however are discriminatory in nature, then the jurisdiction of the Court will be engaged. The article outlines the competency of the CJEU in this matter and also the merits of taking such an approach. Nonetheless, it will be demonstrated that the CJEU's approach to such matters has left much to be desired, although recent case-law suggests the court may finally be progressing toward a more coherent approach.

A INTRODUCTION: THE NEED TO BREAK DOWN BARRIERS

At the time of writing, the European Union is in the midst of a 'Eurozone' debt crisis of unprecedented proportions. The Member States are faced with two options. One possible eventuality envisages the demise of the Union, with each State shouldering the burden of its own national debt. As the various EU treaties did not foresee such an eventuality, there is thusly no simple method of exiting the fiscal union which took so many years of preparatory work to formulate. Moreover, the split would have disastrous consequences for the world economy if the teetering countries such as Greece, Ireland, Italy, Portugal and Spain enter bankruptcy.[1] The alternative is to further integrate European Economic markets in pursuit of the ultimate goal of the EU, namely, the establishment of a single integrated market.[2]

One of the most prominent obstacles to such integration to date, and the creation of a single market, is that of national direct taxation measures, an area in which Member States are

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[1] Jordan Weissmann, 'Eurogeddon A Worst Case Scenario Handbook for the European Debt Crisis' (*The Atlantic* 12 June 2012) <http://www.theatlantic.com/business/archive/2012/06/eurogeddon-a-worst-case-scenario-handbook-for-the-european-debt-crisis/258368/> accessed 19 February 2013.

[2] For support of this argument and an interesting analysis of the causes of the European crisis, See Matthias Matthijs and Mark Blyth, 'Why Only Germany Can Fix the Euro' (*Foreign Affairs* 17 November 2011) <http://relooney.fatcow.com/0_New_12120.pdf> accessed 19 February 2013. The article by Mark Blyth and Matthias Matthijs quotes Kindleberger's *The World in Depression 1929-1939.* The article goes on to list four other primary reasons for the collapse of the European economy-failure to provide countercyclical long-term lending, stable exchange rates, macroeconomic policy coordination, and real lending of last resort during financial crises. Solving these problems are said to result in the strengthening of the European economy.

thought to have retained competency.[3] The Court of Justice of the European Union (hereinafter *'CJEU'*), in its case-law however, has sought to minimise the effect of this constraint by successfully invoking the principle of prohibition of discrimination in direct taxation. As Professor Pistone has noted:

> 'We all know that the CJEU is trying hard to remove cross-border direct tax obstacles, whenever they arise and whatever price we may have to pay in terms of the structure and consistency of our national tax systems.'[4]

This article seeks to critically investigate the CJEU's approach to the principle of non-discrimination in EU Taxation Law. The analysis will demonstrate that the jurisprudence has been primarily characterised by inconsistency, uncertainty and unpredictability. Whilst deconstruction of the tax systems of Member States, through invocation of the principle, in itself is unpalatable, the resulting haphazard, inconsistent and piecemeal development of the jurisprudence on Direct Taxation is completely unacceptable.

B THE COMPETENCY OF THE CJEU IN ADJUDICATING MATTERS OF DIRECT TAXATION

We must first briefly assess a preliminary issue, namely, the competency of the CJEU to adjudicate matters of Direct Taxation.

Weatherill and Beaumont observed that 'the heart of the Community is the pursuit of economic integration. Accordingly, the heart of the substantive law of the EC treaty is the range of provisions that prohibit the erection or maintenance of barriers to trade between member states'.[5]In order for such 'economic integration' to be achieved, the institutions of the community are empowered to remove obstacles to trade.[6] Against this, one area in which the Member States are thought to have retained competence is in the area of direct tax,[7] given that taxation obstructs trade by its very nature. The CJEU has, however, 'frequently held that

[3] Discussed below.
[4]Pasquale Pistone, 'European direct tax law: quo vadis?' in Michael Lang and Frans Vanistendael*Accounting and Taxation & Assessment of ECJ Case Law* (IBFD Publications BV 2008).
[5] Stephen Weatherill and Paul Beaumont, *EC Law* (2nd edn, Penguin 1995) 30.
[6] See Further*:* Paul Craig and Grainne De Burca, *EU Law:Cases, Texts and Materials,* (5th edn, OUP 2011); Catherine Barnard, *The Substantive law of the EU: The Fundamental Freedoms,* (3rd edn, OUP 2010).
[7] Christiana HJI Panayi, 'Reverse subsidiarity and EU Tax Law: can Member States be left to their own devices?' [2010] BTR 267, 267.

the powers retained by the Member States must be exercised consistently with Union[8] Law'[9] which is superior to the national law of Member States as a result of the landmark cases of Van Gend en Loos[10] and Costa.[11] Although Member States have retained sovereignty in relation to Direct Tax matters, the power must not be exercised in a manner contrary to the principles of Community Law, in which case taxation would become analogous to an obstacle to 'economic integration'. Thus, this article critically evaluates one such principle, namely, the principle of prohibition of discrimination in direct taxation matters.

