Building a Fiscal Territory in Europe

Prohibiting, Harmonizing, Approximating, Guaranteeing and Informing[1]

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Summary

Community law has created a fiscal territory by using a series of legal techniques founded on different parts of the Treaty. By dividing Europe's complex legal structures into five categories of action, we seek to elucidate the foundations, and nature, of EU tax policy. We can separate these legal techniques into two groups, depending on whether they involve taxation, in the strict sense of the word, or other rights and liberties. Three actions are directly associated with taxation: prohibition, harmonization and approximation. Two other actions do not affect substantial tax law, but influence its application: guaranteeing the exercise of fundamental liberties and informing the Member States. We shall evaluate the relative weight of these two groups of actions through an analysis of the instruments available to the Community and their associated jurisprudence.

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Introduction

Community law has built what can be described in metaphor as a "fiscal territory", by using a series of legal techniques founded on different parts of the Treaty. These techniques can be designated by five verbs in the infinitive, which define the nature of the action in question: they can then be sorted into two groups, according to whether they involve taxation, in the strict sense of the word, or other rights and liberties. Three actions are directly associated with taxation: prohibition, harmonization and approximation. Two other actions do not affect substantial tax law, but influence its application: guaranteeing the exercise of fundamental liberties and informing the Member States. It is the relative weight of these two groups of actions that will be analysed in this text using the instruments available to the Community and their associated jurisprudence.

1. Fiscal mechanisms: prohibition, harmonization and approximation

1.1. Prohibition

European law has been built around the figure of an internal market "characterised by the abolition, between Member States, of obstacles to the free movement of goods, people, services and capital" (article 3 EC). In the treaties, tax law was initially approached from the perspective of customs duties, seen as "obstacles" to this free movement. The deontic modality employed here is that of *prohibition,* which can now be found in the EC Treaty under two headings: customs duties and discrimination.

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1.1.1. Prohibiting the imposition of customs duties

Chapters I and II of the Treaty are devoted to the prohibition of customs duties on imports and exports, as well as any taxes having equivalent effect, between Member States. Chapter I concerns the customs union (articles 23 EC to 25 EC); Chapter II concerns the prohibition of quantitative restrictions between Member States (articles 28 EC to 30 EC). The prohibition of customs duties is absolute and general, meaning that these duties are prohibited "...regardless of the purpose for which they were introduced and the destination of the revenue from them" (ECJ, 21 September 2000, Kapniki Michaïlidis AE *versus* Idryma Koinonikon Asfaliseon, C-441/98 and C-442/98).

Taxes having equivalent effect are also prohibited. This concept was already present in the ECSC (European Coal and Steel Community) Treaty, article 4, and it reappears in the EC Treaty, in articles 23 EC §1[3] and 25 EC.[4]

The Court has exercised control over these taxes since 1962. It has also drawn up a set of criteria, both legal and economic, to distinguish between charges having equivalent effect and domestic taxes, the latter falling under the provisions of article 90 EC and therefore governed by regulations based on the principle of non-discrimination, which we shall come to later. Certain parafiscal taxes (exclusively affecting the imported or exported product *per se*), are subject to this type of control. Thus, when Germany enacted a law requiring exporters of waste to other Member States to contribute to a solidarity fund, the Commission brought it before the European Court of Justice (ECJ) for failure to fulfil obligations (ECJ, 27 February 2003, Commission of the European Communities *versus* Federal Republic of Germany). In keeping with consistent case-law, the Commission considered that this contribution represented a pecuniary charge unilaterally imposed on the

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3 Article 23 EC: "The Community shall be based upon a customs union which shall cover all trade in goods and which shall involve the prohibition between Member States of customs duties on imports and exports and of all charges having equivalent effect, and the adoption of a common customs tariff in their relations with third countries."

4 Article 25 EC: "Customs duties on imports and exports and charges having equivalent effect shall be prohibited between Member States. This prohibition shall also apply to customs duties of a fiscal nature."

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goods by reason of the fact that they crossed a border, and therefore constituted a charge having equivalent effect as understood by articles 23 EC and 25 EC, even if it was not levied on behalf of the State (judgements of 9 November 1983, Commission/Denmark, 158/82, Rec. p. 3573, point 18, and 27 September 1988, Commission/Germany, 18/87, Rec. p. 5427, point 5).

In order for the charge to have avoided that qualification, it should have been part of a general system of internal dues applied systematically, and in accordance with the same criteria, to domestic and imported and exported products alike, either constituting payment for a service rendered to the economic operator – of a sum proportionate to the service – or relating to inspections carried out to fulfil obligations imposed by Community law.

All these measures are part of what has been called "customs disarmament". This is the oldest and most visible part of European competition law. It is also the part for which Community law has been the most effective (it was established before 1968), despite its rocky beginnings. As far as customs duties were concerned, the reform was relatively straightforward – being simply a matter of abolishing clearly identified taxes. It proved to be more complicated when it came to dealing with charges of equivalent effect, which required case-by-case assessment of the purpose of the taxes.

1.1.2. Prohibiting discriminatory fiscal measures

The main foundation of this lies in article 90 EC, part of a chapter entirely devoted to fiscal measures: "No Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products. Furthermore, no Member State shall impose on the products of other Member States any internal taxation of such a nature as to afford indirect protection to other products."

