Chapter 1

Tax Coordination between Member States in the EU – Role of the ECJ

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1.1. Introduction

The coordination of different taxes has many facets that range from the avoidance of inconsistencies within a national tax system[1] to the international allocation of taxing rights between different sovereign states. From a federalist perspective, tax coordination has two dimensions: vertical coordination of tax competences between different levels of government[2] and horizontal coordination of the taxing powers of different jurisdictions at the same level of government. In general, a lack of coordination within the federal framework entails the danger of excessive tax or tax compliance burdens. With respect to horizontal tax coordination in particular, inadequate coordination may also lead to distortions that prevent the optimal allocation of economic resources and thus reduce social welfare. Moreover, insufficient vertical tax coordination may undermine the fiscal autonomy of certain entities that form part of the federal system, typically the sub-national levels of government.

As is well known, the European Union today is neither a confederation nor a federation within the traditional meaning of this concept, but it has indeed "charted its own brand of constitutional federalism".[3] One of its most important objectives is economic integration through the creation of an internal market that comprises the economies of all 27 Member States and that resembles, as closely as possible, the ideal of a single market.[4]

1. Abundant examples of such inconsistencies do exist; for instance, the German federal legislator has conceded an income tax deduction for contributions for general liability insurances, because such insurances have been considered to cover existential risks, but at the same time levies federal insurance tax on the corresponding insurance contracts.
2. Within the traditional Westphalian nation-state, this could be the federal government, on the one hand, and the states or autonomous provinces that together constitute the federation, on the other hand, and possibly also the municipalities or other entities.
3. J.J.H. Weiler, *Federalism and Constitutionalism, Europe's Sonderweg*, in *The Federal Vision: Legitimacy and Levels of Governance in the US and the EU* p. 70 (K. Nicolaidis & R. Howse eds., Oxford: Oxford University Press, 2001).
4. Art. 26(2) TEU defines the internal market as "an area without internal frontiers in which the free movement of goods, persons, services, and capital is ensured in accordance

However, Europe still has a "highly fragmented tax landscape".[5] Against this background, the quasi-federal European Union, too, is confronted with the challenge of coordinating legislative and administrative competences in order to remove barriers to interstate commerce and avoid distortions within the internal market. As the Commission has aptly pointed out, the present lack of coordination may also lead to an erosion of tax revenues through the exploitation of tax arbitrage or loopholes, interfering with the ability of the Member States to operate efficient and balanced tax systems.[6] It also entails higher administrative complexity, especially due to various anti-avoidance measures.[7]

Even though vertical coordination also raises many critical issues in the EU context, the present contribution will only be concerned with horizontal tax coordination between Member States, since it focuses on the role of the European Court of Justice (ECJ or Court) in this context. And the Court's jurisprudence is far more extensive and controversial with respect to the horizontal aspect of tax coordination within the EU. For the purposes of this study, the notion of horizontal tax coordination between Member States will be understood to encompass all measures intended to promote tax neutrality for economic transactions within the internal market[8] by removing obstacles resulting from the parallel existence and the interaction of different national tax systems. In essence, horizontal tax coordination between Member States thus has two dimensions: first, the approximation of substantive tax law and related procedural rules of the Member States in order to overcome or at least reduce disparities between national tax systems in so far as these disparities lead to distortions of competition or increased compliance and administrative costs and second, the coordination of competing tax claims of the Member States so as to avoid double burdens on cross-border commerce.

The concept of horizontal tax coordination between Member States is thus distinguished from the removal of barriers to market access and of distor-

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with the provisions of the Treaties". This definition has remained unchanged since its introduction in the EEC Treaty by the Single European Act.

5. Cf. M. Monti, *A New Strategy for the Single Market, Report to the President of the European Commission José Manuel Barroso*, 9 May 2010, p. 79.

6. Cf. Communication from the Commission, Co-ordinating Member States' direct tax systems in the Internal Market, 19 Dec. 2006, COM(2006) 823 final, p. 4; see also M. Aujean, *Tax Policy in the EU: Between harmonisation and coordination?*, 16 Transfer: European Review of Labour and Research 1, p. 11 (2010).

7. Cf. PWC, Impact of corporate income tax reforms at the EU level on European business taxpayers, 9 July 2008 (available at http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/ccctb/pwc_compliance. pdf), p. 4 et seq.

8. See also, in this regard, W. Schön, *Tax Competition in Europe – the legal perspective*, EC Tax Review, p. 92 (2000) and the academic references cited there.

tions of competition caused by discriminatory and restrictive tax provisions that form part of the tax system of one and the same Member State.[9] Of course, it cannot be disputed that such obstacles also need to be tackled as a *necessary* precondition for facilitating access to foreign national markets within the European Union and for ensuring that competition within the internal market is not distorted by taxation.[10] However, the equal playing field within a national tax jurisdiction is not as yet a *sufficient* condition for a level playing field within the entire European internal market as long as disparities and double burdens persist.[11] Notwithstanding this conceptual distinction, it cannot be precluded a priori that a uniform non-discrimination standard may also have an impact on the horizontal coordination of Member States' tax systems.

This study will examine the role that the ECJ plays with respect to promoting or complicating tax coordination between the Member States of the EU. It will also draw some tentative conclusions regarding the implications of the Court's case law for future EU tax policy. In this context, it is useful to distinguish between non-harmonized and harmonized areas of taxation, because the impact and relevance of the Court's jurisprudence is quite different in the two fields. It is acknowledged that scholars[12] and also the European Commission[13] and the ECJ[14] tend to distinguish between tax coordination, on the one hand, and harmonization through European legislation, on the

9. See, in this regard, B.J.M. Terra & P.J. Wattel, *European Tax Law*, 5th ed., p. 44 (Alphen aan den Rijn: Kluwer Law International, 2008); M. Gammie, *The Compatibility of National Tax Principles with the Single Market*, in *EU Freedoms and Taxation* p. 115 (F. Vanistendael ed., Amsterdam: IBFD, 2006). The Commission has endorsed a broader concept of tax coordination between Member States, cf. Communication from the Commission, Co-ordinating Member States' direct tax systems in the Internal Market, 19 Dec. 2006, COM(2006) 823 final, p. 4.

10. Cf. A. Cordewener, *The Prohibitions of Discrimination and Restriction within the Framework of the Fully Integrated Internal Market,* in *EU Freedoms and Taxation*, id., p. 4 et seq.

11. Cf. J. Englisch, *Wettbewerbsgleichheit im grenzüberschreitenden Handel* p. 244 et seq. (Tübingen: Mohr Siebeck, 2008); S. van Thiel, *Free Movement of Persons and Income Tax Law* p. 1 et seq. (Amsterdam: IBFD, 2002).

12. Cf. Aujean, *supra* n. 6, at p. 20; A. Grau & P.M. Herrera, *The link between tax coordination and tax harmonization*, EC Tax Review p. 28 (2003); G. Kopits (ed.), *Tax Harmonization in the European Community* p. 3 et seq. (Washington DC: International Monetary Fund, 1992); T. O'Shea, *Tax Harmonization vs. Tax Coordination in Europe: Different Views*, 46 Tax Notes International 2, p. 811 (2007).

13. Communication from the Commission, Co-ordinating Member States' direct tax systems in the Internal Market, 19 Dec. 2006, COM(2006) 823 final, p. 4.