C DEVELOPMENT OF THE PRINCIPLE OF PROHIBITION OF DISCRIMINATION IN DIRECT TAXATION

The basic non-discrimination principle of EU law is that EU non-nationals and non-resident EU companies have to be treated in the host Member State in the same manner as nationals and companies of that state.[12] Different treatment of domestic source income and income sourced in another Member State or, in general, different tax treatment of the cross-border situation as compared to the similar domestic situation is in principle prohibited.[13] Metzler[14] concisely summarises the test which the CJEU employs in order to ascertain whether national tax provisions are discriminatory. First, it determines whether or not two situations are comparable.[15] Thereafter, it determines whether the different rules apply to comparable situations or the same rules apply to different situations.

[8] Although Dr Panayi refers to 'Community Law', parlance amongst writers today is to refer to Union Law given that the once separate entities of EU and the EC have now been amalgamated under the one heading, namely, European Union Law. For a concise summary of this development, see Jones & Sufrin, *EU Competition Law* (4th edn, OUP 2011) 94-95.
[9] Panayi (n 7) 267.
[10] *NV Algemene Transporten Expeditie Onderneming van Gend en Loos v Nederlandse Administratis der Belastingen* Case 26/62 [1963] ECR 1.
[11] *Flaminio Costa v ENEL* Case 6/64 [1964] ECR 585. Thus any provision of Member States Law which is found to be contrary to Community Law becomes inapplicable. For further reading on concepts such as 'Supremacy', 'Direct Effect', 'Indirect Effect' and 'State Liability' see (n 7).
[12] Vanessa E Metzler, 'The Relevance of Fundamental Freedoms for Direct Taxation', in M Lang, P Pistone, J Schuch and C Staringer (eds), *Introduction to European Tax Law: Direct Taxation* (Spiramus, Biddles 2008) 44.
[13] Ben Terra and Peter Wattel, *Fiscale Handboeken : European Tax Law* (Kluwer Law International, The Hague, 2008) 717-718. The authors also note that measures rendering cross border activity excessively difficult without justification are also prohibited, citing Case C 415/93 *VZW Koninklijke Belgische Voetbalbond and others v. Jean-Marc Bosman* [1995] ECR I-4921 as evidence that even CFC rules, thin capitalisation rules, transfer pricing documentation requirements, exclusion of cross-border loss relief, and in general all national tax base conservation measures are suspect, even if they are applied indiscriminately in comparable situations.
[14] Metzler (n 12) 44.
[15] ibid.

Discrimination in both the former and latter scenario[16] results in a breach of Community Law as it infringes the Fundamental Freedoms. According to Meltzer, the classical pair of comparison is that of a person who exercises its freedoms compared to a person who remains in the home state. In other words, the factual cross border situation is compared with the hypothetical situation of a taxpayer who remains in the home state.[17] This is in spite of the fact that the resident and non-resident are not, *prima facie*, in comparable situations.[18] Under this heading, the Court also compares the situation of a permanent establishment and a home state company.[19] Further, the court has established that residents and non residents are entitled to the same personal and family deductions.[20] Meltzer cites several other headings under which the CJEU has interpreted the situations as being comparable.[21] The heading of cross-border situations comprises comparisons between cross border situations with national situations and also comparisons between two cross border situations.[22] Should a national tax provision be held to fall foul of this test, it may be justified,[23] but such justification is subject to the principle of proportionality.[24]

The proceeding passage of this article will seek to highlight several areas in which commentators are highly critical of the CJEU's application of the principle. As alluded to above, it will be argued that the application has been inconsistent, unpredictable and uncertain.

[16]*Kerckhaert-Morres* [2006] ECR I-10967 [hereinafter *'Kerckhaert'*].
[17]Metzler (n 12) 45.
[18]ibid 46.
[19]ibid 47.
[20]*Schumacker* [1995] ECR I-225.
[21]Metzler (n 12) 49-52.
[22] ibid.
[23] See below for the discussion on justification. As Joachim English notes, the CJEU is generally reluctant to allow Member States to have resort to *discriminatory* measures in order to counteract beneficial aspects originating in the tax system of another Member State, even if such tax benefits can arguably be qualified as unfair cf *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* (C-196/04) [2006] ECR I-7995 (J. English 'HMRC v Philips Electronics UK Ltd: another contribution to EU law jurisprudence on loss relief' [2012] BTR 586 (n 73).) See also DMMA Arens-Sikken v Staatssecretaris van Financiën (C-43/07) [2008] ECR I-6887 [66]; Amurta SGPS v Inspecteur van de Belastingdienst/Amsterdam (C-379/05) [2007] ECR I-9569; [2008] STC 2851 (Amurta) [78] et seq.; Hans Eckelkamp and Others v Belgian State (C-11/07) [2008] ECR I-6845 [69].
[24] See below for the discussion on the principle proportionality.

