

The Jurisprudence of the European Court of Justice: Limitation of the Legal Consequences?

I. "JUDICIAL ACTIVISM" AND DIRECT TAXATION

Regarding to direct taxation, ECJ case law has become the driving force in Community law. In various judgments, the ECJ has emphasized that the Member States may only administer their competences in line with Community law.¹ On this basis, the ECJ has exerted its full competence regarding Community law. It has regularly interfered with national direct tax law by emphasizing the freedoms of movement of the Internal Market, especially the free movement of workers (Art. 39 of the EC Treaty), the freedom of establishment (Art. 43 of the EC Treaty), the freedom to provide services (Art. 49 of the EC Treaty) and the

¹ Compare ECJ, 14 February 1995, Case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker* [1995] ECR I-225, Para. 21; ECJ, 14 September 1999, Case C-391/97, *Frans Gschwind v. Finanzamt Aachen-Außenstadt* [1999] ECR I-5451, Para. 20; ECJ, 21 September 1999, Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v. Finanzamt Aachen-Innenstadt* [1999] ECR I-6161, Para. 58; and ECJ, 8 March 2001, Joined Cases C-397/98 and C-410/98, *Metallgesellschaft Ltd and Others, Hoechst AG and Hoechst UK Ltd v. Commissioners of Inland Revenue, HM Attorney General* [2001] ECR I-1727, Para. 37. Examples in scientific literature include Cordewener, *Europäische Grundfreiheiten und nationales Steuerrecht* (Cologne: Dr. Otto Schmidt Verlag, 2002), pp. 53 et seq and Kluge, *Das Internationale Steuerrecht*, (Munich: Beck, 2000), K 17 et seq.

free movement of capital (Art. 56 of the EC Treaty), in the context of "useful effect" (*effet utile*).²

The ECJ's practice has been characterized as "harmonization through the back-door".³ This description is, however, as often read, not exactly to the point. As the ECJ has tried to safeguard the Community in terms of interpretation and application (Art. 220(1) of the EC Treaty), the Court can only create "selective highlights", but not, a priori, conceptual changes. Specifically, in preliminary ruling (Art. 234 of the EC Treaty) or infringement procedures (Art. 227 and Art. 232 of the EC Treaty), the ECJ cannot act in a constructive manner to improve the compatibility of the national taxation systems of the Member States with each other. Naturally, the ECJ's judgments may have rather destructive effect on national tax law.⁴ I like to illustrate this by two representative examples of recent ECJ judgments, the *Manninen* and *de Lasteyrie du Saillant*⁵ cases, to

² With regard to the principle of *effet utile*, see ECJ, 9 November 1983, Case 199/82, *Amministrazione delle Finanze dello Stato v. SpA San Giorgio* [1983] ECR 3595, Para. 14 and ECJ, 14 December 1995, Case C-312/93, *Peterbroeck, Van Campenhout & Cie SCS v. Belgian State* [1995] ECR I-4599, Para. 12 both with further references.

³ See Cordewener, note 6, pp. 25 et seq and Drüen and Kahler, "Die nationale Steuerhoheit im Prozess der Europäisierung", *Steuer und Wirtschaft* (2005), pp. 171 et seq, at p. 174.

⁴ See Mössner, "Der EuGH als Steuergesetzgeber", *Archiv für Schweizerisches Abgabenrecht*, Bd. 72 (2004), pp. 673 et seq, at p. 678; Ahmann, "Das Ertragsteuerrecht unter dem Diktat des Europäischen Gerichtshofs? Können wir uns wehren?", *Deutsche Steuerzeitung* (2005), pp. 75 et seq, at p. 78; Birk, "Das sog. 'Europäische' Steuerrecht", *Finanz-Rundschau* (2005), pp. 121 et seq, at pp. 125-126 with examples; and Hey, "Erosion nationaler Besteuerungsprinzipien im Binnenmarkt?", *Steuer und Wirtschaft* (2005), pp. 317 et seq, at p. 321. See also Fischer, "Europa macht mobil - bleibt der Verfassungsstaat auf der Strecke?", *Finanz-Rundschau* (2005), pp. 457 et seq.