The aim of this article is to eliminate discrimination between imported products and domestic products so as to facilitate the free movement of goods. It

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applies to *all forms of taxes, including excise duties*. Its application is exclusive from that of "charges having equivalent effect", although it has similar objectives. According to consistent case-law, one measure cannot belong to both categories at the same time, on the grounds of the difference between sanctions: the prohibition of taxes having equivalent effect is absolute, their collection being purely and simply forbidden, whereas in the second case, only that part of the tax which gives it a discriminatory or protectionist character is required to be reformed.

This text has given rise to detailed, case-by-case jurisprudence by the Court. Application of the first paragraph of article 90 presupposes that imported products and domestic products are considered similar, whereas the second paragraph is directed at those national regulations that impose different taxes on products that are not strictly similar, but which are nevertheless in a situation of competition with each other, such as wine and beer, whether the competition is direct or indirect, real or potential. The Court has ruled that products are similar if their properties and the needs they meet place them in a situation of competition with each other. The assessment must therefore be made at the same stage of finishing or marketing. In the judgement Commission/France (ECJ, 15 March 2001), it was decided that vehicles imported into France from other Member States were subject to a much higher rate of annual excise duty because of a minor difference in the design of the gearbox. The French government argued that the vehicles were not similar and that the charge of discrimination was therefore groundless. The concept of similarity is interpreted in an extensive manner: even if products are not identical, they are treated as similar if they are analogous and have comparable functions. In the Roders case, (ECJ, 11 August 1995), the Court considered that table wines and fortified wines (vermouth, in this particular case) were similar products, the similarity deriving both from objective characteristics such as origin, production processes, organoleptic qualities, and from their capacity to satisfy the same consumer needs. As for the *indirect* protection of domestic products, the Commission considered that the Swedish tax system gave an unjustified protection to beer, generally made locally, compared with wine, imported from other Member States (Commission, 21 October 2004, IP/04/1280). The criterion of "indirect"

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protection can therefore be used to sanction taxes affecting products for which the condition of similarity is not met, which comes down to restricting the right of Member States to impose domestic taxes. Moreover, if equivalent products do not exist, we return to the qualification of taxes having equivalent effect. There are taxes, however, particularly parafiscal ones, which fall outside the jurisdiction of article 25 EC and which do not introduce discrimination in the sense of article 90.

1.2. Harmonization

The second Community action in the sphere of taxation involves harmonization.

The Treaties only made limited provision for this, in the domain of *indirect taxation.* Today, the perimeters of harmonization are defined by article 93 EC.[5] This article has therefore formed the basis for the relative *Communitization* of indirect taxation.

1. The Council directive 69/335/EEC of 17 July 1969, concerning indirect taxes on the *raising of capital*, abolished stamp duty on the issue and movement of foreign securities. It also harmonized the rules governing capital contributions and forbade Member States from charging companies flat-rate fees to register their official documents with the register of companies each year, unless these fees are calculated on the basis of the real cost of the operation. The directive precludes Member States from applying taxes and other charges of more than 1 per cent on the incorporation of a company, increases in capital or the transformation of a company into a joint stock company.

2. As far as *VAT* is concerned, the Commission originally planned to harmonize

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5 Article 93 EC: "The Council shall, acting unanimously on a proposal of the Commission and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation, to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market within the time-limit laid down in article 14".

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the rates. In the face of resistance from Member States, it had to accept, in the directive of 16 December 1991, a "transitory" regime lasting until 1993, date on which the internal borders were abolished.

3. Indirect taxes, and *excise duties* in particular,[6] fall within the domain of "harmonizable" taxes. According to consistent case-law, article 33 of the sixth company directive[7] allows States the freedom to maintain or introduce certain indirect taxes, such as excise duties. However, these taxes should not be of the nature of turnover taxes. Control is therefore exercised over the characteristics of indirect taxes, with the Court verifying any resemblance to VAT. It must be verified that these excise duties do not constitute an obstacle to the import of goods. In particular, duty must be paid in the product's country of origin and not in the importing country, at least for products (manufactured tobaccos, alcoholic beverages) destined for personal consumption or any non-commercial purpose (article 8 of directive 92/12/EEC).[8] The 1992 directive also specified that although Member States have the right to introduce national measures to enforce Community rules on excise duties, the controls carried out must respect the principle of the free movement of goods. If Member States impose penalties for the infringement of these rules, the penalties must be in accordance with the general principles of Community legislation, particularly the principle of proportionality.

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6 Excise duties are indirect taxes on the consumption or use of certain products, whether they are produced within a Member State or imported from another country either inside or outside the Union. A distinction is made between ordinary excise duty and special excise duty; total excise duty is the sum of these two categories.

7 Council directive 82/891 EEC, founded on article 54 (3) (g) of the Treaty, concerning the division of public limited liability companies).

8 The products covered by this directive, and the six that followed, are mineral oils, alcohol, alcoholic beverages and manufactured tobaccos. These can be subject to other indirect taxes levied for specific purposes. Member States are free to maintain or introduce indirect taxes on products other than those mentioned above, provided that they do not give rise to border-crossing formalities. Each Member State determines its own regulations in the matter of the production, transformation and holding of products subject to excise duty, subject to the provisions of the present directives. Where excise duty has not been paid, the production and holding of products are monitored under the tax warehousing arrangements (storage of goods from third countries with suspension of VAT).