D CRITICAL DISCUSSION OF THE CJEU'S APPLICATION OF THE PRINCIPLE OF NON-DISCRIMINATION

1 The Shift in Terminology

Commentators have noted that there has been a marked transition in the terminology used in relation to Direct Tax cases. Snell[25] notes that the Court has started to use language which mirrors its terminology used in the field of regulatory barriers to free movements. Early cases of the CJEU in tax matters were decided on the basis of the discrimination test outlined above. In *Bachmann*,[26] the CJEU held that the difference in treatment of tax deductions for insurance premiums constituted unlawful discrimination between nationals and non-nationals. However, the court later abandoned the language of discrimination in direct tax case law, first seen in *Futura Participations.*[27] The full court stated that Luxembourg's rule on accounts amounted to a 'restriction'[28] and was prohibited 'as it specifically affected companies having their seat in another Member State'.[29] The same 'restrictions' terminology was also utilised in *Safir*[30] and *Verkooijen.*[31]

Snell argues, however, that there is no actual shift in judicial thinking; that the test is still one based on discrimination and that substantive obstacle-based analysis has not been engaged with in relation to Direct Taxation by the CJEU. Whilst the terminology employed is the same as that language used in the obstacle-orientated jurisprudence developed in a regulatory context, Snell contends the reality is that judicial thought continues in its more restrictive discrimination based approach.[32] He states[33] that there have been cases where the Court has allowed national tax rules to stand in the absence of discrimination without examining whether they might constitute a barrier.[34]

In spite of Snell's attestations, this author opines that there is an argument to be made that the shift is more than merely apparent and has in reality led to inconsistency in the case-law. In

[25] Jukka Snell, 'Non discriminatory tax obstacles in Community Law' (2007) ICLQ 339, 349.
[26] Case C-204/90, *Bachmann v. Belgium* [hereinafter '*Bachmann*'].
[27]Case C-250/95 *Futura Productions* [1997] ECR I-12471. [hereinafter '*Futura Productions*'].
[28]ibid [24].
[29]ibid [26].
[30]Case C-118/96 *Safir* [1998] ECR I-1897.
[31] Case C-35/98 *Verkooijen* [2000] ECR I-4071 [hereinafter '*Verkooijen*'].
[32]Snell (n 25) 350.
[33] ibid.
[34] ibid.

Bosal,[35] the court found a breach of Article 49 TFEU due to its assessment that a Dutch tax rule 'might dissuade a parent company from carrying on its activities in another Member State'.[36] According to Barnard,[37] State Treasuries expressed grave concern about the implication of the Court's 'restrictions' analysis as the case cost the Dutch Treasuries millions. Such aresult renders it difficult to concur entirely with Snell's assertion that the shift has been merely cosmetic.

The shift therefore is worrying for Member States as it purports to import into EU Law a much lower barrier for what kind of tax measure will be constituted as an infringement of the Treaties. Given that virtually all national tax provisions would constitute an 'obstacle' under the restrictions analysis, it is argued that this shift may be a source of further confusion for Member States. The initial confusion, as Panayi notes, is a direct result of 'Reverse Subsidiarity'; 'a situation whereby, in exercising their technically exclusive powers, Member States find themselves significantly constrained by EU Law'.[38]

In brief, the shift in judicial thinking, whether actual or cosmetic, leads to a situation wherein Member States are uncertain as to the balance between their sovereignty in Direct Tax Matters and the competency of CJEU.

2 Instances of Inconsistency, Unpredictability and Uncertainty

First; Panayi[39] argues that there has been a 'patchwork' application by the CJEU of the non-discrimination principle which has led to inequality of treatment between Member States. Following the judgment of the CJEU in *Marks & Spencers,*[40]the UK was required to amend its existing legislation in order to grant relief for terminal losses. However, countries such as Finland or the Netherlands are not required to include such losses as a result of their fiscal

[35]*Bosal Holding BV v. Staatsecretaris vanFinancien* [2003] ECR I-9409.
[36] ibid.
[37] Catherine Barnard 'Restricting restrictions: lessons for the EU from the US?' (2009) 68(3) CLJ 575, 600.
[38]Panayi (n 7) 267.
[39]ibid 300.
[40]*Marks& Spencers plc v. Halsey (Inspector of Taxes*) (C-446/03) [2005] ECR I-10837.

unity regime.[41] In this instance, inconsistent application of the non-discrimination principle[42] has clearly led to inequality between states.[43]

Second; whilst Snell might not acknowledge an actual shift in judicial thinking, the learned professor does accept that there has been an unacceptable level of unpredictability and uncertainty in the case-law in relation to three main defences[44] put forward by Member States to justify discriminatory direct tax provisions: *Reciprocity, Territoriality* and *Fiscal Competence*. The acceptance of such defences in Taxation Law stands in direct contrast to their dismissal in other matters of EU Law.

The *Reciprocity* argument, that mutual exchange of privileges between Member States are permissible in the absence of conflict with Union Law, pivots on the basis that privileges are not discriminatory against non-residents of one country but rather are advantageous for non-residents of another country.[45] Such reciprocal, preferable treatment has been accepted in *D*[46]as being distinguished from discrimination.[47] Tax allowances for Dutch residents were extended to Belgians by virtue of a bilateral tax convention. The court rejected the argument that the resulting difference in treatment between Belgian and German residents amounted to discrimination. The Court stated that 'reciprocal rights and obligations apply only to persons resident in one of the two contracting Member States as an inherent consequence of bilateral taxation conventions'.[48] This treatment of the reciprocity argument stands in direct contrast with the judgment in *Matteucci,*[49] notwithstanding the fact that the case concerned a bilateral cultural agreement rather than a tax treaty. The court there held that the bilateral agreement cannot preclude the application of Community rules on equal treatment. Snell argues that the contrast displays a shift in emphasis towards a more favourable treatment of reciprocity in