⁵ ECJ, 11 March 2004, Case C-9/02, *Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie* [2004] ECR I-2409.

focus attention on the different quality of case law in contrast to the "creative nature" of acts of Community law.

The *Manninen* case both dealt with national rules designed to compensate for double taxation on dividend payments at the corporate and shareholder levels. In the *Manninen* case, to avoid economically unsustainable results, Finnish tax law granted shareholders a tax credit related to the amount of the dividend payment. The tax credit was limited to the dividend payments of domestic corporations. The ECJ held that this rule in Finnish tax law restricted the free movement of capital in Art. 56 and 58 of the EC Treaty. Specifically, according to the ECJ, by limiting the tax credit to domestic dividends, the rule discriminated against the shareholders of corporations in other Member States who were subject to unlimited Finnish tax liability. The ECJ stated that this restriction of the free movement of capital could not be justified by the "restriction of taxation" in Art. 58 (1) of the EC Treaty, as this exception to the principle of the free movement of capital could only be applied within strict limits.⁶ This required that the facts to be assessed were not comparable, impartially, or that common interest necessitated a differentiation between these facts. In respect of the intention of the national rule to prevent double taxation, shareholders, who

⁶ ECJ, 7 September 2004, Case C-319/02, *Petri Manninen* [2004] ECR I-7477, Paras. 32 et seq.

were subject to unlimited tax liability in Finland, were in a comparable situation, regardless of whether they received their dividend payment from a domestic or from a foreign Member State corporation.

The ECJ did not accept the coherence of the national tax systems as a justification for a restriction of the freedom of capital movement. The Court admitted that the advantage of a tax credit directly related to the disadvantage that the dividend payment has already been subject to corporate income tax. There was, however, no remedy for an unequal treatment because of a lack of proportionality. The ECJ simply stated that the double taxation of dividends could be avoided if the shareholders of corporations situated in foreign Member States were also granted such a tax credit.⁷ The Finnish rule was, therefore, not essential to maintain the coherence of the national tax system. By ruling in this way, the ECJ gave the impression that the "coherence of the national tax systems" is nothing more than a worthless phrase for justifying restrictions to the free movement of capital.⁸ Specifically, the ECJ did not positively examine what is essential to the coherence of the Finnish tax system. Neither did the ECJ

⁷ Id., Para. 46.

⁸ In contrast, Advocate General Kokott deemed it possible to extend the principle of coherence to cases in which the tax advantage and the corresponding disadvantage was divided between two tax subjects. See ECJ, Advocate General Kokott's Opinion, 18 March 2004, Case C-319/02, *Petri Manninen* [2004] ECR I-7477, Para. 61.

give any general indication as to which elements would form a coherent tax system. The ECJ's statement is, therefore, limited to mere negation.

The judgment in the *Manninen* case does not convince. *Dieter Birk* has rightly asked "Can the application and interpretation of the freedoms of movement force a Member State to credit tax payments, which it did not levy?"⁹ This is, indeed, what the ECJ demanded. The ECJ did not even refer to the fact that the foreign dividend had not been subject to Finnish corporate income tax, which is the striking fact from a national perspective. Despite national sovereignty in respect of direct taxation being clearly defined in the EC Treaty, the ECJ ignored the fiscal competence of the Member States and expected the Member States to give a credit for a foreign Member State's tax without even explicitly stating this.¹⁰ It is the ECJ's silence on how a solution to a cross-border case could be decided so as to conform with Community law, whilst, at the same time, respecting the sovereignty of the Member States with regard to direct taxation, that gives rise to the destructive impact of the ECJ case law.

⁹ Birk, note 9, p. 126, i.e. "*Können die Grundfreiheiten so weit gehen, dass ein Mitgliedstaat gezwungen wird, Steuern zu erstatten, die er gar nicht eingenommen hat?*" From a different perspective but also critical, see Englisch, *Dividendenbesteuerung* (Cologne: Dr. Otto Schmidt Verlag, 2005), pp. 349-350.

