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Direct Taxation in the European Union:From Maastricht to Lisbon

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INTRODUCTION

From the Maastricht Treaty to the Treaty of Lisbon, there has been a steady movement in fields such as social security, professional licensing, and transport, to lower the voting requirement from unanimity to qualified majority voting.[1] Tax legislation, however, must still be adopted unanimously by the Council of the European Union ("Council") after consulting the European Parliament and the Economic and Social Committee.[2] Although the European Commission ("Commission") recommended qualified majority voting with respect to certain corporate tax matters at the 2003–2004

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1. *See* Stephen C. Sieberson, *Inching Toward EU Supranationalism? Qualified Majority Voting and Unanimity Under the Treaty of Lisbon*, 50 VA. J. INT'L L. 919, 945–47 (2010).

2. Consolidated Version of the Treaty on the Functioning of the European Union arts. 113, 115, 2010 O.J. C 83/47, at 94–95 [hereinafter TFEU].

Intergovernmental Conference,[3] Ireland and the United Kingdom were vehemently opposed to such a change in the unanimity requirement for direct taxes.[4] Deprived of using the qualified majority legislative process, direct tax harmonization has proceeded slowly. The enlargement of the European Union to twenty-seven Member States has further exacerbated the problem.[5]

The one legislative innovation that may impact direct taxation is the enhanced cooperation procedure.[6] This procedure was more fully developed in the Treaty of Nice to allow closer cooperation by a smaller group of Member States[7] and was further modified in the Treaty of Lisbon.[8] It now

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3. The European Commission ("Commission") stated that because of the more clearly defined EU authority, unanimous voting is no longer necessary in several cases:

> -taxation in connection with the operation of the internal market (the incompatibility of different Member States' tax systems frequently leads to double taxation),
> -modernizing and simplifying existing legislation,
> -administrative cooperation,
> -combating fraud or tax evasion,
> -measures relating to tax bases for companies, but not including tax rates,
> -the aspects of free circulation of capital linked to the fight against fraud, [and]
> -taxation in respect of the environment . . . .

Patricia Lampreave, *Fiscal Competitiveness Versus Harmful Tax Competition in the European Union*, 65 BULL. INT'L TAX'N 6, 7 (2011).

4. *See* Charles E. McClure, Jr., *Corporate Tax Harmonization in the European Union: The Commission's Proposals*, 36 TAX NOTES INT'L 775, 782 n.19 (2004).

5. Since the Treaty of Maastricht, Austria, Finland, and Sweden joined in 1995, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic, and Slovenia joined in 2004, and Bulgaria and Romania joined in 2007. *See Representation in Bulgaria*, EUR. COMMISSION, http://ec.europa.eu/bulgaria/abc/eu_glance/eu_timeline/index_en.htm (last updated Oct. 30, 2010).

6. The Treaty of Amsterdam initially introduced the enhanced cooperation procedure. Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, Protocol on Article J.7 of the Treaty on European Union, 1997 O.J. C 340/1, at 92; *see* Konstantinos Komaitis, *Aristotle, Europe and Internet Governance*, 21 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 57, 64 & n.18 (2008).

7. Treaty of Nice Amending the Treaty on the European Union, the Treaties Establishing the European Communities and Certain Related Acts arts. 1–2, 2001 O.J. C 80/1, at 8–14 [hereinafter Treaty of Nice]; *see* Komaitis, *supra* note 6, at 64. The Treaty of Nice was signed on February 26, 2001, and entered into force on February 1, 2003. *See* Komaitis, *supra* note 6, at 64 n.19.

8. Treaty of Lisbon Amending the Treaty on European Union and the Treaty Establishing the European Community art. 1(22), 2007 O.J. C 306/01, at 22 (amending

requires a minimum group of at least nine Member States in order to take advantage of the enhanced cooperation mechanism.[9] However, critics express concern that use of the enhanced cooperation procedure will lead to a two-tier European Union.[10]

In this Essay, I outline the direct tax harmonization that has taken place over the last two decades, focusing predominately on tax administration and the corporate tax law area. Both legislative initiatives (positive integration) and judicial decisions (negative integration) have played a role in shaping the Member States' national tax laws. The legislative path is slow and the resulting directives have often suffered from compromises that weaken their impact. The European Union's Savings Directive that I discuss in Part I is an example of this

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Articles 27(A)–27(E), 40–40(b), and 43–45 of the Treaty on European Union, and Articles 11 and 11(a) of the Treaty Establishing the European Community).