[41]*X Holding C-337/08*. The Netherlands allows liquidation losses of domestic and foreign subsidiaries to be surrendered to the Dutch parent company.
[42] In applying to one country but not to another in the same scenario.
[43]Panayi (n 7) 300. Panayi further states that the situation is exacerbated by the fact that in some countries, tax payers and national courts are more familiar with EU Law than in other countries. Legislation in these countries gets struck down or removed more frequently. The author then asks the question whether this means that some Member States are penalised for their pro-activeness and ultimate commitment to the EU whereas others are indirectly rewarded for their inactivity, intransigence and potential illegality.
[44]Snell (n 25) 350.
[45] As per Advocate-General Ruiz-Jarabo, [101], the argument will be accepted subject to the satisfaction of two criteria. First, in setting in those agreements the criteria for allocating competence in taxation matters, the Member States must act with the utmost care, avoiding any provisions which might hinder that objective (of establishing the single market). Second, the right to equal treatment stands alone and is independent from the principle of reciprocity and therefore, in the event of a conflict, it takes precedence over mutual commitments.
[46]Case C-376/03 *D* [2005] ECR I-5821.
[47]The ruling in Case C-374/04 *ACT Group Litigation* [2006] ECR I-0000 *confirmed the judgment.*
[48]D case (n 46) [61].
[49] Case 235/87 *Matteucci* [1988] ECR 5589.

bilateral tax conventions. Professor Van Thiel is even more equivocal[50] in his criticism of this inconsistency in the law,[51] citing the considerable potential for distortion of the optimal allocation of resources on the European internal market. The learned Professor submits that such distortion flows from allowing a different tax treatment by one host Member State of two identical incoming capital flows from two different home Member States, on the sole ground that it is treaty-based.[52]

Snell provides further examples of this unpredictability and uncertainty in relation to the treatment of the principle of *Territoriality*. This principle states generally that each state taxes only such income of a non-resident that has a connection with its territory.[53] In other words, a taxpayer participating in economic intercourse in the domestic territory is only taxed on his profits and losses generated in the domestic territory.[54] Snell convincingly contrasts the favourable treatment in *Futura Participations* of the territoriality principle in a fiscal context with that of the treatment of the same principle in *Musik,*[55] albeit in a regulatory context.[56]

Finally, Snell further demonstrates inconsistency in the jurisprudence by citing the principle of *Fiscal Competence*. This argument centres on the premise that, in the absence of EU harmonising measures, Member States are competent to determine criteria for taxation with a view to eliminating double taxation by way of, *inter alia*, bi-lateral agreements.[57] In *Gilly,*[58] the court drew a distinction between the allocation and exercise of fiscal competence. It was thereafter held that the use of national criterion in the allocation of *Fiscal Competence* did not amount to unlawful discrimination on the grounds of nationality. Such an argument however was expressly rejected in the regulatory context in *Van Hilten.*[59]

Snell's analysis displays instances where discrimination is distinguished in Direct Tax matters but is categorically rejected in the regulatory context. Accordingly, it is quite logical for Snell to conclude that this differing treatment of the same arguments has led to an

[50] See also: Axel Cordewener and Ekkehart Reimer, 'The future of most-favoured-nation treatment in EC tax law--Did the ECJ pull the emergency break without real need?--Part 2' (2006) 46 ET 291.
[51] Servaas van Thiel, 'A slip of the European Court in the D case (C-376/03): denial of the most favoured-nation treatment because of absence of similarity?' (2005) 33 Intertax 454, 455-7.
[52] ibid.
[53] Marjaana Helminen, *EU Tax Law – Direct Taxation* (2nd edn, Amsterdam: IBFD 2011) 134.
[54] Andreas Geiger and Thorsten Fischer 'The clash of EU law and national direct tax laws – example: Germany' (2005) ICCLR 328, 333.
[55] Joined cases 55 and 57/80 *Musik-Vertrieb Membran* [1981] ECR 147.
[56] Snell (n 25) 352.
[57] Gilly (n 58) 609-610.
[58] Case C-336/96 *Gilly* [1998] ECR I-2793.
[59] Case C-513/03 *Van Hilten-van der Heijden* [2006] ECR I-1957.

unacceptable level of unpredictability and uncertainty. The critical importance of such matters in tax law gives extra weight to this argument. As Advocate General Geelhoed has noted, 'predictability and certainty are crucial'[60] in tax law as Member States need to be able to plan their budgets and design their tax systems on the basis of relatively reliable revenue predictions.