¹⁰ For a discussion on the relevance of national tax sovereignty in relation to the freedoms of movement in the EC Treaty see Kube, "Grundfreiheiten und Ertragskompetenz - die Besteuerung der grenzüberschreitenden Konzernfinanzierung nach dem Lankhorst-Urteil des EuGH", *Internationales Steuerrecht* (2003), pp. 325 et seq, at pp. 329 et seq; Seiler, "Das Steuerrecht unter dem Einfluss der Marktfreiheiten", *Steuer und Wirtschaft* (2005), pp. 25 et seq, at pp. 28 et seq; and Fischer, note 9, pp. 458-459.

One of the recent judgments on international taxation of the ECJ that is most referred to is the *de Lasteyrie du Saillant* case. In this case, having resided in France for a long time, the taxpayer moved to Belgium. At that time, the taxpayer had held shares for more than five years that entitled him to a share of more than 25% in the revenue of a company residing in France. According to the French rule regarding "expatriation taxation", a taxpayer had to pay taxes in respect of the increase in the value of the shares. This was computed as the difference between the historical cost and the fair market value of the shares. It was, however, possible for the taxpayer to defer the payment of the tax due.

Following the Opinion of Advocate General Mischo,¹¹ the ECJ held that the French rule regarding expatriation taxation did not comply with the freedom of establishment.¹² Specifically, the ECJ drew attention to the discriminating effect of the French rule. In contrast to persons who retained their French residence, taxpayers who move abroad were liable to pay tax on unrealized income. In this context, the ECJ emphasized that Art. 43 of the EC Treaty is not only designed to provide treatment equal to that of the destination Member State's citizen, but

¹¹ ECJ, Advocate General Mischo's Opinion, 13 March 2003, Case C-9/02, *Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie* [2004] ECR I-2409.

¹² ECJ, 11 March 2004, Case C-9/02, *Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie* [2004] ECR I-2409, Para. 48 and Art. 43 of the EC Treaty.

also to prevent the home Member State from creating any obstacles for its own citizens to move their residence to another Member State.

As a justification, the ECJ discussed various arguments advanced by the Member States.¹³ It was argued that this contradicted the referring court in its view that the rule in question was intended to prevent tax evasion. The transfer of residence alone could not, however, result in the conclusion that the taxpayer was avoiding or even evading tax.¹⁴ The objective of preventing tax evasion could also be achieved by means that were less drastic. The fact that the rule permitted the deferral of the payment did not result in a different conclusion, as the deferral was not granted automatically, but only subject to restrictions.¹⁵ In line with its previous judgments, the ECJ ignored the Danish government's regarding the protection of tax revenue.¹⁶ In addition, the ECJ did not accept the argument of the coherence of the French tax system.¹⁷ In the reasons for its judgment, the ECJ stated that expatriation taxation according to the French government was intended to prevent French citizens from transferring their residence abroad and not to tax an increase in the value of share during residence in France.

¹³ Id., Paras. 19-34.

¹⁴ Id., Paras. 50 et seq.

¹⁵ Id., Paras. 55-56.

¹⁶ Id., Paras. 59-60.

¹⁷ Id., Paras. 61 et seq.

As in the *Manninen* case, the ECJ again limited its reasoning to negation. Why was it not a legitimate characteristic of a coherent national tax system to tax the "hidden reserves" that had accumulated during the period of domestic residence due to the increase in the value of shares when the shareholder ceased being subject to national taxation?¹⁸ If the Member States could not tax such a hidden reserves later when the shares were finally sold, there was no alternative to taxing the reserves on transferring residence. Even the Council Directive on administrative assistance by the competent authorities of the Member States¹⁹ does not provide any assistance. What tax administration voluntarily supervises the activities of immigrants for the benefit of foreign tax authorities? How could the home Member State enforce the taxpayer's legal responsibility if the taxpayer moved residence again? Anyway, consistent cross-border tax supervision will remain illusory for the foreseeable future.²⁰

A constructive harmonization of the transfer residence would, however, inevitably result in the following scenario. A cross-border valuation system in these cases would have to be established as well as a cross-border supervision system.