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1.3. Approximation

For direct taxation, which remains essentially within the competence of Member States, a third technique was adopted, that of *approximation*. One means of approximation, laid down by article 293 EC, concerns the elimination of double taxation, which had given rise to many bilateral treaties.[9] At the level of the Union, approximation had been envisaged as early as 1967 for the taxation of securities and direct taxes, and in 1975 for systems of corporate income tax. At the end of the 1990s, this approximation process crystallized around one method: *coordination*. On 1 December 1997, the Council and the Representatives of the Governments of the Member States meeting within the Council adopted a resolution establishing a code of conduct for business taxation. In the explanatory statement, it is emphasized that this code of conduct is a political commitment and does not affect Member States' rights and obligations or the respective spheres of competence of the Member States and the Community in accordance with the Treaty. The Council formed a working group to select and assess potentially harmful tax measures, comprising a representative from each Member State and from the Commission.

This working group shrewdly presented its objective as a search for *coordination,* with a view to abolishing the regimes clearly the furthest removed from the *rationale* of most systems. The finger was pointed, not at tax competition as such, but at "tax havens", which attract investments by more or less artificial means.[10] Thus, the Commission encouraged the members of the Union to adopt a

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9 Article 293 EC: "Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals: – the protection of persons and the enjoyment and protection of rights under the same conditions as those accorded by each State to its own nationals; – the abolition of double taxation within the Community; – the mutual recognition of companies or firms within the meaning of the second paragraph of Article 48, the retention of legal personality in the event of transfer of their seat from one country to another, and the possibility of mergers between companies or firms governed by the laws of different countries; – the simplification of formalities governing the reciprocal recognition and enforcement of judgments of courts or tribunals and of arbitration awards".

10 Daniel Gutman, "Les lois de la construction communautaire: l'example de la fiscalité directe", *Petites affiches,* 6 October 2004, n° 200, p. 31.

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form of self-discipline in which each of them could find something to their advantage. The Member States undertook to freeze ("stand-still") and eliminate within five years ("roll-back") those measures that had been found harmful. The final report submitted to ECOFIN on 29 November 1999, and made public on 28 February 2000, had inspected 271 measures implemented within Member States, of which 66 were considered detrimental. These measures fall into six categories: dispensation schemes for financial services, group financing and the payment of royalties; special tax regimes in the domain of insurance and reinsurance; special legislation for holdings, especially their creation solely for tax purposes; total or partial exemption from corporate income tax, various measures concerning the Netherlands Antilles tax-free zone; the Spanish regime for hydrocarbon prospecting; the French regime of provisions for the reconstruction of mineral and hydrocarbon deposits. The roll-back of these measures should be governed by codes of conduct.[11]

This process is directed towards finding "positive" tax measures, within a "level playing field", which Member States can adopt to improve their fiscal attractiveness. The importance of this orientation has been heightened by the accession to the Union of countries offering highly advantageous business tax regimes, so that the divergences observed in the Europe of 15 have grown wider in the Europe of 25.[12]

In addition to these three mechanisms "dedicated" to taxation – the abolition of customs duties, the harmonization of indirect taxation and approximation through the coordination of direct taxation – the Community has other means at its disposal for acting on taxation. Direct and indirect taxation by Member States is subject to permanent control through two more general mechanisms of the Community, more powerful by very reason of their general nature: the guarantee of fundamental freedoms and the exchange of information between Member States.

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11 Thierry Lambert, "Marché intérieur et evasion fiscale", *Petites affiches*, 15 May 2002, n° 97, p. 34.
12 Daniel Gutman, *ibid.*

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2. General mechanisms: guaranteeing and informing

2.1. Guaranteeing the exercise of fundamental freedoms

The Member States may be required to justify their fiscal policy even in their reserved domain, that of direct taxes. The encroachment of control into this reserved domain derives from the general organization of the distribution of competences between the Community and the Member States. Even when they are acting within the framework of their reserved competence, the States must avoid infringing upon the provisions of Community law existing in other domains, especially those concerning the fundamental freedoms. The tax systems of Member States are put to a severe test by application of the principle of guaranteeing fundamental freedoms. Thus, Community law is applied to tax matters other than those specified in article 93 on the basis of other provisions in the Treaty. These provisions, which grant certain rights to private individuals, are incorporated into the legal systems of Member States and prevail over their jurisdictions. Judged in the light of these rights, which form a set of fundamental freedoms, some national tax laws can be seen as *constraints* about which private individuals can complain, and this explains the profusion of instruments of Community law and European jurisprudence in all the domains of taxation. Grouping these measures together according to the type of Community rule they bring into play, we end up with two main mechanisms: removing *obstacles to the free movement of people and capital*, and monitoring *State aid*.