The justification by way of the *Fiscal Cohesion* argument is often cited[61] as another instance of inconsistency in the application by the CJEU of the non-discrimination principle. This concept concerns cohesion between tax base reductions (or unrealised gains) and corresponding base increases (or realisation, respectively) within the same taxing jurisdiction.[62] In *Bachmann*, a German national, employed in Belgium, was not allowed to deduct contributions paid in Germany for various insurance and assurance policies from his total occupational income. Such contributions paid in Belgium were deductible. The Court accepted the inherent discrimination could be justified by the cohesion of the Belgian national tax system. The dismissal of the *fiscal cohesion* argument in the subsequent cases of *Baars*[63] and *Verkooijien*[64]led academics such as Snell to conclude that the defence had been rendered largely redundant. Advocates General Kokott,[65] Polares Maduro[66] and Stix Hackl[67] moreover had called for its rehabilitation. It has been assumed that this justification had essentially been distinguished out of existence on the basis that there must be a direct link between the deductibility of contributions and the liability to tax payments.[68]

It must be noted that a justification for a discriminatory taxation measure will only be accepted if it does not go beyond what is necessary to achieve its purpose and aim.[69] An example of the application of this principle of *proportionality* can be found in *Futura Participations,* [70] the court accepted Luxembourg's justification on the basis of Fiscal Supervision. However, it was held that it would be disproportionate to ask the French company involved to keep separate records. The main criticism of the proportionality

[60] Case C-374/04 *ACT Group Litigation* [2006] ECR I-0000 [hereinafter '*ACT Group Litigation*'].
[61] Mattias Dahlberg, *Direct Taxation in Relation to the Freedom of Establishment and the Free Movement of Capital,* (Kluwer Law International, The Hague 2005) 119-124.
[62]Terra and Wattel (n 13) 761.
[63]Case C-251/98 *Baars* [2000] ECR I-2787.
[64] See also, Cases C-80/94 (Wielockx), C-168/01 (Bosal Holding).
[65] Case C-319/02 *Mannimen* [2004]ECR I-7477.
[66]Case C-446/03 *Marks and Spencer* [2005] ECR I-10837.
[67]Case C-150/04 *Commission v Denmark* [2006] ECR I-6435.
[68]Metzler (n 12) 54.
[69]ibid 64.
[70] See also Case C-436/00 *X and Y* [2002] ECR I-10829 [49].

principle generally lies in its subjectivity. What may seem proportionate to one judge may be disproportionate to another judge. Dr. Gerard Hogan[71] cites several cases[72] which demonstrate the inconsistent application of the principle, sometimes even in relation to the same case, resulting in wildly differing conclusions.

3 Recent Trends

Recent case-law however suggests that the CJEU may finally have found a coherent course of action in relation to *justifications* and is now less systematic in dismissing the defences of Member States, at least in relation to the manner in which the CJEU now deals with the *Taxing Power* defence of Member States. This pivots on the need to preserve the allocation of powers of taxation between Member States. A Member State's power of taxation is impaired if losses incurred within the scope of the exclusive power of taxation of another Member State are required to be taken into account.[73]

The initial inconsistency in the law stems from the fallout of the *Marks* case.[74] As noted by Advocate General Kokott, the name Marks & Spencer had been interpreted as being 'synonymous with chaos and despair'.[75] This 'chaos and despair' flowed from the CJEU's discussion of the *Taxing Power* justification. The Court here found that there was a restriction on the Freedom of Establishment, running contrary to the principle against discrimination.[76] Following the finding, the CJEU argued that the restriction could be justified on the basis of three grounds,[77] taken together:[78] First, the need to preserve the allocation of taxing rights between Member States;[79] Second, the need to prevent the relief of losses in both the

[71]Gerald Hogan 'The Constitution, Property Rights and Proportionality' (1997) 32(1) JUR 373, 390-392.
[72]*Air Canada v. United Kingdom* (1995) 20 EHRR 150 and *Bhosphorus Hava Yollari Turizm Ve Tickaret Anonim Sirekti v. Minister for Transport* [1994] 2 ILRM 551.
[73]Case C-18/11 *HMRC v. Philips Electronics U.K. Ltd* [2012] ECR I-0000 (hereinafter *'Philips Electronics')* [50] (Kokott AG).
[74]*Marks & Spencer plc v Halsey (Inspector of Taxes)* (C-446/03) [2005] ECR I-10837 (hereinafter *'Marks'*).
[75]C-123/11, *A Oy* (judgment pending, Opinion of the Advocate General Kokott of 19 July 2012) (hereinafter'*A Oy*') [1].
[76] For a succinct explanation of the interaction between the Freedom of Establishment under Articles 49 and 54 TFEU and the principle against discrimination, see *Philips,* (n 74) [24]: 'Article [49 TFEU] expressly leaves traders free to choose the appropriate legal form in which to pursue their activities in another Member State, that freedom of choice must not be limited by discriminatory tax provisions in the host Member State' (Kokott AG).
[77] The succinct enumeration of these three grounds is taken from Panayi (n 7) 278.
[78]*Marks* (n 74) [51].
[79]ibid [43]-[46].