14. Cf. ECJ, 15 June 2010, Case C-211/08, *Commission v. Spain*, n.y.r., para. 61; ECJ, 14 Oct. 2010, Case C-345/09, *Delft*, n.y.r., para. 99.

other hand.[15] According to their terminology, tax coordination only refers to legally non-binding instruments of "soft law" or "soft legislation", such as recommendations, communications, codes of conduct, etc.[16] However, for the purposes of this paper, harmonization will be regarded as a specific form of horizontal coordination within the above meaning.[17] A chief objective of tax harmonization by acts of the EU institutions, too, is to reduce disparities between national tax systems and allocate taxing rights between Member States.[18]

1.2. Non-harmonized areas of national tax law

1.2.1. Role of the ECJ

With respect to national tax rules that do not implement European tax directives, the ECJ has consistently held that from the perspective of European law, Member States are, in principle, at liberty to design their tax system as they see fit in order to meet their domestic policy objectives. However, the powers retained by the Member States must be exercised consistently with Union law.[19] More specifically, the tax sovereignty of the Member States is limited by two categories of directly applicable provisions of the EU Treaties: on the one hand, the four free movement guarantees listed in article 26 of the TFEU, also referred to as "fundamental freedoms",[20] and on the

15. See also J. Malherbe et al., *Direct Taxation in the Case-Law of the European Court of Justice*, paras. 312 et seq. (Bruxelles: Larcier, 2008), who draw the dividing line between measures that leave national tax sovereignty intact and measures that are aimed at streamlining national tax systems. This study is also available in an online version titled *The impact of the rulings of the European Court of Justice in the area of direct taxation* (2008); accessible at http://www.europarl.gr/ressource/static/files/projets_pdf/econ_2007_27.pdf; here, the relevant statement is made in paras. 213 et seq.

16. As regards the range of soft law instruments, see Communication from the Commission, Tax Policy in the European Union – Priorities for the Years Ahead, 23 May 2001, COM(2001) 260 final, p. 22. For a comprehensive overview, consult L. Senden, Soft *Law in European Community Law* p. 123 et seq. (Oxford: Hart Publisher, 2004).

17. See also *Webster's Collegiate Dictionary*, 11th ed. 2003, "coordinate: to bring into a common action, movement, or condition: harmonize".

18. Cf. ECJ Case C-300/89, *Commission v Council*, [1991] ECR I-2867, at para. 15.

19. See landmark ruling ECJ, 14 Feb. 1995, Case C-279/93, *Schumacker* [1995] ECR I-225, para. 21; settled Case law, cf. ECJ, 13 Dec. 2005, Case C-446/03, *Marks & Spencer* [2005] ECR I-10837, para. 29; see also Englmair, *The Relevance of the Fundamental Freedoms for Direct Taxation*, in *Introduction to European Tax Law on Direct Taxation* paras. 92 et seq. (M. Lang et al. (Wien: Linde Verlag, 2010).

20. The free movement of goods (arts. 34 et seq. TFEU), the free movement of workers (art. 45 TFEU), the freedom of establishment (art. 49 TFEU), the free movement of services (art. 56 TFEU) and the free movement of capital (art. 63(1) TFEU).

other hand, the prohibition of State aid enshrined in article 107 of the TFEU. These quasi-constitutional requirements are directly applicable within the national legal orders of the Member States[21] and render any non-complying norms inapplicable[22] or, in case of article 107, any implementation measures invalid.[23] Furthermore, the Member State's procedural autonomy[24] is limited by general principles of Union law, and in particular the principles of equivalence and effectiveness,[25] and protection of legitimate expectations,[26] with respect to procedural and administrative remedies against infringements of the aforementioned Treaty guarantees within the framework of the national legal system.

The Court's tax-related case law on the aforementioned primary Union law provisions now comprises far more than 100 rulings, most of them concerning direct tax matters. Its jurisprudence is credited with achieving "negative integration" through enforcing quasi-constitutional Treaty limits on Member States' sovereign discretion in tax matters, as contrasted with "positive integration" through legislation enacted by the competent institutions of the Union.[27] The ECJ has accordingly been referred to as an "engine of integration" when it removed unilateral obstacles to market access and

21. See landmark Cases ECJ, 3 July 1974, Case 192/73, *Van Zuylen* [1974] ECR 731, paras. 2/5; ECJ, 4 Dec. 1974, Case 41/74, *van Duyn* [1974] ECR 1337, paras. 5/7; ECJ, 21 June 1974, Case 2/4, *Reyners* [1974] ECR 631, paras. 24/28 et seq.; ECJ, 3 Dec. 1974, Case 33/74, *van Binsbergen* [1974] ECR 1299, para. 27; ECJ, 14 Dec. 1995, Case C-163/94, *Sanz de Lera* [1995] ECR I-4821, para. 48 (with respect to the fundamental freedoms); ECJ, 8 Nov. 2001, Case C-143/99, *Adria Wien Pipeline* [2001] ECR I-8365, paras. 26 et seq. (with respect to the prohibition of State aid).

22. Cf. ECJ, 19 Nov. 2009, Case C-314/08, *Filipiak* [2009] ECR I-11049, para. 81; ECJ, 22 June 2010, Case C-188/10, *Melki*, n.y.r., para. 43. For further details, consult M. Lang, *Der Anwendungsvorrang der Grundfreiheiten auf dem Gebiet des Steuerrechts*, in *Gestaltung der Rechtsordnung – Festschrift für Joachim Lang* p. 1003 et seq. (K. Tipke et al., Köln: Schmidt Otto Verlag, 2010).

23. ECJ, 12 Feb. 2008, Case C-199/06, *CELF* [2008] ECR I-469, para. 40. For further details, consult U. Geisenberger, *Der Einfluss des Europarechts auf steuerliches Verfahrensrecht* p. 48 et seq. (Baden-Baden: Nomos, 2010).

24. Cf. ECJ, 15 Mar. 2007, Case C-35/05, *Reemtsma Cigarettenfabriken* [2007] ECR I-2425, para. 40; ECJ, 6 Oct. 2009, Case C-40/08, *Asturcom* [2009] I-9579, para. 38. See also A. van Eijsden et al., in *Procedural Rules in Tax Law in the Context of European Union and Domestic Law* p. 16 et seq. (M. Lang et al. eds., Alphen aan den Rijn: Kluwer Law International, 2010); Terra & Wattel, *supra* n. 9, at p. 88.

25. For an explanation in a nutshell, see ECJ, 8 Mar. 2011, Case C-240/09, *Lesoochranárske zoskupenie*, n.y.r., para. 48, with references to the Court's Case law. For further details, see *infra* at notes 183-185.

26. See landmark ruling ECJ, 3 May 1978, Case 112/77, *August Töpfer* [1978] ECR 1019, para. 19; see also ECJ, 10 Sept. 2009, Case C-201/08, *Plantanol* [2009] ECR I-8343, para. 46; ECJ, 2 Dec. 2009, Case C-358/08, *Aventis Pasteur* [2009] ECR I-11305, para. 47.

27. Cf. Terra & Wattel, *supra* n. 9, at p. 29 et seq.

a level playing field based on the fundamental freedoms and article 107 of the TFEU. However, the question that arises in the context of the present study is whether the Court also played the role of an engine of international tax coordination by doing so. The topics to be discussed here are: Does case law promote real or at least de facto harmonization of Member States' national tax systems? Does it contribute to the coordination of competing tax claims of the Member States? And does the ECJ "harden" the Commission's soft-law approach towards horizontal tax coordination, which has become increasingly popular since a 2001 shift in the Commission's strategy on tax policy?[28]

1.2.1.1. Non-discrimination approach: Varying impact on the approximation of Member States' tax systems

The ECJ relies primarily on the free movement guarantees enshrined in article 26(2) of the TFEU, and specified in subsequent sections of the Treaty, when it scrutinizes national tax systems as regards their compatibility with primary EU law requirements. As a tribute to the wording of some of the provisions governing these "fundamental freedoms" and to the historical development of its related jurisprudence,[29] the Court still tends to frame its free movement test of home state tax scenarios (concerning the taxation of outbound investments, outbound services or outbound free movement in general) in terms of a "restriction analysis", without making explicit reference to discriminatory effects of the tax provision at issue.[30] Occasionally, the same approach can even be observed in host-state tax scenarios, where the Court traditionally[31] referred to the prohibition of "indirect discrimination" on grounds of nationality when a national tax norm was suspected of infringing a fundamental freedom.