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2.1.1. Removing the obstacles to fundamental freedoms

A. Obstacles to the free movement and establishment of workers

- Freedom of movement

In the field of direct taxation, this liberty, guaranteed by article 39 EC,[13] has been invoked as grounds for prohibiting Member States from treating nationals of other Member States less favourably than their own citizens. Thus, in a legal dispute between a Belgian national, living with his family in Belgium but working in Germany, and the German tax authorities, fundamental questions were raised about the limits imposed by the provisions concerning the free movement of workers on the application of national income tax legislation (judgement of 14 February 1995, case C-279/93, Finanzamt Köln-Altstadt/R. Schumacker).

The Court of Justice observed first that direct taxation does not as such fall within the purview of the Community, but that the powers retained by the Member States must nevertheless be exercised in a manner consistent with Community law, in particular with provisions relating to the free movement of workers and its basic principle, which is the abolition of all nationality-based discrimination between the workers of the Member States. According to consistent case-law, the rules of equal treatment forbid not only overt discrimination by reason of nationality, but also all covert forms of discrimination which, by the application of other criteria of differentiation, have the same end result. The Court considered that tax legislation that makes a distinction based on the criterion of residence, in the sense that it denies to non-residents certain benefits granted to residents, is likely to operate mainly to the detriment of nationals of other Member States, for non-residents are in the majority of cases foreigners. The Court therefore ruled that "tax benefits

13 Article 39 EC: "1. Freedom of movement for workers shall be secured within the Community. 2. Such freedom of movement shall entail the abolition of any discrimination based on nationality between workers of the Member States as regards employment, remuneration and other conditions of work and employment".

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granted only to residents of a Member State may constitute indirect discrimination by reason of nationality". It also observed, however, that discrimination can only arise through the application of different rules to comparable situations or the application of the same rule to different situations. To compare these situations, the Court undertook a detailed examination of the economic situation of residents. Thus, provisions relating to the free movement of workers do not, in principle, preclude the application by a Member State of regulations that levy higher taxes on non-residents employed in that State than on residents working in the same job. However, the position is different when the non-resident receives no significant income in the State of his residence and obtains the major part of his taxable income from an activity performed in the State of employment. The Court judged that in such a situation, there is no objective difference such as to justify different treatment, for in such a case of a non-resident receiving the major part of his income and almost all his family income in a Member State other than that of his residence, discrimination arises from the fact that his personal and family circumstances are taken into account neither in the State of residence nor in the State of employment. Consequently, the provisions relating to the free movement of workers precludes the State of employment from denying him the tax benefits granted to residents.

For its part, the Commission looked into the question of complementary pension schemes. According to the Commission, to improve social protection and facilitate the mobility of workers, it would be necessary to eliminate all forms of double taxation and non-taxation of the pensions of migrant workers resulting from the diversity of tax systems.[14]

The question of the income tax regime of cross-border workers was also raised. In the field of taxation, there are no rules at the Community level concerning the definition of cross-border workers, the division of taxing rights between Member States or the application of tax rules. Neighbouring Member States whose

14 Communication from the Commission to the Council, to the European Parliament and to the European Economic and Social Committee, of 19 April 2001, entitled "The elimination of tax obstacles to the cross-border provision of occupational pensions" (COM (2001) 214 final).

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nationals cross the border for professional reasons often adopt special measures for cross-border workers in their bilateral agreements, the goal being to eliminate double taxation. There is no rule, however, that guarantees cross-border workers the right to the most advantageous of the tax systems of the Member States involved (Gilly, paragraph 46, Case C-336/96).

The issue of cross-border taxation was therefore tackled from the perspective of the liberties enshrined in the EC Treaty. The principle of non-discrimination has been interpreted to mean that a cross-border worker who pays income tax in her country of residence for a professional activity exercised in another Member State has the same right to the deduction of professional or personal expenses incurred in her State of residence as she would have if it was also her State of employment. In particular, this can include travelling expenses to and from work, social security contributions paid in the Member State by reason of the wage earning/non-wage earning activity, child-minding expenses, pension contributions, and so on. If the worker is taxed in her State of employment, she belongs to the wider category of non-resident workers, non-resident in the sense that they have their tax residence in another State. The Court of Justice considers that residents and non-residents are generally not in the same situation. Consequently, disparities between the levels of taxation levied on residents and non-residents are not necessarily discriminatory. If, however, the situation of a non-resident worker (the category to which cross-border workers belong) is almost identical to that of a resident worker (particularly if she receives all or almost all her income in that State), then the non-resident worker cannot be subjected to less favourable tax treatment in her State of employment than residents of that State.

- Freedom of establishment

Laid down in article 43 EC,[15] the freedom of establishment has been used as an

15 Article 43 EC: "Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by

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argument both for and against the application of various tax measures. Today, this principle has a wide field of influence, first because the Treaty applies to all taxes, and second because of the development of bilateral treaties in the domain of tax sovereignty, essentially concerning income tax and capital taxes.[16]

This has led the Court of Justice to rule that exclusion from a tax advantage is an obstacle to the freedom of establishment. The advantage in question concerns the capital gains made on the transfer at undervalue of shares by a national company to a foreign company and *vice versa*, when each company has a holding in the other, either directly or indirectly. In this particular case, a Member State had refused to grant to establishments located on its territory certain tax concessions, provided for by treaties signed with third countries, when the head office of the permanent establishment is also located in one of the Member States (ECJ, 21 September 1999, Case C-307/97, Saint Gobain ZN). In a "*Tax Credits*" judgement (ECJ, 28 January 1986, Case C-270/83), the Court ruled that Member States must grant to permanent establishments of non-resident companies from other Member States the same tax concessions as those it grants to resident companies. This is an unconditional right, which cannot be restricted by the effect of a tax treaty signed with another Member State. In the Saint-Gobain judgement, the Court defined the principle of national treatment: "***A permanent establishment must benefit (like resident companies) from all the advantages granted by tax treaties signed by the State in which it is established. In practice, if Member State A, on the basis of a treaty A-B, grants tax advantages to its resident companies for income generated in State B (whether or not B is a member of the Community), then it must grant the same advantages to permanent establishments – located on its territory – of companies whose head office is located in Member State C***". The

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nationals of any Member State established in the territory of any Member State. Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital".