Member State of the subsidiary *and* the Member State of the parent company;[80] Third, the need to prevent tax avoidance.[81]

Two primary questions arose from the ashes of the *Marks* judgement. The first was whether there was in fact a need for the presence of all three criteria in order to satisfy the *Taxing Power* exception. In *Oy AA,*[82]the Court recognised that a justification is possible through the two elements of safeguarding the allocation of the power to tax between the Member States and the need to prevent tax avoidance.[83] Subsequently, in *Lidl Belgium*[84] it also accepted a justification solely on the basis of the allocation of the power to tax between the Member States and the danger that the same losses will be taken into account twice.[85]

The Court examined and accepted the justification on this singular basis also in *National Grid Indus.*[86]In *Philips Electronics*, a UK company (Philips Electronics) was the parent of a Dutch-resident company (NL Co). NL Co indirectly owned LGPD Netherlands, which had a loss-making permanent establishment in the UK (UK PE). Philips Electronics wanted to use UK PE's losses to be set off against its own profits. This was refused by the HMRC as a result of the fact that those losses could also be used against profits in the Netherlands (by NL Co). According to UK tax law, the offsetting of such losses would have been permissible if incurred by a UK resident, rather than the UK branch of a non-resident. The Court established that the UK provision constituted a restriction to the freedom of establishment, holding that the difference in treatment between resident and non-resident companies could not be justified on the basis that the companies were not in comparable positions, as evidenced by objective elements.[87] The Court then turned to a possible justification of the restriction by virtue of the *Taxing Power* defence. The CJEU found that the UK was the Taxing Power and, following the Advocate General's opinion, thusly rejected the argument

[80]ibid [47]-[48].
[81]ibid [49]-[50].
[82]Case C-231/05 *Oy AA* [2007] ECR I-6373 [60].
[83] (n 73) [41] (Kokott AG).
[84] See also, *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo* (C-470/04) [2006] ECR I-7409 [42]; *Proceedings brought by Oy AA (Oy AA)* (C-231/05) [2007] ECR I-6373 [51]-[60]; *Amurta SGPS v Inspecteur van de Belastingdienst/Amsterdam* (C-379/05) [2007] ECR I-9569 [57]-[59].
[85] (n 73) [41] (Kokott AG).
[86]Case C-371/10 *National Grid Indus* [2011] ECR I-0000, [45]-[49]; Case C-470/04 *N* [2006] ECR I-7409 [42].
[87]*Philips* (n 74) 221.

that the denial of group relief could be justified on the grounds of preservation of a balanced allocation of taxing powers.[88]

Following this trend of jurisprudence, it has now been firmly established that the second and third criterion of *Marks*, preventing the double use of losses and tax avoidance, do not constitute an end in themselves, but are relevant only in so far as they serve to preserve the allocation of the power to tax between the Member States.[89] Therefore it is clear that the crucial factor for the justification is ultimately that national legislation pursues the objective of preserving the allocation of the *Taxing Power.*[90] Such coherency is a welcome development to an area of law which has been primarily typified by inconsistency, uncertainty and unpredictability.

The second issue related to the scope of the exception to the *taxing power* justification, in other words, the requirement to offset such losses against which there was no other recourse. This exception was laid down in *Marks* where the Court found that the *Taxing Power* restriction also had to be proportional. As per Panayi, it was *only* when the resident parent company demonstrated to the tax authorities of its Member State that all possibilities for relief had been exhausted that it became contrary to freedom of establishment to preclude the possibility for the parent company to deduct from its taxable profits in that Member State the losses incurred by its non-resident subsidiary.[91]

In *A Oy,*[92] at issue was the allowing the losses of a foreign company, this time in the context of a merger. A Finnish company wanted to merge with a Swedish subsidiary. There were 3 retail companies in Sweden with losses of about €5 m. Finnish tax law prevented the Finnish company from taking into account those losses upon the merger. According to Kokott, this was a restriction of the freedom of establishment. The question was then whether there was a possible justification. The Advocate General focused on whether the *Taxing Power* justification would be proportional. The case was distinguished from *Marks* on the basis that, in the within case, there was a choice on the part of the Swedish taxpayer.[93] In *Marks*, the subsidiary in Europe was in liquidation, thus leaving the company no avenue to offset the losses in the State with the Taxing Power. In *A Oy* however, the Swedish partner could have

[88]ibid 226.
[89]Case C-311/08 *SGI* [2010] ECR I-487 [59] (Kokott AG).
[90] (n 74) [42] (Kokott AG).
[91]Panayi (n 7) 278-279.
[92](n 75) (Kokott AG).
[93] ibid.

decided to continue trading. Therefore, the Advocate General recommended a finding that the Finnish tax measure was justifiable to preserve the taxing power of Finland.[94] The opinion is seen to limit the *Marks* exception to its own exceptional facts wherein the European subsidiary company had no recourse in the Taxing Power State to offset the losses. Following the opinion of the Advocate General, as this author expects,[95] will bring further clarity to this issue.

In brief summation, the recent case-law suggests that the chaos and despair caused by the *Marks* judgment has finally been laid to rest, resulting in a welcome coherency in relation to the *Taxing Power* defence.

E ACADEMIC COMMENTARY ON THE PRINCIPLE

It is quite clear that the CJEU has applied quite inconsistently the principle of prohibition of discrimination to direct taxation measures, notwithstanding the argument that the Court may finally have found a coherent path for determination of whether *Justifications* by Member States will absolve discriminatory taxation approaches. There is no shortage of academic commentary to criticise the court in this respect. It is interesting to consider the reasons for the seeming inability of the Court to find a steady course of action in this area of law.