But despite the Court's fuzzy rhetoric, it cannot be denied that virtually all ECJ decisions on the incompatibility of national tax rules with EU funda-

28. See, in this regard, the Communication from the Commission., Tax Policy in the European Union – Priorities for the Years Ahead, 23 May 2001, COM(2001) 260 final, p. 22; H. Gribnau, *Improving the Legitimacy of Soft Law in EU Tax Law*, Intertax, p. 30 (2007); Terra & Wattel, *supra* n. 9, at p. 163 et seq.

29. For further details, consult A. Cordewener, in *EU Freedoms and Taxation* p. 8 et seq. (F. Vanistendael ed.).

30. See, for instance, ECJ, 18 Sept. 2003, Case C-168/01, *Bosal* [2003] ECR I-9409, para. 27; ECJ, 19 Jan. 2006, Case C-265/04, *Bouanich* [2006] ECR I-923, paras. 30 et seq.

31. See, for instance, ECJ, 14 Feb. 1995, Case 279/93, *Schumacker* [1995] ECR I-225, paras. 26 et seq.; ECJ, 27 June 1996, Case C-107/94, *Asscher* [1996] ECR I-3089, paras. 38 et seq.

mental freedoms have been based on a discrimination analysis, regardless of whether the disputed provision formed part of the tax system of the Member State of origin of the cross-border transaction (i.e. the state of residence of the taxpayer) or of the Member State of destination (i.e. the state where the income is sourced).[32] There is always a comparative or "relative" element inherent to the "restriction" analysis, which indicates that the ECJ is really looking for a discrimination of cross-border activities as compared to purely national activities that are carried out within the boundaries of one and the same Member State.[33] If outbound or inbound activities are not "rendered *less* attractive" than wholly domestic ones, the measure at issue will not found to be restrictive.[34]

This approach differs markedly from the more extensive, "genuine" restriction analysis practiced by the ECJ in other non-harmonized areas of law. In general, the Court will find a national legal system to constitute a restriction of free movement whenever it is likely to "prevent, limit or deter" cross-bor-

32. Cf. C. Barreiro Carril, *National tax sovereignty and EC fundamental freedoms: The impact of tax obstacles on the internal market*, Intertax p. 107 (2010); Cordewener, *supra* n. 29, at p. 27 et seq.; P. Farmer, *The Court's Case law on direct taxation: A castle built on shifting sands?*, EC Tax Review p. 80 et seq. (2003); D. Hohenwarter, *Verlustverwertung im Konzern* p. 52 (Wien: LexisNexis, 2010); H. Kube, *EuGH und Steuerrecht – Steuerrechtliche Probleme bei der Ausübung der Grundfreiheiten*, in *Europäisches Gesellschafts- und Steuerrecht* p. 235 (M. Dillmann et al., München: Beck, 2007); S. Lammel & E. Reimer, *Europäisches Unternehmenssteuerrecht. Eine Einführung*, in *Europäisches Gesellschafts- und Steuerrecht* p. 179, id.; M. Lang, *Die Rechtsprechung des EuGH zu den direkten Steuern* p. 34 et seq. (Frankfurt am Main/Wien: Peter Lang Frankfurt, 2007); R. Lyal, *Non-discrimination and direct tax in Community law*, EC Tax Review p. 74 (2003; W. Schön, *Unternehmensbesteuerung und Europäisches Gemeinschaftsrecht,* in *Steuerberater-Jahrbuch 2003/2004* p. 31 (N. Herzig, M. Günkel & U. Niemann eds., Köln: Otto Schmidt, 2004); S. van Thiel, *The Direct Income Tax Case Law of the European Court of Justice: Past Trends and Future Developments*, Tax Law Review p. 149 et seq. (2008); P. Wattel, *Commentary: Judicial Restraint and Three Trends in the ECJ's Direct Tax Case Law*, Tax Law Review p. 208 et seq. (2008); see also ECJ, 25 Oct. 2007, Case C-240/06, *Fortum Project Finance* [2007] ECR I-9413, para. 27; M. Graetz & A. Warren, *Income Tax Discrimination and the Political and Economic Integration of Europe*, The Yale Law Journal p. 1199 (2006); W. Hellerstein, G. Kofler & R. Mason, *Constitutional Restraints on Corporate Tax Integration in the EU and the U.S.*, Tax Law Review 62 p. 24 et seq. (2008).

33. Likewise M. Lang, *Recent Case Law of the ECJ in Direct Taxation: Trends, Tensions and Contradictions*, EC Tax Review p. 99 (2009); T. O'Shea, *Freedom of Establishment Tax Jurisprudence: Avoir Fiscal Re-visited,* EC Tax Review p. 269 et seq. (2008); F. Vanistendael, *The ECJ at the Crossroads: Balancing Tax Sovereignty Against the Imperatives of the Single Market*, Eur. Taxn. p. 414 (2006).

34. Cf. ECJ, 23 Feb. 2006, Case C-513/03, *van Hilten-van der Heijden* [2006] ECR I-1957, paras. 45 et seq.; ECJ, 6 Dec. 2007, Case C-298/05, *Columbus Container* [2007] ECR I-10451, paras. 39 et seq. and para. 49.

der movement of products or factors of production.[35] It is settled – albeit questionable[36] – case law that the restrictive nature of such a national measure will be affirmed even when it applies without distinction to both cross-border and purely internal transactions if the measure is liable to affect the market access of potential "free movers".[37] National tax regimes are certainly liable to constitute an obstacle to the exercise of economic free movement rights and thus affect market access, in particular when the tax burden imposed in the intended Member State of destination is higher than the domestic tax on proceeds from similar activities carried out in the Member State of residence, or when international double taxation is not fully avoided. However, the Court has been extremely reluctant to apply its standard approach to tax-related disputes, presumably because this would potentially entail the need for Member States to justify all provisions of their national tax law before the ECJ; such a degree of quasi-constitutional control at Union level would imply a serious curtailment of national sovereignty in a sensitive policy area. Regarding direct taxation in particular, the Court so far has not even conducted an analysis as to whether seemingly neutral tax regimes – such as e.g. thin capitalization rules or interest deduction barriers also applicable for domestic groups of companies – are nevertheless liable to predominantly affect cross-border situations or transactions.[38]

35. See, for instance, ECJ, 28 Sept. 2006, Joined Cases C-282/04 and C-283/04, *Commission v. Netherlands* [2006] ECR I-1941, para. 20; ECJ, 11 Mar. 2010, Case C-384/08, *Attanasio*, n.y.r., para. 43; ECJ, 16 Mar. 2010, Case C-325/08, *Olympique Lyonnais*, n.y.r., para. 34; ECJ, 11 Nov. 2010, Case C-543/08, *Commission v. Portugal*, n.y.r., para. 47; As S. van Thiel, *Removal of income tax barriers to market integration in the European Union: Litigation by the Community citizen instead of harmonization by the Community legislature?*, EC Tax Review 12 p. 5 (2003), correctly pointed out, this far-reaching jurisprudence on access restrictions has obliged Member States, in principle, to recognize home-state standards, and has thus "greatly reduced the need for further harmonization to those limited aspects of domestic regulatory systems that serve mandatory requirements of a non-economic nature." The latter qualification is a consequence of the rule of reason (*see* 1.1.2.).