16 European Commission, Directorate-General Taxation and Customs Union, "EC law and tax treaties", TAXUD E1/FR DOC (05) 2306/A.

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Court emphasized that, "*at present, contrary to this reasoning, most tax treaties of Member States limit the application of treaty rules to companies resident in one of the two contracting States, refusing to grant these treaty advantages to permanent establishments of companies from other Member States, without giving any valid justification for this limitation of a general nature*". It concluded that there was "*an obvious incompatibility between these treaty measures and Community law*".

Freedom of establishment was also put forward by the ECJ as the grounds for ruling against a measure intended to limit tax evasion, in reply to an interlocutory question by the French Conseil d'Etat about the legislation for taxing capital gains when the taxpayer moves outside France (11 March 2004, Hugues de Lasteyrie du Saillant). In this judgement, where three Member States (Germany, Denmark and the Netherlands) had intervened in support of the French legislation, the Court ruled directly for the first time on the compatibility between Community law and exit taxes levied as a means of combating tax evasion.

In this particular case, the taxpayer had left France to take up residence in Belgium. At the time, he held securities conferring entitlement to more than 25 per cent of the earnings of a company established in France and subject to corporation tax. As the market value of the securities was higher than the price at which they were acquired, Mr. de Lasteyrie was subject to immediate taxation on the unrealized increase in value of the securities held, in accordance with the provisions in force in France (article 167 *bis* of the CGI – the General Tax Code). The Conseil d'Etat referred to the Court the question of whether this legislation was compatible with the principle of freedom of establishment. The Court underlined the fact that this freedom is one of the fundamental provisions of Community law and recalled that observance of this freedom precludes a Member State from hindering the establishment of one of its nationals in another Member State, including by tax measures.

The Court decided that such was the case for the French legislation, even if it concerned an obstacle to the establishment of one of its own nationals outside the country. According to the court, "*the provision in question was likely to restrict the exercise of that right, having at the very least a dissuasive effect on taxpayers*

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wishing to establish themselves in another Member State, because they are subjected, by the mere fact of transferring their tax residence outside France, to tax on a form of income that has not yet been realised, and thus to disadvantageous treatment by comparison with a person maintaining his residence in France".

The Court ruled that such taxation can only be allowed if it pursues a legitimate purpose that is compatible with the Treaty and is justified by imperative reasons in the public interest. It rejected in detail all the justifications put forward by the different Member States that had intervened in the case. In particular, it rejected the argument put forward by France that the purpose was to prevent tax evasion. The Court judged that a general presumption of tax evasion or fraud cannot be founded on the simple fact that a physical person has transferred his residence to another Member State. The provision was aimed generally at any situation in which a taxpayer with substantial holdings in a company subject to corporation tax transfers his residence outside France for any reason at all. It thus presumed an intention to circumvent French tax law on the part of any taxpayer transferring his residence outside France, and was therefore held to be disproportionate to its declared purpose.

According to the Court, the objective envisaged – to prevent a taxpayer eluding payment of the tax on increased value due in France – could be attained by measures that are less coercive or less restrictive of the freedom of establishment, for example by taxing a taxpayer who, after a short stay abroad, returns to France once his increased values have been realized.

It is worth noting that the departure of the interested party was evidently motivated by the desire to take advantage of the more favourable provisions of Belgian law, rather than the desire to change his place of establishment. The Court did acknowledge this point, but considered that it is up to Member States to devise a system which, while providing them with a means of action when fraudulent intention can be proved, does not restrict freedom of establishment. Thus, the Advocate General suggested that the national tax authorities could provide for tax on capital gains realized by a taxpayer who, after a relatively short stay in another

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Member State with a very favourable capital gains tax system, returns to his former State of residence after having sold his shares (point 64).

Be that as it may, this decision sounded the death knell of the tax. The French Conseil d'Etat revoked the provisions of the decree of 6 July 1999 enacting article 167 *bis* of the CGI on the grounds of *ultra vires*. The revocation was, however, of limited scope, and did not concern either transfers carried out strictly for fiscal reasons or transfers to third countries (French Conseil d'Etat, 10 November 2004, Litigation Section, 9th and 10th subsections combined, n° 211341, Rec.). Nevertheless, article 167 *bis* was abrogated by the Finance law, thus removing any possibility of reformulation (article 19 of the Finance law, n° 2004-1484 for 2005, 30 December 2004).