9. *Id.* On enhanced cooperation, the Treaty of Lisbon amended the Treaty on European Union to incorporate the following:

> The decision authorising enhanced cooperation shall be adopted by the Council as a last resort, when it has established that the objectives of such cooperation cannot be attained within a reasonable period by the Union as a whole, and provided that at least nine Member States participate in it.

Id.

10. *See, e.g.*, SELECT COMMITTEE ON THE EUROPEAN UNION, THE 2000 INTER-GOVERNMENTAL CONFERENCE, 1999–2000, H.L. 92, ¶ 71 (U.K.), *available at* http://www.publications.parliament.uk/pa/ld199900/ldselect/ldeucom/92/9201.htm (citing statements of Professor Helen Wallace cautioning that flexibility might become "a vehicle for extensive opting out of collective regimes by one government after another. Thus a reform ostensibly designed to facilitate initiatives might turn out to be the driver of a large wedge between the real insiders and the rest," and warning that flexibility could be used as a tool to deny new Member States a real voice in EU decisionmaking); Komaitis, *supra* note 6, at 65–69 (heralding the enhanced cooperation principle as "a notable achievement in the history of the European Union" but discussing its shortfalls, including its potential for creating substantial obstacles and causing disruption in the European Union); Irene Aronstein, Student Paper, *'The Union Shall Respect Cultural Diversity and National Identities': Lisbon's Concessions to Euroscepticism—True Promises or a Booby-Trap?*, UTRECHT L. REV., Nov. 2010, at 89, 108 (discussing both advantages and disadvantages of the enhanced cooperation procedure and highlighting the possibility that the procedure could result in a "Europe of two speeds"). "The UK has no interest in the development of mechanisms that create first and second class members of the EU." Memorandum of Evidence from Helen Wallace on the Intergovernmental Conference to the Foreign Affairs Comm. of the House of Commons & the Select Comm. on the European Union of the House of Lords, ¶ 12 (Feb. 2000) *available at* http://www.publications.parliament.uk/pa/cm199900/cmselect/cmfaff/384/384ap05.htm.

phenomenon.[11] Nevertheless, unlike the judicial path, the process is consensual and the results are deliberate.

Given the enormous obstacles to any direct tax legislation, the Commission's accomplishments detailed in Part I are impressive. One of the Commission's most exciting initiatives has taken more than twelve years to produce. Finally, on March 16, 2011, the Commission proposed its system for a common consolidated corporate tax base that is discussed in Part II.[12] Furthermore, the Commission continues to pursue any noncompliance with EU law by the Member States through the proactive use of the infringement procedure.[13] I illustrate this phenomenon with an example in Part III of this Essay.

Since the Maastricht Treaty, the European Court of Justice ("ECJ" or "Court") has exerted an overwhelming amount of influence on the national tax laws of the Member States through its jurisprudence.[14] A 2003 report from the Centre for Policy Studies estimated that the revenue loss to the United Kingdom from ECJ decisions was approximately UK£10 billion.[15] The Court continues to assess the compatibility of various national tax laws with the fundamental freedoms espoused by the Treaty on the Functioning of the European Union ("TFEU" or "Treaty"), releasing on average twenty judgments each year on direct taxation issues such as cross-border losses and group relief, withholding tax on outbound dividends, and exit taxes.[16]

11. *See generally* Thomas Rixen & Peter Schwarz, *How Effective is the European Union's Savings Tax Directive? Evidence from Four EU Member States*, 50 J. COMMON MKT. STUD. 151 (2012).

12. Commission Press Release, IP/11/319 (Mar. 16, 2011) [hereinafter CCCTB Press Release]. *See infra* note 88 for the Common Consolidated Corporate Tax Base Proposal.

13. *See infra* notes 192–95 and accompanying text for further discussion of the infringement procedure.

14. Since the Treaty of Lisbon, the European Court of Justice ("ECJ" or "Court") has been renamed the Court of Justice of the European Union. This Essay will continue to refer to the Court as the ECJ.

15. *See* ALISTAIR CRAIG, CTR. FOR POLICY STUDIES, EU LAW AND BRITISH TAX: WHICH COMES FIRST?, at i, 1, 49 (2003) ("The ability of the British Parliament to set its own taxing laws and to raise its own revenues is now being fundamentally affected by judges in the European Court of Justice (ECJ) in Luxembourg."); *see also* Eileen O'Grady, *EU Wrestling Control of Corporate Tax Away from U.K., Report States*, 32 TAX NOTES INT'L 1080, 1082 (2003).