¹⁸ Rightly critical, see Fischer, "Mobilität und Steuergerechtigkeit in Europa", *Finanz-Rundschau* (2004), pp. 630 et seq and note 9, p. 465.

¹⁹ Council Directive 77/799/EEC of 19 December 1977, Official Journal (EEC), L 336, 27 December 1977, p. 15.

²⁰ Fischer, note 24, pp. 633-634 and Hey, note 9, p. 323.

At the same time, it would be necessary to consent to the distribution of revenue amongst the Member States. All these problems could only be resolved by a directive at Community level and not by case law. As long as this has not occurred, the author prefers to understand "exit taxation" as one element of a coherent national income tax system.²¹

In contrast, the ECJ only compared the legal position regarding taxation from the perspective of the market participant. This is primarily oriented towards a functioning Single Market. The participants in the Single Market exercise their right to make extensive use of the Single Market without regard to national borders and to invest or even transfer their residence to other Member States that are potentially more attractive for taxation reasons. **In these circumstances**, according to the ECJ, the fiscal interests of the Member States are subordinated, although the ECJ did assume national sovereignty regarding fiscal revenue.²² Accordingly, the ECJ sacrificed national sovereignty with regard to taxation, as symbolized by the coherence of national tax systems in a one-sided manner.

²¹ Concurring, see Fischer, note 24, pp. 632-633.

²² See Seiler, note 16, p. 28.

II. LIMITS TO COMMUNITY LAW IN RECENT ADVOCATES GENERAL'S OPINIONS

ECJ judgments generally have effect *ex tunc*. The Court adjudicates on the application and interpretation of Community law from the very moment of its enforcement. The ECJ's judgments are, therefore, of a declaratory, but not of a constitutive character. The results of the ECJ's interpretation are also regularly applied to legal relationships that came into existence before the relevant judgment.²³ In as far as tax assessments are based on national rules contrary to Community law and the relevant limitation period has not yet expired, the taxpayers concerned may in hindsight claim changes to their benefit.

Previously, there have been very few examples of the ECJ restricting the effects of its judgments to a limited period in time. Compelling reasons of legal certainty may, however, require such a restriction, for example, if a large number of legal relationships entered into in "good faith" are involved and, therefore, the retroactive effect would result in significant economic disruption. Accordingly, the ECJ restricted the application of EU customs regulations in respect of the French overseas *départements* before the enforcement of these regulations to

²³ See ECJ, 15 September 1998, Case C-231/96, *Edilizia Industriale Siderurgica Srl (Edis) v. Ministero delle Finanze* [1998] ECR I-4951, Paras. 15-17.

those persons who had taken legal action or had previously appealed.²⁴ The special legal position of the French overseas *départements* and the fact that the *octroi de mer* was only levied in the *départements* created a state of uncertainty with regard to the compatibility of the tax with Community law. The legal bodies of the Community had, however, behaved in such a way that the French tax authorities could have assumed that levying the charge complied with Community law. As a result, compelling reasons of legal certainty prevented past legal relationships being questioned, otherwise the financial system of the local authorities involved would have been at risk.

In dealing with the comparable problem of the Austrian municipal beverage tax (*Gemeindegetränkesteuer*), the ECJ also granted similar *protection* regarding budgetary sovereignty.²⁵ As the Commission allowed the Austrian government to assume that the municipal beverage tax complied with Community law, the ECJ similarly restricted tax repayments to those subjects of tax that had appealed against the tax assessments before the enforcement of the judgment. Compelling reasons of legal certainty precluded a legal relationship that only resulted in the past being questioned in hindsight. As with the judgment regard-

²⁴ ECJ, 16 July 1992, Case C-163/90, *Administration des Douanes et Droits Indirects v. Léopold Legros and others* [1992] ECR I-4625.