To condemn the tax, the reporter to the Senate added an argument of efficiency: this measure had failed to prevent tax relocations, and the return on costs was very low. For the reporter, only a substantial reorganization of the asset taxation system could render tax relocation pointless. In other words it was suggested that France should participate in the great "dumping" of direct taxation, rather than trying to avoid it. As one shrewd commentator observed, "everyone will strive to increase their attractiveness, even if it is to their neighbour's detriment".[17]

B. Obstacles to the free movement of capital

Today, the free movement of capital is laid down in article 56 of the Treaty,[18] and is exercised in accordance with the conditions stipulated in articles 57 to 60.

Unlike the other fundamental liberties enshrined in the Treaty, which were

17 Thierry Lambert, "L'exit tax", suite et fin, *Petites affiches*, 1 August 2005, n° 151, p. 14.

18 Article 56: "1. Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited. 2. Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited".

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considered from the outset to be unconditional and of direct effect, the freedom of movement of capital was no more than an objective to be aimed at, until the issuing of directive 88/361/EEC of 24 June 1988, which committed Member States to the abolition of restrictions on such movements. It was the ECJ's Verkooijen judgement of 6 June 2000, concerning the tax regime for dividends received by persons resident in the Netherlands, that affirmed the free movement of capital as a basic liberty. In another judgement, the Court ruled that, by prohibiting the acquisition by persons resident in Belgium of securities of a loan issued abroad, exempt from withholding tax, the Kingdom of Belgium had failed to fulfil its obligations under article 56 (ECJ, Case C-478/98, 26 September 2000).

French legislation has adapted accordingly, and transfers of money or securities in or out of the country are now subject to a simple declaration rather than the previous compulsory authorization (Law of 29 December 1989 and article 23 of the Law of 12 July 1990, in accordance with the EC Directive of 24 June 1988). The Business Chamber of the Court of Appeal deemed this measure to be legitimate, in application of the Directive of 24 June 1988 (Com.18 June 2002, n° 99-12760).

For its part, the ECJ decided that legislation on the taxation of dividends is incompatible with article 56 EC when it only exempts or favours domestic dividends. The Commission considered that this solution should be extended to outbound dividends (COM (2003) 810 final). In certain circumstances, however, differential treatment could be justified by overriding reasons in the general interest (ECJ, 6 June 2000, Verkooijen, point 43).

2.1.2. Sanctioning tax measures as State aid

The foundation of sanction lies in article 87 EC, which starts by laying down the prohibition of State aids as a general principle,[19] before going on to list compatible

19 Article 87, 1: "Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain

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aids, ranked in order of importance of the conditions attached.[20]

For a measure to be qualified as State aid, it must only favour certain companies or certain productions. Thus, general measures of economic, fiscal or social policy, even if they provide a competitive advantage to the companies of the country implementing them, are not governed by competition rules on State aid, but constitute general measures subject to the provisions of the Treaty on the approximation of national legislations. The final condition for a measure to be categorized as aid is that it affects the conditions of competition and trade between Member States. Distortion of competition is considered to occur almost automatically when aid favours certain businesses to the detriment of others.

Taxes paid to support certain bodies are therefore subject to this appraisal, with results that vary according to the circumstances. In the *Institut Français du Pétrole* (IFP) case, it was ruled that parafiscal taxes levied on certain petroleum products and paid to the IFP did not constitute a State aid either in favour of the IFP (a public, non-profit establishment) or in favour of the businesses profiting from the results of the research, given the absence of discrimination in the

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undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market".

20 Article 87, 2: "The following shall be compatible with the common market: (a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned; (b) aid to make good the damage caused by natural disasters or exceptional occurrences; (c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, insofar as such aid is required in order to compensate for the economic disadvantages caused by that division".

Article 87, 3: "The following may be considered to be compatible with the common market: (a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment; (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State; (c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest; (d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest; (e) such other categories of aid as may be specified by decision of the Council acting by a qualified majority on a proposal from the Commission".

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provision of access to the results. In this particular case, the factual data disproved the presumption of discrimination according to which a parafiscal tax is, "by its very nature", primarily profitable to national companies. This system did not, therefore, distort competition (EU Bulletin, 9-1994). As far as the effects of the measure on trade between Member States is concerned, in the *Corsica Free Zone* case (EU Bulletin, 10-1996), and the *Urban Renewal Pact* case (EU Bulletin, 3-2000), the Commission judged that trade between Member States was not affected, insofar as the tax exemptions in favour of existing companies were limited to small firms with purely local activities or operating below the *de minimis* ceiling. In the case of Italy, on the other hand, the Commission adopted a final negative decision, on the 22 October 1996, on the tax credit system in favour of road carriers applied by the Italian authorities for the tax years 1993 and 1994. The Commission declared this to be an operating aid and ordered its recovery. This decision is in line with the one taken in 1993 for the tax year 1992, which was subsequently the subject of proceedings against Italy, brought before the Court of Justice in 1995, for non-enforcement of the Commission's decision.

2.2. Exchanging tax information

Paradoxically, it was the field of taxation not subject to harmonization – direct taxes, which provided the occasion for a revival of Community action in this domain. This revival was essentially founded on one tool: the communication of information. This tool has become central in the fight against tax evasion and fraud, to such an extent that the Commission and the Council are locked in dispute over who should control it.