First, the CJEU is not a specialised Tax Court.[96] Therefore, it may lack expertise, depending on the judges appointed to the bench at a particular time and sitting in a particular case.[97] Second, Emer Hunt[98] concludes that there is an underlying tension between a national tax system based on residence and the impact of the fundamental freedoms on residence as a determinant of liability. The *status quo* arises as a result of political sensitivity[99] in relation to fiscal issues. The power to tax is a power of the State to coercively raise revenue. This forms a fundamental part of State sovereignty. At one extreme, it allows the State to accumulate resources in preparation for a period of 'State Emergency', such as war. On the other end, the power to tax is a central instrument of economic and social policy. For example, 'tax breaks'

[94] ibid.
[95] Such an assertion is based on the fact that Advocate General Kokott's opinions on matters of Direct Taxation have been consistently followed. For instance, see the aforementioned Philips and SGI cases.
[96]Snell (n 25) 369.
[97]PJ Wattel, 'Red Herrings in Direct Tax Cases Before the ECJ' (2004) 31 LIEI 81, 82.
[98] E. Hunt 'What Can be Done? The Tax Wars Between Member States and the CJEU' (2004) 17(1) ITR 77, 79.
[99]*See:* Inland Revenue PN06, issued 9th April, 2003 wherein it was stated that 'The Government is determined to protect his corporation tax system against legal challenges under European law, particularly where these challenges have the potential to undermine international agreements'.

were offered to Irish companies establishing themselves in Templebar in Dublin in order to encourage tourism.[100] Another reason for this tension results from the fact that regulation and taxation pursue fundamentally different objectives. Regulation is largely about economic efficiency, thereby rectifying market failures no more than necessary, whereas Tax rules are essential elements in the redistribution of wealth.[101]Third, Snell points out that as long as the fundamental ambiguity about the nature of the single market persists, whether the goal is a common market or an internal market, the Court will struggle to achieve coherence in its case-law:

> [i]f the aim is the common market, a patchwork of highly dissimilar national tax regimes is difficult to tolerate. By contrast, the internal market is favourably disposed towards differing national rules as long as they do not constitute barriers.[102]

Notwithstanding the aforementioned problems relating to its application, the literature does attest to the merit of retaining the principle within EU Taxation Law. First, discriminatory rules are considered unlawful because they allow irrelevant factors to be taken into account (*e.g.* the need to protect the insider from the outsider)[103].Account for such irrelevant factors runs contrary to the concept of the Union and undermines the solidarity between the constituent elements of the polity.[104] Second, discrimination and protectionism are inefficient criteria because they divert 'business away from presumptively low-cost [foreign] producers [to high-cost (local) producers] without any colourable justification in terms of benefit that deserves approval from the point of view of the nation as a whole'.[105] A third rationale, and one strongly pushed by Justice Stone in the 1930s in the US, concerns the operation of the political process:[106] Although pre-dating the existence of the EU, the argument pertains relevance to the matter at hand. Community Law should be used to invalidate discriminatory state rules. National Rules, as with state rules, are the product of a successfully functioning democratic process operating at national level. Where discriminatory rules are produced in the process, the party most affected (i.e. the non-national) is not represented. Fourth, the great advantage of the principle is that it leaves room for state action, largely unhindered by

[100]Snell (n 25) 355.
[101]ibid 355-356.
[102]ibid 368.
[103] Barnard (n 37) 581.
[104] ibid.
[105] ibid.
[106] ibid.

concerns that the Commission or European Courts will intervene: 'State rules can therefore respond to the demands of the local electorate, so long as that electorate does not insist on discriminatory rules being put into place'.[107] Furthermore, this results in a diversity of rules across the Member States which leaves room for experimentation; experimentation from which the other States can learn.[108]Finally, the merit of applying such a principle is evidenced by the fact that the similarly structured United States[109] also applies the Discrimination principle, subject to one minor proviso. It is prudent at this juncture to briefly outline the manifestation of the principle in US Tax Law. The 'Commerce Clause'[110] states that 'The Congress shall have Power...to regulate Commerce with foreign Nations and among the several States...' This gives the federal government the power to *legislate* in respect of commerce, although it does not prohibit state-created restrictions on inter-state commerce.[111]

Facially discriminatory and *discriminatory in effect*[112]statutes are subject to a 'strict scrutiny' review[113] which essentially means that the court checks whether the statute serves 'a legitimate local purpose' *and*[114] whether there is an 'absence of non-discriminatory alternatives'.[115] Therefore, the US approach essentially mirrors the EU approach to direct taxation matters. In both instances, discriminatory taxation provisions are *prima facie* unlawful unless they can be justified (the EU model), or they give effect to 'legitimate local purposes' (the US Model) and are not disproportionate to the desired object (the EU Model) or absent of 'non-discriminatory alternatives' (the US model). Where this becomes interesting, is in relation to double taxation. Essentially, the US Supreme Court has interpreted the Commerce Clause as prohibiting cumulative tax burdens that would expose businesses active in interstate trade to a higher tax burden than those operating in a single state.[116] Justice Stone feared the multiplication of State taxes burdening the same activity 'would spell the destruction of inter-state commerce'.[117] However, the CJEU in