²⁵ ECJ, 9 March 2000, Case C-437/97, *Evangelischer Krankenhausverein Wien v. Abgabenberufungskommission Wien and Wein & Co. HandelsgesmbH v. Oberösterreichische Landesregierung* [2000] ECR I-1157, Paras. 57 et seq.

ing the *octroi de mer*, the ECJ emphasized that tax repayments for previous charges would place the budgets of the local Austrian authorities at severe risk.

In conclusion, the ECJ does not accept national budgetary interests as a substantial justification, the consistent extension of its judgments to the past is **one** way of attaining the discipline of the Member States in this respect. Accordingly, the ECJ has only accepted a limitation on the temporal effect of a ruling “*in quite specific circumstances, ... where it appeared that both individuals and national authorities had been led into adopting practices which did not comply with Community law by reason of objective, significant uncertainty regarding the implications of Community provisions, to which the conduct of other Member States or the Commission may even have contributed*”²⁶.

In the *Banca di Cremona*, the Italian *imposta regionale sulle attività produttive* (IRAP), which is a regional indirect tax, has come under scrutiny with regard to Community law. According to Advocate General Jacobs, IRAP has all the characteristics of harmonized VAT and, therefore, violates Art. 33 of the Sixth

²⁶ ECJ, 20 September 2001, Case C-184/99, *Rudy Grzelczyk v. Centre public d'aide sociale d'Ottignies-Louvain-la-Neuve* [2001] ECR I-6193, Para. 53 and ECJ, 15 March 2005, Case C-209/03, *The Queen (on the application of Dany Bidar) v. London Borough of Ealing, Secretary of State for Education and Skills*, Para. 69.

VAT Directive.^{27,28} Studies by the Italian government conclude that a judgment following this Opinion, without limit to its time scope, would result in tax repayments of more than EUR 120 billion. The Commission had also evidently and actively induced the good faith of the Italian legislator by stating that the draft IRAP law complied with Community law in advance of its enforcement.²⁹ Taking this into consideration, both Advocates General Jacobs and Stix-Hackl argue for a time limit regarding the effects of any judgment with regard to the case and referred to the *Unvereinbarkeits-judicature*³⁰ of the German Constitutional Court (*Bundesverfassungsgericht*).³¹ At least, Advocate General Jacobs has admitted that the ECJ would enter into unknown territory if it followed his Opinion.³²

Unfortunately, the ECJ did not take the opportunity to put its jurisdiction which is dealing with limitation of legal consequences into concrete terms. Instead of this, the ECJ judgment denied a violation of the 6th VAT directive by the

²⁷ Council Directive 77/388/EEC, Official Journal (EEC), 13 June 1977, L 145, pp 1 et seq.

²⁸ See ECJ, Advocates General Jacobs' and Stix-Hackl's Opinions, 17 March 2005 and 14 March 2006, Case C-475/03, *Banca Popolare di Cremona v. Agenzia Entrate Ufficio Cremona*, Paras. 70 and 128, **respectively**.

²⁹ *Id.*, Paras. 77 and 156, **respectively**.

³⁰ Jurisprudence regarding incompatibility with the German Constitution.

³¹ See ECJ, Advocate General Jacobs' Opinion, 17 March 2005, Case C-475/03, *Banca Popolare di Cremona v. Agenzia Entrate Ufficio Cremona*, Para. 86. **See also** ECJ, Advocate General Stix-Hackl's Opinion, 14 March 2006, Case C-475/03, *Banca Popolare di Cremona v. Agenzia Entrate Ufficio Cremona*, Paras. 150 et seq.

³² *Id.*, Para. 87.