16. *See CJEU Cases in the Area of, or of Particular Interest for, Direct Taxation*, TAX'N & CUSTOMS UNION—EUR. COMMISSION, at 13–17, http://ec.europa.eu/taxation_

As there have been more than one hundred direct tax decisions in the last two decades, I have chosen to analyze in detail one landmark decision that was issued at the end of 2011 in Part III. This case exemplifies the trend that has been observed by some commentators since 2005, namely a return by the ECJ to a more cautious application of internal market principles in the income tax area.[17] While the ECJ still finds Member States' national tax provisions discriminatory, the Court is more willing to accept Member States' justifications such as the prevention of tax evasion,[18] the cohesion of the tax system,[19] and the balanced allocation of taxing rights.[20]

The judicial path also is slow and has caused upheaval with respect to the Member States' national tax laws,[21] in particular, their anti-tax avoidance regimes.[22] There is an element of arbitrariness in that the cases are, of course, subject to the vagaries of who decides to sue and which of the Member States' courts then refer the cases to the ECJ. For example, in 2005, of the thirty-nine pending tax cases, twenty-five came from British, Dutch, and German court referrals.[23] Nevertheless, the ECJ has

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customs/resources/documents/common/infringements/case_law/court_cases_direct_taxation_en.pdf (last updated June 4, 2012). In 2010, there were fifteen judgments by the ECJ in the area of direct taxation, and one of particular interest for direct taxation. *Id.* In 2011, there were twenty-two judgments by the ECJ in the area of direct taxation, and two of particular interest for direct taxation. *Id.*

17. *See* Servaas van Thiel, *The Direct Income Tax Case Law of the European Court of Justice: Past Trends and Future Developments*, 62 TAX L. REV. 143, 179 (2008); *see also* Michael Lang, *Recent Case Law of the ECJ in Direct Taxation: Trends, Tensions, and Contradictions*, 18 EC TAX REV. 98 (2009).

18. *See, e.g.*, X & E.H.A. Passenheim-van Schoot v. Staatssecretaris van Financiën, Joined Cases C-155/08 & 157/08, [2009] E.C.R. I-5093, ¶ 45.

19. *See, e.g.*, Finanzamt für Körperschaften III in Berlin v. Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt GmbH, Case C-157/07, [2008] E.C.R. I-8061, ¶¶ 42–43.

20. *See, e.g.*, X Holding BV v. Staatssecretaris van Financiën, Case C-337/08, [2010] E.C.R. I-1215, ¶¶ 31–36; *see also* Vanessa E. Englmair, *The Relevance of the Fundamental Freedoms for Direct Taxation*, *in* INTRODUCTION TO EUROPEAN TAX LAW: DIRECT TAXATION 41, 71–72 (Michael Lang et al. eds., 2d ed. 2010).

21. *See* Lee A. Sheppard, *Dowdy U.K. Retailer Set to Destroy European Corporate Tax* (pt. 1), 35 TAX NOTES INT'L 132, 134 (2004).

22. *See, e.g.*, Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt, Case C-324/00, [2002] E.C.R. I-11779, ¶ 34. Thin capitalization rules, such as those of Germany, are widely used by governments to prevent excessive interest deductions. *See id.*

23. *See* Lee A. Sheppard, *Dowdy Retailer Set to Destroy European Corporate Tax* (pt. 3), 38 TAX NOTES INT'L 943, 943 (2005) (citing statements by Malcolm Gammie QC of Lord Grabiner).

been effective in moving forward the tax harmonization agenda, "forcing member governments to consider the community implications of the design of their tax systems."[24] In response to the increasing number of ECJ judgments, the former Commissioner for the Internal Market, Customs and Taxation wrote: "As an alternative to this 'destructive' process I favour closer co-operation between member states and the Commission. Such co-operation could include . . . Commission recommendations, and codes of conduct agreed between governments, as well as directives to harmonise national legislation."[25]

The use of nonlegislative approaches, or "soft law," has become prevalent in the direct tax area.[26] Established by the Economic and Financial Affairs Council ("ECOFIN") based on a recommendation from the Commission with regard to the elimination of harmful tax competition,[27] the EU's Code of Conduct for Business Taxation was the first example of "soft law" in the area of corporate taxation.[28] Although not legally binding, Member States made the political commitment to eliminate any existing tax measures that constitute harmful competition and to refrain from introducing similar measures in the future.[29] This initiative is responsible for the repeal of many

24. *See id.* at 945.