[107] ibid.
[108] ibid.
[109] Any discussion of the Substantive Law of the EU would be incomplete without reference to the United States. The inclusion is justified given the comparable structure of Federal Laws superseding State Law just as EU Law is supreme to National Laws, whilst conversely each state has autonomy to determine its own laws provided these do not conflict with the overriding Federal or Union Law.
[110]United States Constitution (Article I, Section 8, Clause 3).
[111] Barnard(n 37) 585.
[112] There is case law to suggest, however, that these statutes are subjected to a more relaxed standard-*Dean Milk* v *Madison* 340 US 349 (1951).
[113]*Hughes* v. *Oklahoma* 441 US 322, 337 (1979).
[114] Both limbs are required: *City of Philadelphia* v. *New Jersey* 437 US 617, 626 (1978).
[115]*Chemical Waste Management Inc* v. *Hunt* 504 US 334, 342-3 (1992).
[116]Snell (n 25) 360.
[117]*Western Live Stock v Bureau of* Revenue 303 US 250 (1938) 256.

Kerckhaert[118] held that double taxation does not fall foul of the discrimination principle provided that it is applied in an even handed fashion. Thus, it may be said that the application of the principle in the US runs parallel to the application by its EU counterpart, albeit, with the potential for catching infringements which fall beyond the parameters of the pure discrimination test.

Thus, it is rational to summate that the discrimination principle does indeed have a 'good and well-respected pedigree'.[119] The conclusion to be drawn from the above discussion must, however, be that the application in practice by the CJEU of the principle unfortunately leaves a lot to be desired. The literature presents cogent reasons as to why such misapplication has inevitably occurred. Moreover, the literature asks serious questions as to whether the CJEU is indeed the appropriate forum to determine Union-wide taxation matters.

F CONCLUSION

This critical discussion of the application by the CJEU of the principle of non-discrimination in Direct Taxation matters has pragmatically laid out the unacceptable flaws in the CJEU case-law. The marked shift in terminology has not only led to unpredictability and uncertainty but there is also merit in the proposition that the shift has resulted in inconsistency. Moreover, the treatment by the CJEU of cross border schemes has resulted in inequality of treatment between EU Member States. Serious questions have also been asked of the CJEU's application of the principle in relation to justifications. It has been found that the jurisprudential development to date has been characterised by inconsistency, uncertainty and unpredictability. However, recent trends might lead one to tentatively summate that there is a possibility that the CJEU may reign in these flaws of application. Nevertheless, the fundamental importance of 'certainty and predictability' in taxation matters[120] overall renders the CJEU's application of the principle unacceptable. Several reasons have been cited for the development whilst the merit of the principle itself has concurrently been outlined.

[118] *Case* C-513/04. The case concerned a blanket Belgian tax of 25 per cent imposed on all dividends, regardless of source. The Kerckhaerts, two Belgian residents, received dividends from a French company which had already been subjected to a 15 per cent withholding levy in France. The dividends were then taxed by the relevant Belgian authorities. The Grand Chamber of the court, concurring with Advocate General Geelhoed, rejected the Kerckhaerts argument that the double taxation violated (then) article 56EC on free movement of capital. This case was later followed by the Grand Chamber of the Court in *ACT Group Litigation C-446/0*, again following Advocate General Geelhoed, holding that a home state is free to impose a second tax regardless of what the source State has done. Furthermore, the source state is not obliged to provide relief in cross-border situations, even if it does grant such relief internally.

[119] Barnard (n 37) 581.

[120] As noted above by Geelhoed AG.

But should we be surprised at the above conclusions, given that Advocate General Geelhoed once opined that 'judicial intervention, by its very nature, is casuistic and fragmented'?[121]

The opening paragraph alluded to the concept that further integration of the internal market is of fundamental importance going forward. What is required is an impenetrable and comprehensive reformulation of the principle which provides certainty for the Member States' judiciary, legislature and taxpayers.[122] This, it is suggested, will result in uniformity across the 27 Member States. In this manner, the obstructive effect of national direct taxation measures could be limited to the furthest extent possible. Given the economic climate and the unacceptable CJEU jurisprudential development to date, the author posits that the legislative pen[123] is required to be the paramount, omnipotent arbitrator in the pursuance of certainty in direct taxation matters and concurrently, the illusive single market.

[121] *ACT Group Litigation* [39].

[122] A detailed discussion of this option is beyond the scope of this essay. The author suggests however that the Commission ought to produce a comprehensive report outlining precisely the scope of the principle. Such has had the effect in the analogous arena of EU Insolvency Law, through the *Virgo-Schmidt Report*, of significantly clarifying the law and providing uniformity.

[123] Whether by way of regulation, directive or Commission report. There is evidence to suggest that the legislative intervention is already attempting to combat the shortfalls in the market. For example, the Commission has been eager to establish a Common Consolidated Corporate Tax Base. The European Commission on 16 March 2011 proposed a common system for calculating the tax base of businesses operating in the EU. The proposed Common Consolidated Corporate Tax Base (CCCTB), would mean that companies would benefit from a 'one-stop-shop' system for filing their tax returns and would be able to consolidate all the profits and losses they incur across the EU. See: *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base* at<http://eur-lex.europa.eu> accessed 19 February 2013.