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2.2.1. The principle of mutual assistance

Several directives, founded on article 94 EC,[21] have been issued in the domain of direct taxes, with the aim of establishing a system of mutual assistance between the competent authorities of Member States.

Direct and indirect taxation find a meeting point in the policy of mutual assistance between Member States. To begin with, the practice of mutual assistance was introduced into the domain of direct taxes by directive 77/799/EEC of 19 December 1977, founded on article 100 of the EEC Treaty (later to become article 100 of the EC Treaty, and then article 94 EC). Subsequently, the question of information was considered important enough to be extended to the "harmonizable" domain of indirect taxation.

Directive 79/1070 widened the scope of directive 77/799 by extending it to VAT on the basis of a double foundation (article 99 of the EEC Treaty, later to become article 99 of the EC Treaty, then article 93 EC, and article 100 of the EEC Treaty). This second directive was clearly adopted with a view to the establishment and operation of the common market: "the practice of tax evasion and tax avoidance leads to budget losses and to violations of the principle of fair taxation and jeopardizes healthy competition; [it] therefore affects adversely the smooth running of the common market". It was agreed that "cooperation between tax administrations within the Community should be strengthened in accordance with common principles and rules", by extending mutual assistance between the competent authorities of Member States to the domain of indirect taxes, "in order to ensure that these are correctly assessed and collected". It was considered that: "as a matter of particular urgency, mutual assistance must be extended to cover value added tax, both because it is a general tax on consumption and because it plays an important part in the Community's own resources system".

Directive 92/12, also founded on article 99 of the EEC Treaty as amended by

21 Article 94 EC: "The Council, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, issues directives for the approximation of such laws, regulations or administrative provisions of Member States as directly affect the establishment or functioning of the common market".

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the Single European Act, once again widened the scope of directive 77/799 by extending it to excise duties on mineral oils, alcohol and alcoholic beverages and manufactured tobaccos: "In accordance with this Directive, the competent authorities of the Member State shall exchange any information that may enable them to effect a correct assessment of taxes on income and capital and any information relating to the assessment of the following indirect taxes: value added tax, excise duty on mineral oils, excise duty on alcohol and alcoholic beverages, excise duty on manufactured tobacco".

This body of directives was applied in the case C-349/03 of 21 July 2005 (Commission of the European Communities *versus* the United Kingdom of Great Britain and Northern Ireland). A case was brought before the Court for failure of a Member State to fulfil obligations concerning the partial transposition of the amended directive 77/799. The Commission of the European Communities sought a declaration from the Court that the United Kingdom had failed to implement, in the territory of Gibraltar, the amended directive 77/799/CEE. The United Kingdom contended that article 28 of the Act, concerning the Conditions of Accession of the Kingdom of Denmark, Ireland and the United Kingdom of Great Britain and Northern Ireland and the Adjustments to the Treaties, excluded Gibraltar from the field of application of the acts on the harmonization of legislation of Member States concerning turnover taxes, unless the Council, acting unanimously on a proposal from the Commission, should provide otherwise. Under article 29 of the Act of Accession, Gibraltar did not form part of the Community customs territory. In reply, the Commission acknowledged that the territory of Gibraltar was, under article 28 of the Act of Accession, excluded from the field of application of rules on the harmonization of turnover taxes and on the harmonization of excise duties, but submitted that directive 77/799, concerning *mutual assistance by the competent authorities* of the Member States in the fields of VAT and excise duties, was among the provisions of Community law applicable to Gibraltar. The Commission argued that information provided by the tax authorities of Gibraltar could be useful for the correct establishment of VAT or excise duties in other regions of the European Community, even if these taxes are not applied in

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Gibraltar, and the amended directive 77/799, as far as it relates to VAT, does not come into the category of "acts on the harmonization of legislation of Member States concerning turnover taxes" within the meaning of article 28 of the Act of Accession.

The Commission therefore concluded that the United Kingdom, by refusing to apply directive 77/799 in the territory of Gibraltar, had failed to fulfil its obligations under the EC Treaty.

2.2.2. Institutional control over communication between Member States

A priori, all these reforms concern taxation, and they are therefore subject to the condition of unanimity. By virtue of article 95-2, the simplified procedure of article 251 (whereby the Commission submits a proposal to the European Parliament and the Council, and the Council acts by qualified majority, after obtaining the opinion of the European Parliament), is not applicable to tax matters.[22]

Very soon after, however, the Commission tried to regain control by arguing that communication does not fall within the province of fiscal exception, and that the procedure of article 95-1 should apply. The Commission went so far as to bring the matter before the Court, questioning the legal foundation of two instruments: regulation n° 1798/2003, which had been adopted on the basis of article 93 EC, and directive 2003/93, adopted on the basis of articles 93 EC and 94 EC (case C-

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22 Article 95 EC: "1. By way of derogation from Article 94 and save where otherwise provided in this Treaty, the following provisions shall apply for the achievement of the objectives set out in Article 14. The Council shall, acting in accordance with the procedure referred to in Article 251 and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market. 2. Paragraph 1 shall not apply to fiscal provisions, to those relating to the free movement of persons nor to those relating to the rights and interests of employed persons".