36. For further details, consult J. Englisch, *Wettbewerbsgleichheit im grenzüberschreitenden Handel* (Köln: Verlag Mohr Siebeck, p. 234 et seq., 2008).

37. See, for instance, ECJ, 13 May 2003, Case C-463/00, *Commission v. Spain* [2003] ECR I-4581, para. 61; ECJ, 19 May 2009, Case C-531/06, *Commission v. Italy* [2009] ECR I-4103, paras. 44 et seq.; ECJ, 8 July 2010, Case C-171/08, *Commission v. Portugal,* n.y.r., para. 67; ECJ, 11 Nov. 2010, Case C-543/08, *Commission v. Portugal*, n.y.r., para. 68; see also, however, ECJ, 21 Oct. 2010, Case C-81/09, *Idryma Typou*, n.y.r., para. 58 et seq.

38. For critical comments, see O. Thoemmes et al., *Thin Capitalization Rules and Non-Discrimination Principles*, Intertax 32 p. 135 (2004). For a seemingly different analysis of the implications of the Case law of the Court, see Terra & Wattel, *supra* n. 9, at p. 717 et seq.

The judicial restraint exercised by the ECJ in tax matters has important consequences for the spectrum of political options available to each Member State after a negative verdict on certain discriminatory features of a national tax system: A Member State may chose to altogether abolish the detrimental tax regime at issue, or at least limit its territorial scope to third-country relationships not covered by the relevant fundamental freedom and its EEA counterpart.[39] Conversely, it could be decided to extend its scope to purely domestic scenarios in order to sidestep the Court's non-discrimination analysis. Mutatis mutandis, the same alternatives exist with a view to beneficial tax regimes that were formerly limited in scope to purely internal constellations. Depending on the circumstances, namely on the availability of a justification for the discriminatory tax law provision that was dismissed by the Court merely on grounds of a lack of proportionality,[40] the national legislator may even have a third option: the discriminatory tax regime could be modified, or its substantive scope could be scaled back, so that the remaining restrictive effects will no longer be out of proportion to its legitimate objectives.

In general, the following reactions can be identified.[41] If the extension of a tax concession or another favourable tax regime to cross-border scenarios would be fiscally costly, or if the discriminatory limitation to domestic situations served protectionist motives, Member States will tend to either abolish or modify it rather than grant it in the case of a cross-border situation as well. An exception is made where the tax relief is considered to form a core aspect of tax justice or a key element of a cherished national policy. As became obvious in the wake of the *Marks & Spencer* judgment and subsequent decisions concerning intra-group or intra-company loss relief schemes, the tendency to merely introduce modifications and uphold discriminatory elements will increase when only minor amendments are needed in order to shield the provision from future findings of lack of proportionality and ensuing incompatibility with fundamental freedoms. In relation to detrimental tax regimes

39. If the transaction at issue falls under the scope of the free movement of capital, it will also be protected by the non-discrimination requirement with respect to third countries; however, justifications might be more readily available than in an internal market context, cf. ECJ, 12 Dec. 2006, Case C-446/04, *FII Group Litigation* [2006] ECR I-11753, para. 171; ECJ, 18 Dec. 2007, Case C-101/05, *"A"* [2007] ECR I-11531, paras. 28 et seq.; ECJ, 18 Dec. 2007, Case C-101/05, *"A."* [2007] ECR I-11531, paras. 36 et seq.; ECJ, 23 Apr.2008, Case C-201/05, *Test Claimants in the CFC and Dividend Group Litigation* [2008] ECR I-2875, para. 93; ECJ, 20 May 2008, Case C-194/06, *Orange Smallcap* [2008] ECR I-3747, para. 90; ECJ, 4 June 2009, Cases C-439/07 and C-499/07, *KBC Bank* [2009] I-4409, para. 73; ECJ, 28 Oct. 2010, Case C-72/09, *Établissements Rimbaud*, n.y.r., para. 40.

40. For further discussion, see 1.1.2.

41. See also P. Farmer & A. Zalasinski, *General Report*, in *Direct Tax Rules and the EU Fundamental Freedoms* p. 399 (X.L. Xenopoulos ed., Nicosia: FIDE Congress, 2006).

that seek to protect the national revenue base, such as thin capitalization rules or exit taxes, Member States will tend to chose the opposite strategy: The more important the objectionable norm is fiscally for the respective treasury, the stronger the incentive will be to extend the tax law provision at issue also to domestic cases so as to elude the standard non-discrimination analysis. If such an approach is unfeasible because its consequences would be administratively or economically unsustainable in a domestic scenario, Member States will frequently try to adapt the discriminatory tax regime to the Court's justification requirements rather than abandon it outright.

Obviously, the fiscal significance of certain tax regimes varies from Member State to Member State, and so do political priorities with respect to conflicting interests that have to be balanced when deciding about the options described above. Therefore, the impact of an ECJ ruling will often differ among the 27 tax jurisdictions affected within the Union.[42] The changes enacted in the Member State's tax systems with respect to thin capitalization and CFC regimes after the Court had handed down its *Lankhorst Hohorst*[43] and *Cadbury Schweppes*[44] judgments, respectively, are paradigmatic. This means that it is far from certain that the standard fundamental freedom scrutiny of the ECJ in the area of non-harmonized tax law will, by itself, enhance de facto harmonization, understood as approximation of national tax systems.[45] To the contrary, the Court's rulings may even spark or increase legal diversity in certain parts of national tax systems that were formerly aligned to internationally accepted models and thus quite congruent.

Two more aspects add to the centrifugal tendencies that can often be observed after landmark cases of the Court. First, Member States' national governments will tend to show different standards of compliance with such a ruling.[46] Some will change their tax systems based on mere precedence in anticipation of a probable condemnation of their own, similar regime; e.g. this could often be observed in Austria. Other Member States are less inclined to question their own tax system in the light of a judgment concerning legislation of another Member State, even if the essential elements

42. Cf. C. Brokelind, in *Towards a Homogeneous EC Direct Tax Law* p. 13 (C. Brokelind ed., Amsterdam: IBFD, 2007); J. Hey, *Wettbewerb der Rechtsordnungen oder Europäisierung des Steuerrechts*, in *Europäisches Gesellschafts- und Steuerrecht* p. 309 (M. Dillmann et al., München: Beck, 2007); Malherbe et al., *supra* n. 15, at para. 61.
43. ECJ, 12 Dec. 2002, Case C-324/00, *Lankhorst-Hohorst* [2002] ECR I-11779.
44. ECJ, 12 Sept. 2006, Case C-196/04, *Cadbury Schweppes* [2006] ECR I-7995.
45. Likewise, A. Grau & P.M. Herrera, *The link between tax coordination and tax harmonization*, EC Tax Review p. 34 (2003).
46. Cf. C. Brokelind, in *Towards a Homogeneous EC Direct Tax Law* p. 16 et seq.; Malherbe et al., *supra* n. 15, at para. 61.

of both national tax regimes are quite similar; they prefer to "wait and see" whether the Court might not hold minor distinctions relevant enough to eventually reach a different verdict in their case. The Court's sometimes erratic[47] and ambiguous[48] case law promotes such a strategy. Second, most landmark cases do not provide detailed guidance as to all of their ramifications for national tax systems, so that different Member States might reach different conclusions as to the required changes.