IRAP³³. Soon, the ECJ will have another opportunity in a pending case, the *Meilicke case*. The former Advocate General Tizzano proposed in his opinion an additional step into unknown territory by further promoting the budgetary sovereignty of the Member States.³⁴ He proposed a "specific" limitation of the legal consequences³⁵. The incompatibility with the community law of the national provision in question should only takes effect from the day of delivery of the judgement of 6th June 2000 in the *Verkooijen case*. With this proposal he opened up the possibility for a "lottery of legal consequences" that has already marked the jurisprudence of the German Federal Constitutional Court.³⁶ The judgements vary from Constitution annulment to declarations of incompatibility with or without retroactive effect, the latter with or without exceptions in respect of contested cases, to the mere appeal of judgments with or without specifying a time limit.³⁷ Accordingly, the German Constitutional Court acknowledges the necessity for periodical budget planning (Art. 110(2) of the German Constitution) as a justification, without giving any indication of why a

³³ ECJ, 3 October 2006, Case C-475-03, *Banca popolare die Cremona v. Agenzia Entrate Ufficio Cremona*, para. 30 et seqq.

³⁴ ECJ, Advocate General Tizzano's Opinion, 10 November 2005, Case C-292/04, *Wienand Meilicke Heidi Christa Weyde Marina Stöffler v. Finanzamt Bonn-Innenstadt*, Para. 59.

³⁵ ECJ, Advocate General Tizzano's Opinion, 10 November 2005, Case C-292/04, *Wienand Meilicke Heidi Christa Weyde Marina Stöffler v. Finanzamt Bonn-Innenstadt*, Paras. 48 et seq.

³⁶ ECJ, Advocate General Tizzano's Opinion, 10 November 2005, Case C-292/04, *Wienand Meilicke Heidi Christa Weyde Marina Stöffler v. Finanzamt Bonn-Innenstadt*, Para. 42.

³⁷ Critical of this, see Seer, "Die Unvereinbarkeitserklärung des BverfG am Beispiel seiner Rechtsprechung zum Abgabenrecht", *Neue Juristische Wochenschrift* (1996), pp. 285 et seq, at pp. 289 et seq; Seer, in Tipke and Lang, *Steuerrecht*, 18th edition. (Cologne: Dr. Otto Schmidt Verlag, 2005), Sec. 22, Paras. 285.

certain legal consequence must dogmatically result from a given case. Although Sec. 78, Sec. 82(1) and Sec. 95(3) of the Federal Constitutional Court Law (*Bundesverfassungsgerichtsgesetz*) generally assume that laws that do not comply with the German Constitution should be revoked, to date such treatment has been the rare exception.

During the hearing in the *Melicke case*, the German Federal Ministry of Finance (*Bundesfinanzministerium*) estimated that tax repayments to shareholders of foreign corporations would amount to EUR 5 billion (having previously estimated the amount at EUR 9 to EUR 13 billion).³⁸ Even if the estimates of the German Federal Ministry of Finance are only approximate, there would be severe consequences for public budgets if the ECJ should, as expected, hold that the German corporate income tax imputation system does not comply with Community law. This is not, however, sufficient for a justification of a limitation of the legal consequences following the ECJ's judgments. Such a justification requires that the German legislator acted in good faith. In respect of Advocate General Tizzano's Opinion, this was not the case, as the Commission had criticized Germany's imputation system due to its incompatibility with Commu-

³⁸ Id., Para. 35.

nity law in writing on 31 October 1995.³⁹ Why should the German government be permitted to assume the opposite just because an infringement procedure had not been opened before the judgment in the *Verkooijen*⁴⁰ case in 2000?

In contradiction to opinion of former General Advocate *Tizzano* the recent General Advocate *Stix-Hackl* does not promote in her new opinion of 5th October 2006 any limitation of legal consequences of the ECJ decisions⁴¹. In particular, she disagrees with *Tizzano* who found an objective and significant legal uncertainty by merely omitting to pursue treaty infringement proceedings against Germany after an informal preliminary procedure. Mere doubts as to whether or not national rules comply with Community law are not sufficient to endanger the budgetary protection of the Member States. The former Advocate General *Tizzano* rather holds the view that significant uncertainties in respect of the scope of Community law constitute a situation in which good faith should be interpreted to the benefit of the national legislator. As perceived from the German national context regarding the judgments of the German Constitutional Court, this would encourage legislators to test if national law complied with

³⁹ Id., Para. 36. Similarly see Balmes and Ribbrock, "Die Schlussanträge in der Rechtssache Meilicke - Vorschlag einer zeitlichen Begrenzung der Wirkung des Urteils 'auf Zuruf' der Mitgliedstaaten ?!", *Betriebs-Berater* (2006), pp. 17 et seq, at p. 19.