25. Fritz Bolkestein, *Company Tax Law Must Not Be Made in Court*, FIN. TIMES (London), Oct. 20, 2003, at 1.

26. *See* Commission of the European Communities, Tax Policy in the European Union–Priorities for the Years Ahead: Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee, COM (2001) 260 Final, at 22–23 (May 2001) [hereinafter Commission Communication: Tax Policy in the European Union]; *see also* Commission of the European Communities: Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee; Co-ordinating Member States' Direct Tax Systems in the Internal Market, COM (2006) 823 Final, at 4–8 (Dec. 2006) [hereinafter Commission, Co-ordinating Direct Tax Systems].

27. *See* Conclusions of the ECOFIN Council Meeting on 1 December 1997 Concerning Taxation Policy, 1998 O.J. C 2/01, at 1. Member States' Finance Ministers meet with respect to tax and other economic matters and are known as the Economic and Financial Affairs Council ("ECOFIN"). *See ECOFIN Council*, COUNCIL EUR. UNION, http://www.consilium.europa.eu/policies/council-configurations/economic-and-financial-affairs?lang=en (last visited May 25, 2012).

28. *See* Claudio M. Radaelli, *The Code of Conduct Against Harmful Tax Competition: Open Method of Coordination in Disguise?*, 81 PUB. ADMIN. 513, 521 (2003).

29. *See Harmful Tax Competition: Code of Conduct*, EUR. COMMISSION, http://ec.europa.eu/taxation_customs/taxation/company_tax/

special tax regimes formerly found in the tax legislation of the Member States.[30]

I. *LEGISLATIVE INITIATIVES*

Within the realm of taxation, the European Union seeks a "balance between the national sovereignty of its Member States and the goal of a harmonized internal market."[31] The internal market is defined as "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured."[32] Although disparities between the tax systems of Member States could be one of those internal frontiers,[33] a conscious choice was made to pursue tax coordination instead of tax harmonization in the direct tax area.[34] For example, the 1992 Ruding Report on corporate taxation concluded that the tax differences did distort the internal market and generated significant differences in the cost of capital.[35] Although the Report recommended many legislative proposals to correct these distortions, most of the proposals were declared by the Commission to be too ambitious.[36]

The Commission must exhibit such political sensitivity because the power to levy direct taxes still rests with the Member

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harmful_tax_practices/index_en.htm (last visited May 25, 2012) (describing the nature and purposes of the Code of Conduct).

30. *See* COUNCIL OF THE EUROPEAN UNION, SN 4901/99, REPORT OF THE CODE OF CONDUCT GROUP (BUSINESS TAXATION) 30–299 (1999), *available at* http://ec.europa.eu/taxation_customs/resources/documents/primarolo_en.pdf.

31. Tracy A. Kaye, *Europe's Balancing Act: Trends in Taxation*, 62 TAX L. REV. 193, 193 (2008).

32. TFEU, *supra* note 2, art. 26, O.J. C 83, at 59.

33. *See* TAX COMPETITION IN EUROPE 4 (Wolfgang Schön ed., 2003). Tax harmonization would improve neutrality and guarantee that companies would locate in specific Member States because of efficiency of resources, not simply because of advantageous tax schemes. *See id.*

34. *See* Tracy A. Kaye, *European Tax Harmonization and the Implications for U.S. Tax Policy*, 19 B.C. INT'L & COMP. L. REV. 109, 110 (1996); *see also* Commission, Co-ordinating Direct Tax Systems, *supra* note 26, at 4.

35. *See* Commission of the European Communities, Subsequent to the Conclusions of the Ruding Committee Indicating Guidelines on Company Taxation Linked to the Further Development of the Internal Market: Communication from the Commission to the Council and to Parliament, SEC (92) 1118 Final, ¶¶ 7–8 (June 1992).

36. *See id.* ¶¶ 23–57; Kaye, *supra* note 34, at 147.