Hence, all that negative integration by ECJ rulings does accomplish per se with a view to intra-Union tax coordination is to set certain – but sometimes indeed not overly certain – minimum standards for Member States that do not opt out entirely of a tax regime whose characteristic features have been held to be incompatible with the EU fundamental freedoms. However, these minimum requirements can be sidestepped by extending the substantive scope of the provisions at issue so as to make them – at least seemingly – neutral regarding domestic and cross-border scenarios.[49] Moreover, even when Member States show a uniform response to certain developments in the Court's jurisprudence – the disappearance of almost all dividend imputation systems across the EU in the wake of the *Verkooijen*[50] and *Manninen*[51] rulings is the most prominent example – the ensuing approximation of national tax systems does not ensure a more level playing field for investors, business and migrant workers within the Union. The inherent limit to negative integration is the persisting disparities between the national tax systems,[52] especially regarding tax base, tax rate, and extra-fiscal objectives,[53] which could only be overcome by comprehensive positive integration through EU legislation. As the ECJ itself has repeatedly emphasized:

47. See also R. Szudoczky, *How Does the European Court of Justice Treat Precedents in Its Case Law? Cartesio and Damseaux from a Different Perspective: Part I,* Intertax 37 p. 348 (2009).
48. Cf. A. Arnull, *The European Union and its Court of Justice*, 2nd ed. p. 10 (Oxford: Oxford University Press, 2006). See also L. Mutén, *The effects of ECJ rulings on Member States' direct tax law – Introductory speech*, in *Towards a Homogeneous EC Direct Tax Law* p. 31 (C. Brokelind ed., Amsterdam: IBFD, 2007): "[T]he texts of the rulings, even before they get through the fateful translation procedure, often bear the sign of compromise [between dissenting judges]."
49. Considering the asymmetry of Member States' reaction to ECJ rulings, negative integration should indeed not be regarded as tantamount to an alternative form of harmonization, cf. Brokelind, in *Towards a Homogeneous EC Direct Tax Law* p. 401, id.
50. ECJ, 6 June 2000, Case C-35/98, *Verkooijen* [2000] ECR I-4071.
51. ECJ, 7 Sept. 2004, Case C-319/02, *Manninen* [2004] ECR I-7477.
52. Likewise, W. Schön, *Tax competition in Europe – the legal perspective*, EC Tax Review 9 p. 98 et seq. (2000).
53. See, in this regard, ECJ, 27 Jan. 2009, Case C-318/07, *Persche* [2009] I-359, para. 47.

> [T]he Treaty offers no guarantee to a citizen of the Union that transferring his activities to a Member State other than that in which he previously resided will be neutral as regards taxation. Given the disparities in the tax legislation of the Member States, such a transfer may be to the citizen's advantage in terms of taxation or not, according to circumstances.[54]

It has even been demonstrated that a European-wide abolition of certain, typically discriminatory tax regimes that are intended to curb international profit shifting (such as e.g. thin capitalization rules) could enhance rather than reduce the distortions caused by different national tax burdens on corporate profits.[55]

Against this background, one could imagine that the real contribution of the Court's jurisprudence on fundamental freedoms in the area of non-harmonized taxation to the improvement of tax coordination between Member States is a merely indirect one. By imposing strict limits on discriminatory measures intended to protect national tax revenue, the ECJ could step up the pressure on reluctant Member States[56] to finally reach agreement on harmonization proposals of the Commission that address these concerns. The alternative of abolishing favourable tax regimes limited in scope to purely internal situations or of extending a detrimental tax rule to domestic scenarios without real need will often be less attractive options for many Member States. However, in practice, the Court does not seem to be paving the way for positive integration, either: none of the only six EU Directives concerning aspects of direct taxation have been passed in the wake of a relevant Court decision, nor any of the main directives on indirect taxation. This may partly be due to the moderating effect of the "rule of reason" based upon which the Court has assumed certain discriminatory tax regimes to be justified, thus

54. Cf. ECJ, 15 July 2004, Case C-365/02, *Lindfors* [2004] ECR I-7183, para. 34; ECJ, 12 July 2005, Case C-403/03, *Schempp* [2005] ECR I-6421, para. 45; in a similar vein, ECJ, 28 Feb. 2008, Case C-293/06, *Deutsche Shell* [2008] I-1129, para. 43. See also, by analogy, ECJ, 1 Oct. 2009, Case C-3/08 *Leyman* [2009] ECR I-9085, para. 45; ECJ, 14 Oct. 2010, Case C-345/09, *Delft*, n.y.r., para. 100, regarding social security. It should be noted that this argument has also been brought forward to defend the presumed compatibility of international double taxation with the fundamental freedoms, cf. ECJ, 12 Feb. 2009, Case C-67/08, *Block* [2009] ECR I-883, para. 35. In this context, though, it cannot be accepted, because double (tax) burdens cannot be regarded as a consequence of disparate national tax systems; they might persist even if Member States' tax systems were fully harmonized (*see*, for further discussion, 1.1.3.).

55. Cf. R. de la Feria & C. Fuest, *Führt die EuGH-Rechtsprechung zu einem Abbau steuerlicher Verzerrungen im Europäischen Binnenmarkt?,* in *Gestaltung der Rechtsordnung – Festschrift für Joachim Lang* p. 1051 et seq. (K. Tipke et al., Köln: Schmidt Otto Verlag, 2010).

56. As regards the reservations of many Member States with respect to a harmonization of taxes on income, see Van Thiel, *supra* n. 35, at p. 4.

taking some heat off Member States to cooperate in order to maintain their revenue base. Such a possible effect will be assessed in closer detail below. However, the main reason for the apparent lack of significant influence of the Court's case law in the process of negotiating new tax legislation at the Union level is probably a different one. Frequently, some, if only a few, of the 27 Member States will benefit revenue-wise from an uncoordinated state of affairs after a ECJ ruling where profits may more easily be shifted to low-tax jurisdictions. Hence, it will often be difficult to reach the required unanimity for a more balanced European legislation.

1.2.1.2. Rule of reason: A disincentive for tax coordination

According to settled case law, a restrictive national measure may be justified by an overriding reason of public interest acknowledged by the Court. However, in order to be justified, a restrictive measure must comply with the principle of proportionality, in that it must be appropriate for securing the attainment of the objective it pursues and must not go beyond what is necessary to attain it.[57] This "rule of reason" had been developed in the *Cassis de Dijon* decision of the Court[58] in 1979 in order to counterbalance the extensive interpretation of the guarantees on free movement of goods based on the *Dassonville*-formula,[59] and it has subsequently been extended to all fundamental freedoms.[60] Since the 1990s, the rule of reason has attained considerable significance in the area of non-harmonized taxation as well,[61] where the unwritten public policy reasons accepted by the Court are far more relevant than those explicitly mentioned in the Treaty, with the exception of articles 64 and 65 of the TFEU regarding the free movement of capital. In the last 5 years, starting with the famous *Marks & Spencer* ruling,[62] the

57. See, e.g. ECJ, 18 Dec. 2007, Case C-101/05, *"A"* [2007] ECR I-11531, paras. 55 et seq.; ECJ, 17 Jan. 2008, Case C-105/07, *Lammers & Van Cleeff* [2008] ECR I-173, para. 25; ECJ, 11 June 2009, Case C-157/08, *Passenheim-van Schoot* [2009] ECR I-5093, para. 47; settled Case law, cf. L. Hinnekens, in *EU Freedoms and Taxation* p. 91 et seq. (F. Vanistendael ed., Amsterdam: IBFD, 2006); M. Isenbaert, *EC Law and the Sovereignty of the Member States in Direct Taxation* p. 372 et seq. (Amsterdam: IBFD, 2010). See also T. Tridimas, *The General Principles of EU Law*, 2nd ed., p. 209 et seq. (Oxford: Oxford Univ. Press, 2006).