⁴⁰ ECJ, 6 June 2000, Case C-35/98, *Staatssecretaris van Financiën v. B.G.M. Verkooijen*, [2000] ECR I-4071.

⁴¹ ECJ, Advocate General Stix-Hackl's Opinion, 5 October 2006, Case C-292/04, *Wienand Meilicke Heidi Christa Weyde Marina Stöffler v. Finanzamt Bonn-Innenstadt*, Para. 39 et seqq.

Community law or even to accept the incompatibility of domestic laws with higher law. In the worst case scenario, the ECJ could compel the Member States to correct such an incompatibility. The fact that the financial consequences are, at the same time, a material condition and the origin for a limitation of the legal consequences regarding the past could even result in a paradox situation, in which serious violations of Community law gave rise to trivial legal consequences, in the form of a mere declaration of incompatibility. Such changes in jurisprudence would be unconvincing⁴².

III. NECESSARY COMPENSATION BY SPECIFYING AND CONSISTENTLY APPLYING THE PRINCIPLE OF COHERENCE

In general, I agree with the ECJ's consistent jurisprudence that mere budgetary reasons cannot justify any limitation on the freedoms of movement. As long as the European Union does not establish international revenue compensation, national budgeting and budgetary balancing should remain solely within the sovereignty of the Member States. The fact that the Community consciously excludes tax policy from harmonization must, however, result in the conclusion that the Member States are generally free to design their national tax systems.

⁴² Seer, *The Jurisprudence of the European Court of Justice: Limitation of the Legal Consequences?*, *European Taxation* (2006), p. 470 et 475.

The Member States must, therefore, be given the opportunity to maintain a systematic and consistent national tax law.⁴³ As such, if a coherent tax law provides rules referring to cross-border cases, it inevitably touches on the freedoms of movement at a Community level.

The sovereignty of the Member States is exactly what the ECJ has recognized and what has made the Court accept the coherence of national tax systems as a principle for justifying limitations of the freedoms of movement with regard to the rule of reason. But this justification is still vague and without substantial application. Accordingly, the ECJ has only once allowed the justification to have effect, i.e. in the *Bachmann*⁴⁴ case. In this case, a mere formal view resulted in the ECJ concluding that a rule limiting the freedoms of movement was justified because of its direct connection to a tax credit that had been granted to the same subject of tax in respect of the same type of tax. To the author's knowledge, the ECJ has not used coherence as a justification again.

In the *Manninen* case, the ECJ stated that there was a lack of commensurability in the Finnish law that imputed corporate income tax in respect of the dividend

⁴³ See Fischer, note 9, pp. 458 et seq and note 24, pp. 633 et seq; Birk, note 9, p. 126; and Hey, note 9, p. 319.

⁴⁴ ECJ, 28 January 1992, Case C-204/90, *Hanns-Martin Bachmann v. Belgian State* [1992] ECR I-249, Paras. 17 et seq. See also Cordewener, note 6, pp. 441 et seq.

payments of domestic corporations. Briefly, the ECJ explained that granting tax credits to shareholders of corporations resident in foreign Member States could also avoid a double tax burden on dividend payments.⁴⁵ On the one hand, the ECJ implicitly extended the connection between tax liability and tax credit with regard to interpersonal cases.⁴⁶ It was evident that restricting the principle of coherence to a single subject of tax was insufficient. On the other hand, the ECJ restricted the scope of coherence by rejecting the previous objective of establishing a uniform single national tax burden.⁴⁷ Overall, the conditions for the justification of coherence have remained vague. It is, therefore, impossible for the national legislator to predict the ECJ's future jurisprudence in this respect.