States.[37] Unlike the indirect taxation area,[38] there is no explicit authorization for direct tax harmonization in the Treaty. The legal basis for taking any action is found in Article 115 of the TFEU: "[T]he Council shall, acting unanimously . . . issue directives for the approximation of such laws, regulations or administrative provisions of the Members States as directly affect the establishment or functioning of the internal market."[39] Thus, although the Council can legislate to eliminate tax obstacles to the internal free flow of goods, persons, services, and capital,[40] direct tax legislation is rare because of this unanimity requirement.[41]

"Unlike VAT, direct taxation is at a purely embryonic stage of harmonization."[42] Although this statement was made more than fifteen years ago, it still remains true. The direct tax legislation that actually has been adopted is limited to a few

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37. *See* Jan Wouters, *The Case-Law of the European Court of Justice on Direct Taxes: Variations upon a Theme*, 1 MAASTRICHT J. EUR. & COMP. L. 179, 180 (1994); *see also* LAURENCE W. GORMLEY, EU TAXATION LAW 2 (2005) (noting that the power retained by the Member States in the area of direct taxation must be exercised in a manner consistent with the terms of the Treaty Establishing the European Community ("EC Treaty")).

38. TFEU, *supra* note 2, art. 113, 2010 O.J. C 83, at 94 ("The Council shall . . . 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 and to avoid distortion of competition.").

39. *Id.* art. 115, at 95. The taxation powers of the European Union also are restricted by the principle of subsidiarity, which permits EU action only if the objectives (such as the development of a common market) cannot be met effectively by individual Member State action. *See* Consolidated Version of the Treaty on European Union art. 5(3), 2010 O.J. C 83/13, at 18 [hereinafter TEU post-Lisbon]; *see also* George A. Bermann, *Taking Subsidiarity Seriously: Federalism in the European Community and the United States*, 94 COLUM. L. REV. 331, 339 (1994); Tracy A. Kaye, *Tax Discrimination: A Comparative Analysis of U.S. and EU Approaches*, 7 FLA. TAX REV. 47, 51 (2005).

40. *See* SERVAAS VAN THIEL, FREE MOVEMENT OF PERSONS AND INCOME TAX LAW: THE EUROPEAN COURT IN SEARCH OF PRINCIPLES 13 (2002).

41. *See id.* at 112; *cf.* Albert J. Rädler, *Tax Provisions of the Treaty of Rome—Lost in Transition*, *in* IN MEMORIAM KARI S. TIKKA 1944–2006, at 422, 425 (Edward Andersson et al. eds., 2007) (discussing the possibility of changing a distortionary tax measure through an Article 96 directive approved by a qualified majority of the Council of the European Union if consultation by the Commission with the Member State is unproductive).

42. Opinion of Advocate General Léger, Finanzamt Köln-Altstadt v. Schumacker, Case C-279/93, [1995] E.C.R. I-228, ¶ 19. To achieve an internal market, border controls had to be removed and this required harmonizing value-added taxes. *See* Kaye, *supra* note 34, at 111.

corporate tax directives (the Parent-Subsidiary Directive,[43] the Merger Directive,[44] and the Interest and Royalties Directive[45]) and directives dealing with tax administration (the Recovery of Tax Claims Directive,[46] the Exchange of Information Directive,[47] and the Savings Directive[48]). In 1990, the Member States also concluded the Arbitration Convention to provide for binding arbitration of transfer pricing disputes when the respective tax authorities are unable to resolve the issues within two years.[49]

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43. Council Directive 90/435/EEC on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States, 1990 O.J. L 225/6, *amended by* Council Directive 2003/123/EC, 2004 O.J. L 7/41, *renumbered* Directive 2011/96/EU on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States, 2011 O.J. L 345/8 (designed to eliminate tax obstacles concerning profit distributions between groups of companies in the European Union by preventing double taxation on the profits of subsidiaries to parent companies and abolishing certain withholding taxes on dividend payments).

44. Council Directive 90/434/EEC on the Common System of Taxation Applicable to Mergers, Divisions, Transfers of Assets and Exchanges of Shares Concerning Companies of Different Member States, 1990 O.J. L 225/1, *amended by* Council Directive 2005/19/EC, 2005 O.J. L 58/19 (establishing a common system of taxation applying to mergers, divisions, transfers of assets, and exchanges of shares regarding companies of different Member States, which also provides for the deferred taxation of capital gains).

45. Council Directive 2003/49/EC on a Common System of Taxation Applicable to Interest and Royalty Payments Made Between Associated Companies of Different Member States, 2003 O.J. L 157/49 (instituting a common system of taxation applying to interest and royalties paid in different Member States between associated companies). There also is a proposal pending for amending this directive. *See* Commission of the European Communities, Proposal for a Council Directive on a Common System of Taxation Applicable to Interest and Royalty Payments Made Between Associated Companies of Different Member States: Communication from the Commission, COM (2011) 714 Final (Nov. 2011).