58. ECJ, 20 Feb. 1979, Case 120/78, *Cassis de Dijon* [1979] ECR 649, para. 8.

59. See landmark Case ECJ, 11 July 1974, Case 8/74, *Dassonville* [1974] ECR 837, para. 5.

60. Cf. ECJ, 30 Nov. 1995, Case C-55/94, *Gebhard* [1995] ECR I-4165, para. 37.

61. For a comprehensive overview, consult A. Cordewener, G. Kofler & S. van Thiel, *The Clash Between European Freedoms and National Direct Tax Law: Public Interest Defences Available to the Member States*, Common Market Law Review 46 p. 1951 et seq. (2009).

62. ECJ, 13 Dec. 2005, Case C-446/03, *Marks & Spencer* [2005] ECR I-10837.

ECJ has been particularly inclined to uphold discriminatory tax provisions based on the rule of reason.

Essentially, the rule of reason seeks to strike a reasonable balance between national (tax) sovereignty, on the one hand, and the requirements of the EU internal market for the establishment of which the fundamental freedoms are instrumental, on the other hand. It prevents the fundamental freedoms from becoming absolute prerogatives; instead they will be qualified or, more precisely, relativized by values that are championed by the respective national legislator and not per se incompatible with primary or secondary Union law. This implies that the principles of free market access and undistorted competition inherent to the internal market concept of the Union will have to be balanced against certain national tax policy preferences. In so far as the latter may legitimately be pursued in a restrictive manner, the Court's already limited role for the promotion of tax coordination between the Member States may be further diminished. There are two possible ways in which the rule of reason could have a negative impact on tax coordination between Member States: First, it has already been pointed out that the possibility to justify – only – some elements of the discriminatory tax regimes under the proportionality condition leaves Member States with additional options after a negative verdict of the Court. National reactions and the ensuing tax landscape might thus be more heterogeneous across Europe. Second, Member States will be less incentivized to cooperate and reach consensus on measures of positive integration if they can cling to well-established albeit restrictive tax regimes with only minor amendments.

However, a closer analysis of the various public interest arguments that have been brought forward by Member States in defence of their restrictive tax regimes and of the Court's assessment of these arguments reveals that their respective relevance from a tax coordination perspective is quite diverse. It is also remarkable that the two aforementioned effects have intensified considerably after the Court's rapprochement to the position of the Member States initiated by the *Marks & Spencer* judgment.

First and foremost, the Court has consistently held that the desire to avert a loss of tax revenue will, by itself, never serve as a valid justification for continued tax discrimination.[63] However, since *Marks & Spencer*, revenue concerns may be regarded as an overriding reason of public interest if they

63. Cf. ECJ, 10 Feb. 2011, Case C-25/10, *Missionswerk Werner Heukelbach*, n.y.r., para. 31, and the Case law cited there; see also M. Dahlberg, *Direct Taxation in Relation to the Freedom of Establishment and the Free Movement of Capital* p. 271 et seq. (The Hague: Kluwer Law International, 2005), with references to the Court's Case law.

can be framed in terms of preserving a balanced allocation of taxing powers as between Member States.[64] The ECJ has repeatedly held that Member States should not be forced to forego revenue that they may regard themselves entitled to in the light of internationally accepted substantiations of the territoriality principle.[65] This argument has proven particularly important with respect to three types of national tax rules. First, loss consolidation regimes which do not permit cross-border 'importation' and offsetting of losses that have been incurred through activities carried out abroad, on grounds of a symmetrical exemption of foreign-sourced profits.[66] Second, the imposition of exit taxes aiming at an *ultima ratio* taxation of accrued but as yet unrealized capital gains upon the imminent loss or impairment of the internationally allocated power to tax these gains.[67] Finally, specific tax clauses designed to prevent "economically unsubstantiated" or "unfair" profit shifting and related tax evasion strategies, such as CFC rules, thin capitalization rules and provisions on transfer pricing adjustments.[68] With respect to all three of these sets of discriminatory tax rules, the Court has now acknowledged that Member States may have a legitimate interest in implementing them, and the ECJ has therefore "merely" elaborated on the limits imposed by the proportionality requirement.

Some aspects of this relatively new development deserve special attention in the context of international tax coordination efforts. In some areas it has undermined to a certain degree the Commission's efforts to approximate the business tax systems within the EU. From the perspective of the Member States, the Court's now consolidated case law on losses is so generous that they feel little inclined to fundamentally change their respective national

64. For critical comments with respect to some consequences of this development, see S. van Thiel & M. Vascega, *X Holding: Why Ulysses Should Stop Listening to the Siren*, Eur. Taxn. 50 p. 338 et seq. (2010).

65. Besides the Cases mentioned in the following notes, see also ECJ, 29 Mar. 2007, case C-347/04 *Rewe Zentralfinanz* [2007] ECR I-2647, para. 42; ECJ, 18 July 2007, Case C-231/05, *Oy AA* [2007] ECR I-6373, para. 54; ECJ, 18 June 2009, Case C-303/07, *Aberdeen Property Fininvest Alp*ha [2009] ECR I-5145, para. 66.

66. Cf. ECJ, 13 Dec. 2005, Case C-446/03, *Marks & Spencer* [2005] ECR I-10837, para. 46; ECJ, 15 May 2008, Case C-414/06, *Lidl Belgium* [2008] ECR I-3601, paras. 31 et seq.; ECJ, 25 Feb. 2010, Case C-337/08, *X Holding*, n.y.r., paras. 28 et seq.

67. Cf. ECJ, 7 Sept. 2006, Case C-470/04, *"N."* [2006] ECR I-7409, para. 46; ECJ, 29 Nov. 2011, Case C-371/10, *National Grid Indus*, n.y.r., para. 46; ECJ, 12 July 2012, Case C-269/09, *Commission / Spain*, n.y.r., para. 78.

68. Cf. ECJ, 12 Sept. 2006, Case C-196/04, Cadbury Schweppes [2006] ECR I-7995, paras. 55 et seq.; ECJ, 23 Apr. 2008, Case C-201/05, *CFC and Divided GL* [2008] I-2875, para. 77 (CFC regime); ECJ, 13 Mar. 2007, Case C-524/04, *Thin Cap GL* [2007] ECR I-2107, paras. 74 et seq.; ECJ, 17 Jan. 2008, Case C-105/07, *Lammers & Van Cleeff* [2008] ECR I-173, para. 28 (thin capitalization); ECJ, 21 Jan. 2010, Case C-311/08, *SGI*, n.y.r., para. 60 (transfer pricing).

systems or to even discuss the Commission's proposal on harmonizing cross-border loss relief. Most Member States have introduced no or only minor changes in reaction to the ECJ jurisprudence,[69] especially since the Court itself has explicitly stated that 'less restrictive measures … in any event require harmonisation rules adopted by the Community legislature.'[70] Together with the Court's broad acceptance of transfer pricing adjustments based on the arm's length principle, this case law has also taken some pressure off Member States to push forward the ambitious agenda of a common consolidated corporate tax base (CCCTB).[71]

Moreover, the Court has, in principle, accepted that Member States may try to remedy inadequate features of their tax treaty law – such as a divergent allocation of taxing powers regarding profits as returns on equity capital investments, on the one hand, and regarding interest payments as returns on debt capital investments, on the other hand – through discriminatory provisions – such as thin capitalization rules – rather than through a change of the treaty provisions. As a consequence, and for some other reasons discussed below, the Court's jurisprudence does not suggest that Member States should multilaterally coordinate a reform of their conventions on the avoidance of double taxation. It should be noted, though, that the ECJ has frequently had recourse to OECD standards in order to determine whether an allocation of taxing rights was indeed "balanced" and its preservation thus an overriding public interest.[72] As a result, national governments might intensify their cooperation at the OECD level and develop new recommendations aimed at protecting the national revenue base, such as in the context of company reorganization, in order to influence European jurisprudence in their favour. Since the Court will seek inspiration from OECD recommendations, Mem-

69. Even in this regard the response is not uniform due to several questions still surrounding the correct implementation of the Court's minimum requirements.