In contrast, Advocate General *Maduro* tried to clarify the principle of coherence in his Opinion in the *Marks & Spencer* case.⁴⁸ On the one hand, the Advocate General rightly recognized that leaving tax sovereignty to the Member States must not interfere with the establishment of the Internal Market and, therefore, must be used neutrally in respect of the freedoms of movement. On the other hand, the freedoms of movement must be implemented as neutrally as possible

⁴⁵ ECJ, 7 September 2004, Case C-319/02, *Petri Manninen* [2004] ECR I-7477, Para. 46.

⁴⁶ There is, at least, a tendency to widen the scope of coherence. See ECJ, Advocate General Kokott's Opinion, 18 March 2004, Case C-319/02, *Petri Manninen* [2004] ECR I-7477, Para. 61.

⁴⁷ Critical of this, see the remarks by Englisch, "Europarechtswidrigkeit des finnischen Körperschaftsteueranrechnungsverfahrens", *Internationales Steuerrecht* (2004), pp. 684 et seq, at p. 685 and Birk, note 9, p. 126.

⁴⁸ ECJ, Advocate General Poiares Maduro's Opinion, 7 April 2005, Case C-446/03, *Marks & Spencer plc v. David Halsey (HM Inspector of Taxes)*, Paras. 66-67.

with regard to national tax systems. In this way, the Advocate General created a correlation between the integrity of a national tax system and the integration of tax systems in the Internal Market that can be characterized as a rule of "mutual neutrality". Although the ECJ did not use the term "mutual neutrality" in its judgment in the *Marks & Spencer* case, the Court generally followed the Advocate General's Opinion in its main reasoning and deemed restrictions to the cross-border loss transfer to be justified.⁴⁹ Specifically, the ECJ did not argue with the concept of coherence but, instead, focused on the question of distributing taxation rights between the Member States and the concept of the prevention of abuse.⁵⁰ The ECJ's thoughts on double loss deduction similarly dealt with the protection of a consistent national tax system, which, in the end, must be coherent.⁵¹

Stronger coherence has already shown convincing results. In the *Marks & Spencer* case, for example, it is possible to establish national tax rules that prevent the multiple exploitation of a foreign subsidiary's losses in relation to

⁴⁹ ECJ, 13 December 2005, Case C-446/03, *Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes)*, Paras. 45 et seq.

⁵⁰ Correctly analysed by Herzig and Wagner, "EuGH-Urteil 'Marks & Spencer' - Begrenzter Zwang zur Öffnung nationaler Gruppenbesteuerungssysteme für grenzüberschreitende Sachverhalte", *Deutsches Steuerrecht* (2006), pp. 1 et seq, at p. 7 and Seer, "The ECJ on the Verge of a Member State Friendly Judicature?", *European Company and Financial Law Review*, Vol. 3 (2006), No. 2, pp. 237 and 243 et seq.

⁵¹ ECJ, 13 December 2005, Case C-446/03, *Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes)*, Paras. 47 et seq.

tax credits. As a result, according to the ECJ, a Member State may design its tax system in a way such that foreign losses can only be taken into account once. Rules that only allow the settlement of a foreign subsidiary's losses if they were not considered in the subsidiary's Home Member State, therefore, justify a restriction of the freedom of establishment.⁵²

If the mere fiscal interests of the Member States according to the ECJ's constant jurisprudence cannot justify any limitation on the freedoms of movement, the principle of coherence rightly demands that, at least, the possibility to maintain a consistent tax system is provided for the national legislators when dealing with EU tax competition. For this reason, a more precise term than the "principle of coherence" is the consistency of the single national tax system (system consistency). National tax system consistency can even be regarded as a sub-principle of the principle of territoriality, which is derived from national tax sovereignty in direct tax matters as a legal principle that is respected by the ECJ. As the ECJ assumes the sovereignty of the Member States in respect of direct taxation, this must enable the Member States to design consistent national tax systems. Accordingly, there is an interaction between the freedoms of movement in a Single Market and a coherent national tax system. Both objects

⁵² ECJ, 13 December 2005, Case C-446/03, *Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes)*, Paras. 51 et seq.

of legal protection must be balanced carefully so that both can have the greatest effect without sacrificing one for the other. This cannot be achieved by only having regard to the legal consequences.