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533/03 of 26 January 2006, Commission of the European Communities *versus* the Council of the European Union). The implications of this action were of far more than symbolic importance. The choice of the legal basis of a Community measure is always open to dispute, because it can determine whether a decision requires unanimity or a qualified majority within the Council. And clearly, a change in the mode of voting can have repercussions on the content of the measure enacted. Given these circumstances, it is understandable that the Commission should argue for article 95-1 as the legal basis for these tools, rather than articles 93 and 94.

It argued, however, in vain. In particular, when dealing with the interpretation of the term "fiscal provisions", mentioned in article 95, paragraph 2, EC, the Court recalled point 63 of its judgement of 29 April 2004, Commission/Council, where it had ruled that, because of its general character, this term covered "*not only all areas of taxation, without drawing any distinction between the types of duties or taxes concerned, but also all aspects of taxation, whether material rules or procedural rules*".

For its part, the Council observed that a large number of measures involving mutual assistance in the field of taxation had been adopted on the basis of a legal foundation other than that constituted by this article, and evoked consistent case-law concerning the choice of the legal foundation of a measure, which must be based on *objective* factors, which are amenable to judicial review. These elements include, notably, the aim and content of the measure (judgement of 17 March 1993, Commission/Council, C-155/91, Rec. p. I-939, point 7).

As regards the *aim* of the measures under question, the Council observed that the aim of the first article of regulation n° 1798/2003 is to fight tax fraud and evasion and to ensure compliance with VAT legislation, to the benefit of national budgets and the smooth running of the common market. Likewise, the Council maintained, the aim of directive 2003/93 was also to fight against tax fraud in order to protect the financial interests of Member States and the neutrality of the common market by strengthening directive 77/799, the aim of which was to provide an accurate determination of the taxable amount for the calculation of direct and indirect taxes. And, the Council continued, provisions whose objective is

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to ensure that the taxable amount is correctly established pursue a fiscal aim.

Turning to the *content* of the measures under question, the Council asserted that the regulations supported the application of fiscal provisions and the fight against tax fraud by harmonizing the rules and procedures governing the collection and exchange of information across borders when this information is necessary in order to establish the taxable amount for the purposes of VAT. The said regulations therefore have a direct impact on the rights of taxable persons and on the determination of the taxable amount, as well as on the tax revenues of Member States.

According to the Council, there was no doubt that the two measures challenged by the Commission enacted provisions concerning "the harmonisation of the laws of Member States relating to turnover taxes", which is "necessary for the establishment and functioning of the common market", within the meaning of article 93 EC. According to the Council, the Commission's position failed to take into account the fact that articles 93 EC and 94 EC constitute more specific legal bases for the adoption of provisions such as those enacted in the measures under question, and that article 95 EC does not limit the scope of these articles.

This reply shows the importance of the stakes involved in the proceedings for control over tax evasion and avoidance. The Council made no mistake, maintaining the requirement of unanimity for decisions concerning taxation, in the face of the Commission's attempts to win back control. Nothing can be done without the agreement of every State, which pushes even further back the prospect of communication on tax matters. This is equivalent to giving a right to veto to those Member States who have tax havens to protect.

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Conclusion

Our brief survey of the perimeters of European Community tax law shows that the Treaty has left Member States with considerable independence, despite the limitations imposed by articles 23 to 25 EC and by article 90. The harmonization of national laws being highly improbable, because of the requirement for unanimity in any Council decision on tax matters, it is up to the Court to monitor national tax practices and to assess their compatibility with the Treaty. This detracts from the value of the *action* of harmonization, to the benefit of methods of control based on other parts of the Treaty, which favour erratic and individualistic attacks on taxation. It also gives the upper hand to the ECJ, to the detriment of the other institutions. This point was deplored by Christian Saint-Etienne and Jacques Le Cacheux, in their report on equitable growth and tax competition.[23] The authors suggest that coordination should be sought through consensus, and they express their preference for proactive action by the Commission against infringements in certain domains, with regard, for example, to the cross-border provision of occupational pensions. In this, they follow the line adopted by the Commission, which concluded, in its communication of April 2001: "The Commission considers that discriminatory tax treatment of pension and life assurance policies concluded with providers established in other Member States is contrary to the fundamental freedoms of the EC Treaty. The Commission will monitor the relevant national rules and take the necessary steps to ensure effective compliance with the fundamental freedoms of the EC Treaty, including bringing the matter before the Court of Justice on the basis of Article 226 of the EC Treaty".

Clearly, the Commission intends to assume the role of guardian of fundamental freedoms, and this is the field on which the battle over taxation is now being fought. But it will take more than this action for the Commission to win back the initiative. Professionals acting on behalf of their clients see fundamental freedoms primarily as an effective resource in the fight against taxation, and they

23 *Croissance équitable et concurrence fiscale,* Les Rapports du Conseil d'analyse économique, n°56, La Documentation française, 2005, 336 pages.

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do not hesitate to use them as a lever.[24] But these actions, guided solely by the interests of those who undertake them, may not be the best way to achieve a coherent fiscal policy.

24 Patrick Philip, Ludovic Vanhove, "Le droit fiscal face aux libertés fondamentales du traité de l'Union européenne", *Petites Affiches*, 9 January 2004, n° 7, p. 4.

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