70. Cf. ECJ, 13 Dec. 2005, Case C-446/03, *Marks & Spencer* [2005] ECR I-10837, para. 58.

71. For further details, see Commission Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), 16 Mar. 2011, COM(2011) 121/4; see also Communication from the Commission, Towards an Internal Market without tax obstacles, 23 Oct. 2001, COM(2001) 582 final, 15 et seq.; Communication from the Commission, An Internal Market without company tax obstacles, 24 Nov. 2003, COM(2003) 726 final, 11 et seq.; Communication from the Commission, Progress Report, 2 May 2007, COM (2007) 223 final. For a comprehensive overview, consult M. Lang, *Common Consolidated Corporate Tax Base* (Vienna: Linde Verlag, 2008). For the latest developments and additional materials, see also http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm.

72. Cf. ECJ, 7 Sept. 2006, Case C-470/04, *"N"* [2006] ECR I-7409, para. 45; ECJ, 15 May 2008, Case C-414/06, *Lidl Belgium* [2008] ECR I-3601, para. 22 and Case law cited there. See also ECJ, 23 Feb. 2006, Case C-513/03, *van Hilten-van der Heijden* [2006] ECR I-1957, para. 48.

ber States may indirectly increase their room to manoeuvre by having the OECD declare certain practices as acceptable or even commendable. The integration of a new chapter IX on the transfer pricing aspects of business restructurings into the 2010 version of the OECD Transfer Pricing Guidelines can be seen as a step in this direction.[73]

As regards the remaining justifications available to Member States, even before the *Marks & Spencer* realignment of the Court's case law, their impact in terms of reducing the impetus for European tax coordination is considerably smaller. The ECJ has consistently rejected the contention that discriminatory national tax measures should be justified on grounds of the promotion of *national* economic interests[74] or other public policy objectives with a bias towards domestic rather than internal market effects,[75] such as tax expenditures in support of the national education sector[76] or the domestic supply of housing.[77] By contrast, the preservation of the cohesion of the national tax system, in the sense of an intrinsic compensation for detrimental taxation of cross-border transactions through directly linked tax burdens only affecting domestic transactions, has in theory been accepted as a valid justification by the Court.[78] However, in practice, Member States have hardly ever succeeded

73. For further details, see the OECD Report on the Transfer Pricing Aspects of Business Restructurings, approved by the OECD Council on 22 July 2010; available at http://www.oecd.org/dataoecd/22/54/45690216.pdf.

74. See, e.g. ECJ, 10 Mar. 2005, Case C-39/04, *Laboratoires Fournie*r [2005] ECR I-2057, para. 23; ECJ, 25 Oct. 2007, Case C-464/05, *Geurts and Vogten* [2007] ECR I-9325, para. 27; ECJ, 17 Jan. 2008, Case C-256/06, *Jäger* [2008] ECR I-123, para. 51; ECJ, 22 Dec. 2010, Case C-287/10, *Tankreederei*, n.y.r., paras. 30 et seq.

75. While the Court does not consider direct subsidies intended to promote national welfare, national infrastructure, the national educational system, etc., to constitute an infringement of the fundamental freedoms, it obviously holds it to be contrary to the internal market objective when a Member State grants incentives to private sector agents to give preference to domestic suppliers or supplies of goods, services or capital in order to promote the national economy etc.; cf. ECJ, 11 Sept. 2007, Case C-76/05, *Schwarz and Gootjes-Schwarz* [2007] ECR I-6849, para. 71. The dividing line is rather artificial from the perspective of an economic analysis, though, at least in so far as direct subsidies have similar effects of attracting private investments or activities to national rather than foreign sectors of the economy. Arguably, the Court's Case law therefore is in need of refinement.

76. Cf. ECJ, 18 Dec. 2007, Case C-281/06, *Jundt* [2007] ECR I-12231, paras. 60 et seq.; ECJ, 16 June 2011, Case C-10/10, *Commission v. Austria*, n.y.r., paras. 33 et seq.

77. Cf. ECJ, 26 Oct. 2006, Case C-345/05, *Commission v. Portugal* [2006] ECR I-10633, paras. 34 et seq.; ECJ, 17 Jan. 2008, Case C-152/05, *Commission v. Germany* [2008] ECR I-39, paras. 27 et seq. But see also the more tentative approach in ECJ, 15 Oct. 2009, Case C-35/05, *Busley and Cibrian* [2009] ECR I-9807, paras. 31 et seq.

78. See landmark ruling ECJ, 28 Jan. 1992, Case C-204/90, *Bachmann* [1992] ECR I-249, paras. 21 et seq. For further details, see A. Cordewener, G. Kofler & S. van Thiel, *The Clash Between European Freedoms and National Direct Tax Law: Public Interest Defences Available to the Member States*, Common Market Law Review 46 p. 1969 et

with that argument.[79] As regards measures designed to combat fiscal elusion and tax avoidance through "abusive" tax schemes, the abuse argument has only become a striking one in the Court's case law when it could be invoked in combination with the interest in preserving a balanced allocation of taxing rights discussed above.[80]

Finally, the need to guarantee the effectiveness of fiscal supervision and of the tax collection have been accepted as overriding requirements of general interest capable of justifying a restriction on the fundamental freedoms.[81] However, at least within an intra-Union context, the Court has established strict proportionality requirements in this regard, to the effect that substantive tax law must not discriminate on these grounds.[82] Member States may only maintain, under certain conditions, asymmetrical (but not final) withholding taxes,[83] and their tax authorities may require the "free mover" to provide any evidence that they may consider necessary for assessing the tax liability.[84] Hence, the only real obstacle to an approximation of Member States' tax systems brought about by the traditional application of the rule of reason in the area of non-harmonized tax law is the lack of effective control with respect to discriminatory national tax procedure. Consequently, and regrettably, the Court's case law on fundamental freedoms so far has not contributed to the emergence of minimum standards for taxpayer compliance burdens.

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seq. (2009); J. Englisch, Dividend Taxation and Fiscal Cohesion, Part I and Part II, Eur. Taxn. pp. 323 et seq. and 355 et seq. (2004).

79. The only exception that is relevant in the context of diminished incentives for tax coordination is the decision of the ECJ, 27 Nov. 2008, Case C-418/07, *Papillon* [2008] ECR I-8947, paras. 41 et seq., concerning discriminatory elements of the French group taxation regime that were held to be justified, in principle, by the need to safeguard fiscal cohesion, and deemed disproportionate only with respect to their concrete implementation.

80. See the Case law cited in notes 66 and 68; as compared to, e.g. ECJ, 11 Mar. 2004, Case C-9/02, *Lasteyrie du Saillant* [2004] ECR I-2409, paras. 50 et seq.; ECJ, 4 Dec. 2008, Case 330/07, *Jobra* [2008] ECR I-9099, paras. 35 et seq.

81. See, e.g. ECJ, 28 Oct. 1999, Case C-55/98, *Vestergaard* [1999] ECR I-7641, para. 25; ECJ, 26 Sept. 2000, Case C-478/98, *Eurobonds* [2000] ECR I-7587, para. 38; ECJ, 14 Sept. 2006, Case C-386/04, *Stauffer* [2006] ECR I-8203, para. 47; ECJ, 11 Oct. 2007, Case C-451/05, *ELISA* [2007] ECR I-8251, para. 81; ECJ, 11 June 2009, Joined Cases C-155/08 and C-157/08, *X & Passenheim van Schoot* [2009] ECR I-5093, para. 45.