46. Council Directive 76/308/EEC on Mutual Assistance for the Recovery of Claims Resulting from Operations Forming Part of the System of Financing the European Agricultural Guidance and Guarantee Fund, and of Agricultural Levies and Customs Duties, 1976 O.J. L 73/18 [hereinafter Recovery of Tax Claims Directive] (allowing tax claims in one Member State to be enforced in another).

47. Council Directive 77/799/EEC Concerning Mutual Assistance by the Competent Authorities of the Member States in the Field of Direct Taxation, 1977 O.J. L 336/15 [hereinafter Exchange of Information Directive] (requiring Member States' authorities to exchange information relevant to the accurate assessment of taxes).

48. Council Directive 2003/48/EC on Taxation of Savings Income in the Form of Interest Payments, 2003 O.J. L 157/38 [hereinafter Savings Directive] (regarding the taxation of savings income).

49. Convention on the Elimination of Double Taxation in Connection with the Adjustments of Profits of Associated Enterprises, 1990 O.J. L 225/10, art. 7(1), at 13. This is a multilateral international law convention rather than a directive and as such is

Exceptionally important in the administration of tax law is the mutual assistance in the collection of taxes that is provided in the form of information exchange, recovery of tax claims, and notification of liabilities.[50] This priority was reflected by early adoption of mutual assistance directives with respect to the recovery of tax claims and the exchange of information in order to strengthen the cooperation between the tax administrations of the Member States.[51] However, the Commission recognized that these original mutual assistance directives were woefully inadequate for the global economy even with the amendments that had been made over time.[52] For example, there was only a five percent recovery of the money requested in the 11,794 requests filed in 2007.[53] To this end, the Commission's Communication to the Council on "Promoting Good Governance in Tax Matters" stressed the importance of adopting the Commission's proposals to replace the Exchange of Information and the Recovery of Tax Claims Directives as well as to amend the Savings Directive.[54]

Progress toward administrative cooperation was accelerated by the global financial crisis, which highlighted the need for greater exchange of information to combat tax avoidance and

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not subject to the jurisdiction of the ECJ. *See* Patrick Plansky, *The EU Arbitration Convention*, *in* INTRODUCTION TO EUROPEAN TAX LAW: DIRECT TAXATION, *supra* note 20, at 199, 203.

50. *See* Philip Baker et al., *International Assistance in the Collection of Taxes*, 65 BULL. INT'L TAX'N 281, 281 (2011).

51. *See* Exchange of Information Directive, *supra* note 47; Recovery of Tax Claims Directive, *supra* note 46.

52. *See, e.g.*, Council Directive 2008/55/EC on Mutual Assistance for the Recovery of Claims Relating to Certain Levies, Duties, Taxes and Other Measures, 2008 O.J. L 150/28, at 28 [hereinafter 2008 Recovery of Tax Claims Directive] (adopting "common rules on mutual assistance for recovery" in response to the threat of fraud "so as to safeguard better the competitiveness and fiscal neutrality of the internal market"). See Michael Schilcher, *The Directives on Mutual Assistance in the Assessment and in the Recovery of Tax Claims in the Field of Direct Taxation*, *in* INTRODUCTION TO EUROPEAN TAX LAW: DIRECT TAXATION, *supra* note 20, at 181, 183, 193–94 for a description of the amendments to the Exchange of Information Directive and the Recovery of Tax Claims Directive.

53. *See* Baker et al., *supra* note 50, at 284.

54. *See* Commission of the European Communities, Promoting Good Governance in Tax Matters: Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee, COM (2009) 201 Final, at 10 (Apr. 2009).

tax evasion.[55] In February 2009, the Commission proposed a new directive on administrative cooperation in the field of taxation, which set up procedures, scope, and conditions for the exchange of information on request, the automatic exchange of information, spontaneous exchange of information, and administrative notification among Member States, as well as procedures with respect to information received from third countries.[56] One goal was to implement the Organisation for Economic Co-operation and Development ("OECD") standard on exchange of information that is set forth in Article 26 of the OECD Model Convention.[57]

After difficult negotiations, this proposal was formally adopted by the Council in 2011 and in general will be effective as of January 1, 2013.[58] The 2011 Exchange of Information Directive is intended to apply to all taxes except for those specifically listed and to all taxpayers including both natural and legal persons.[59] The 2011 Directive allows the information to be "used for the administration and enforcement of the domestic [tax] laws" as well as associated judicial and administrative proceedings.[60] Member States must provide the required information within certain time limits (two months for information they already possess and six months for other information)[61] and are obligated to provide the information even if they do not need it for their own tax purposes and even if held by a bank or other financial institution.[62] This means that Member States cannot justify refusing to provide information on

55. *See* Irma Johanna Mosquera Valderrama, *EU and OECD Proposals for International Tax Cooperation: A New Road?*, 59 TAX NOTES INT'L 609, 609 (2010).

56. *See* Commission of the European Communities, Proposal for a Council Directive on Administrative Cooperation in the Field of Taxation: Communication from the Commission, COM (2009) 29 Final (Feb. 2009).

57. Council of the European Union Press Release, 10737/09, at 23 (June 9, 2009).

58. Council Directive 2011/16/EU on Administrative Cooperation in the Field of Taxation and Repealing Directive 77/799/EEC, 2011 O.J. L 64/1 [hereinafter 2011 Exchange of Information Directive] (setting forth the rules and procedures governing Member State cooperation in terms of information exchange).

59. *Id.* arts. 2, 3(11), at 3–4.

60. *Id.* art. 16, at 9.

61. *Id.* art. 7(1), at 5.

62. *Id.* art. 18, at 9–10.

the basis of their banking secrecy laws.[63] This provision is not retroactive.[64]

Commentators note that the articles on exchange of information on request conceivably go beyond the OECD standard in its obligation to transmit any "information that is foreseeably relevant to the administration and enforcement of the domestic [tax] laws" because the requirements for a valid request are less onerous than those in the OECD Model Agreement on the Exchange of Information on Tax Matters.[65] One interesting innovation is the addition of a most-favored-nation clause such that no Member State may refuse to extend its wider cooperation arrangements with third countries to another "Member State wishing to enter into such mutual wider cooperation."[66]

The most important feature, however, is the extension of the mandatory automatic exchange of information that exists with respect to savings income to income from employment, director's fees, certain life insurance products, pensions, and immovable property to the extent that information is available.[67] Although the article prescribing the automatic exchange of information does not take effect until January 1, 2015, it will cover tax periods beginning January 1, 2014.[68] It is generally understood that the automatic exchange of information is the most effective way to fight tax evasion and may be extended to other categories of income such as dividends, capital gains, and royalties in the future.[69] Finally, procedural measures can be adopted by an implementing committee under what is known as the "comitology procedure," which has rarely been used in the direct taxation area. This means that decisions regarding the practical arrangements of some of the provisions of the directive

63. Marius Vascega & Servaas van Thiel, *Assessment of Taxes in Cross-Border Situations: The New EU Directive on Administrative Cooperation in the Field of Taxation*, 20 EC TAX REV. 148, 152 (2011).

64. 2011 Exchange of Information Directive, *supra* note 58, art. 18(3), at 10.

65. *See* Vascega & van Thiel, *supra* note 63, at 152–53; *see also* 2011 Exchange of Information Directive, *supra* note 58, arts. 1, 20, at 3, 10.

66. 2011 Exchange of Information Directive, *supra* note 58, art. 19, at 10; *see* Valderrama, *supra* note 55, at 614.

67. 2011 Exchange of Information Directive, *supra* note 58, art. 8, at 6.

68. *Id.* arts. 8, 29, at 6, 12.

69. *Id.* pmbl. ¶ 10, art. 8(5), at 2, 6.

have been delegated to the Commission and can bypass the unanimity requirement.[70]

The 2008 Recovery of Tax Claims Directive that enables Member States' tax authorities to assist each other in the collection of tax claims was repealed in 2010, effective January 1, 2012. The new Recovery of Tax Claims Directive, which was approved on March 16, 2010, applies to all taxes and duties levied by any Member State and sets forth more precise rules in a number of areas.[71] It provides a uniform system of recovery assistance, including a "uniform instrument permitting enforcement in the requested Member State," and is designed to prevent tax evasion.[72] Commentators anticipate that these new procedures "will significantly enhance recovery assistance between the Member States."[73] The Member States were required to enact these procedures into their respective national laws by December 31, 2011.[74]

With the liberalization of capital movements both within the European Union and with respect to third countries, it became necessary "to ensure a minimum level of taxation on interest income."[75] The European Union Savings Directive took effect in the Member States in 2005 and, inter alia, enables tax administrations to automatically exchange information on an individual's interest income.[76] The goal of the Savings Directive

70. *See* Vascega & van Thiel, *supra* note 63, at 154.