82. Cf. ECJ, 26 Oct. 1995, Case C-151/94, *Commission v. Luxemburg* [1995] ECR I-3685, para. 21; ECJ, 8 July 1999, Case C-254/97, *Baxter* [1999] ECR I-4809, paras. 19 et seq.; ECJ, 10 Mar. 2005, Case C-39/04, *Laboratoires Founier* [2005] ECR I-2057, para. 25; ECJ, 14 Sept. 2006, Case C-386/04, *Stauffer* [2006] ECR I-8203, para. 49.

83. Cf. ECJ, 3 Oct. 2006, Case C-290/04, *Scorpio Konzertproduktionen* [2006] ECR I-9461, paras. 35 et seq.; ECJ, 22 Dec. 2008, Case C-282/07, *Truck Center* [2008] ECR I-10767, paras. 33 et seq.

84. See, e.g. ECJ, 3 Oct. 2002, Case C-136/00, *Danner* [2002] ECR I-8147, para. 50; ECJ, 30 Jan. 2007, Case C-150/04, *Commission v. Denmark* [2007] ECR I-1163, para. 54; ECJ, 27 Jan. 2009, Case C-318/07, *Persche* [2009] I-359, paras. 53 et seq.

In particular, the principles of equivalence and effectiveness cherished by the ECJ as controls on national procedural autonomy with respect to other Union law standards impinging on national tax law[85] – such as the State aid prohibition of article 107 of the TFEU, or secondary Union law – have so far not gained much traction within the fundamental freedom framework. The recently decided case *Meilicke II* has not significantly improved this state of affairs.[86]

Notwithstanding the general statement that the rule of reason tends to operate as a disincentive for further tax coordination between the Member States, there are two aspects related to it that counteract, to a certain degree, these adverse effects. First, the ECJ has consistently denied Member States any margin for generalizing assumptions, e.g. in the context of the fiscal cohesion argument or with a view towards identifying abusive tax schemes.[87] To put it differently, the administrative efficiency of a restrictive tax regime has not been accepted as an overriding reason of public interest that could shield it from amendments required by the fundamental freedoms. By contrast, the Court tends to be significantly more generous with the Union legislator in this regard.[88] While this double standard is certainly questionable,[89] it nevertheless could provide an enticement for Member States to harmonize their legislation in order to have greater latitude for generalizing tax law provisions. Second, the Court has repeatedly held that "national legislation is appropriate to ensuring attainment of the objective pursued only if it genuinely reflects a concern to attain it in a consistent and systematic manner."[90]

85. Cf. Terra & Wattel, *supra* n. 9, at p. 88 et seq.
86. See ECJ, 30 June 2011, Case C-262/09, *Meilicke*, n.y.r., paras. 42 et seq.; see also ECJ, 10 Feb. 2011, Case C-436/08, *Haribo Lakritzen*, n.y.r., paras. 91 et seq.; ECJ, 15 Sep. 2011, Case C-310/09, *Accor*, n.y.r., paras. 77 et. seq.
87. Cf. ECJ, 15 July 2004, Case C-315/02, *Lenz* [2004] ECR I-7063, paras. 34 et seq.; ECJ, 13 Mar. 2007, Case C-524/04, *Thin Cap GL* [2007] ECR I-2107, paras. 68 et seq.; ECJ, 1 July 2010, Case C-233/09, *Dijkman*, n.y.r., paras. 49 et seq. (fiscal cohesion); ECJ, 12 Sept. 2006, Case C-196/04, *Cadbury Schweppes* [2006] ECR I-7995, paras. 30 et seq.; ECJ, 21 Jan. 2010, Case C-311/08, *SGI*, n.y.r., para. 71 (abusive tax schemes).
88. Cf. ECJ, 26 Oct. 2010, Case C-97/09, *Schmelz*, n.y.r., paras. 56 et seq.
89. For further comments, see 1.1.4.
90. See, e.g. ECJ, 8 Sept. 2009, Case C-42/07, *Liga Portuguesa* [2009] ECR I-7633, para. 61; ECJ, 17 Nov. 2009, Case C-169/08, *Regione Sardegna* [2009] ECR I-10821, para. 42; ECJ, 10 Mar. 2009, Case C-169/07, *Hartlauer* [2009] ECR I-1721, para. 55; ECJ, 1 June 2010, Case C-570/07, *Blanco Pérez*, n.y.r., para. 94. See also Opinion of Advocate General Poiares Maduro, 30 Sept. 2009, Case C-570/07, *Blanco Pérez*, n.y.r., point 21. For an in-depth analysis, consult G. Mathisen, *Consistency and Coherence as Conditions for Justification of Member State Measures Restricting Free Movement*, Common Market Law Review 47 p. 1021 et seq. (2010). See also ECJ, 14 Feb. 1995, Case C-279/93, *Schumacker* [1995] ECR I-225, paras. 43 and 46 (regarding different source state treatment of frontier workers depending on their state of residence); ECJ, 18 Sept. 2003, Case C-168/01, *Bosal* [2003] ECR I-9409, para. 36.

As a consequence, a Member State will find it difficult to defend certain restrictive measures, which judged in isolation could be considered justified and proportional, if it has adopted such measures only with regard to some, but not all other Member States. This will serve as an incentive for a Member State to unilaterally ensure a coordinated approach in its relationships to the other Member States – but, of course, it also implies less room to manoeuvre in tax treaty negotiations.

1.2.1.3. No incentives for the harmonization of tax treaty law

The ECJ has (almost) consistently refused to conduct a most-favoured-nation test of bilateral or unilateral measures aimed at the avoidance of international double taxation and a fair allocation of taxing rights.[91] In particular, the disparities between the allocation rules of tax treaties concluded by a Member State with a variety of other Member or non-Member States do not, by themselves, constitute a restriction of the free movement guarantees.[92] Hence, there is no primary law obligation of a source-country Member State to extend the lowest withholding tax rate negotiated in any of its tax treaties for certain types of income to residents of all other Member States that receive such income, nor is there an obligation for the Member State of residence to apply the exemption method with respect to all income sourced in another Member State if this method is applied with respect to only some source countries.

In the author's view, this highly disputed jurisprudence is indeed well founded, because the imposition of a most-favoured-nation obligation with respect to maximum withholding tax rates in the source country, the application of the exemption method in the country of residence and other allocation rules cannot even theoretically promote the internal market objective of equal conditions of competition (the "level playing field"):[93] Neither within the

91. See, e.g. ECJ, 12 Dec. 2006, Case C-374/04, *ACT Group Litigation* [2006] ECR I-11673, paras. 84 et seq.; ECJ, 20 May 2008, Case C-194/06, *Orange Smallcap* [2008] ECR I-3747, paras. 50 et seq.; however, see also the obiter dictum in ECJ, 11 June 2009, Case C-521/07, *Commission v. Netherlands* [2009] ECR I-4873, paras. 36 et seq. and para. 58.

92. See also ECJ, 6 Dec. 2007, Case C-298/05, *Columbus Container Services* [2007] ECR I-10451, paras. 43 et seq.

93. It should be pointed out, though, that the ECJ routinely fails to sufficiently distinguish between an MFN obligation regarding the allocation of taxing rights, on the one hand, and limitation of benefits (LOB) clauses, on the other hand; see, e.g., ECJ, 12 Dec. 2006, Case C-374/04, ACT *Group Litigation* [2006] ECR I-11673, paras. 84 et seq. and paras. 89 et seq.; P. Pistone, The Need for Tax Clarity and the Application of the Acte Clair Doctrine to Direct Taxes, Intertax p. 534 (2007). The internal market impact analysis with