71. Council Directive 2010/24/EU Concerning Mutual Assistance for the Recovery of Claims Relating to Taxes, Duties and Other Measures, arts. 2, 29, 2010 O.J. L 84/1, at 3, 12 [hereinafter 2010 Recovery of Tax Claims Directive] (setting forth the rules under which Member States must provide assistance for the recovery of any claims relating to taxes, duties, and other measures levied in another Member State).

72. *Id.* art. 12, at 7.

73. Baker et al., *supra* note 50, at 285.

74. 2010 Recovery of Tax Claims Directive, *supra* note 71, art. 28, at 12.

75. Sabine Heidenbauer, *The Savings Directive*, *in* INTRODUCTION TO EUROPEAN TAX LAW: DIRECT TAXATION, *supra* note 20, at 167, 168.

76. Savings Directive, *supra* note 48, arts. 8, 9, 17, at 42–43, 45. Austria, Belgium, and Luxembourg, instead of exchanging information automatically, are obliged to "levy a withholding tax at a rate of 15 % during the first three years of the transitional period [until June 30, 2008], 20 % for the subsequent three years [until June 30, 2011] and 35 % thereafter." *Id.* art. 11, at 43. As of January 1, 2010, Belgium no longer applied the transitional withholding tax and instead exchanges information. *See Rules Applicable*, TAX'N & CUSTOMS UNION–EUR. COMMISSION, http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/rules_applicable/index_en.htm (last updated May 28, 2012).

is to enable the state of residence to effectively tax the beneficial owners on interest payments made to these individuals from another Member State.[77] The Commission proposed amendments to the Savings Directive in 2008 to close loopholes and to ameliorate tax evasion.[78] The Commission's initial reports had found that the Savings Directive's definitions of interest, paying agent, and beneficial owner were deficient in fulfilling the goal of effective taxation.[79] In June 2009, ECOFIN announced recommendations agreed to by all twenty-seven Member States for strengthening the Savings Directive.[80] Furthermore, in March 2011, ECOFIN published a revised proposal that took into account concerns expressed by various Member States and the opinions of the European Parliament and the European Economic and Social Committee.[81] The Commission released its second report on the Savings Directive in March 2012 finding that expansion of the products, transactions, and economic operators covered by the Directive is of paramount importance given "the widespread use of offshore jurisdictions for intermediary entities."[82] Discussions are ongoing.[83]

77. Savings Directive, *supra* note 48, art. 1, at 39.

78. Commission Press Release, IP/08/1697 (Nov. 13, 2008). László Kovács, Commissioner for Taxation and Customs, said: "The first report on the operation of the Savings Taxation Directive concluded that the Directive, although effective within the limits of its scope, can be easily circumvented. The current scope of the Directive needs to be extended, in order to meet our goal of stamping out tax evasion, which affects the national budgets and creates disadvantages for the honest citizens." *Id.*

79. Commission of the European Communities, Proposal for a Council Directive Amending Directive 2003/48/EC on Taxation of Savings Income in the Form of Interest Payments: Communication from the Commission, COM (2008) 727 Final, at 2–3 (Nov. 2008).

80. *See* Charles Gnaedinger, *ECOFIN Agrees on Approach to Improve Savings Tax Directive*, 54 TAX NOTES INT'L 921, 921 (2009).

81. *See generally* Council of the European Union, Proposal for a Council Directive Amending Directive 2003/48/EC on Taxation of Savings Income in the Form of Interest Payments, 2008/0215 (CNS) (Mar. 2011), *available at* http://register.consilium.europa.eu/pdf/en/11/st06/st06946.en11.pdf.

82. Commission of the European Communities, In Accordance with Article 18 of Council Directive 2003/48/EC on Taxation of Savings Income in the Form of Interest Payments: Report from the Commission to the Council, COM (2012) 65 Final, at 2, 12 (Mar. 2012).

83. *See First Review and Amending Proposal*, TAX'N & CUSTOMS UNION–EUR. COMMISSION, http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/savings_directive_review/index_en.htm (last updated May 28, 2012).

II. *COMMON CONSOLIDATED CORPORATE TAX BASE PROJECT*

The Commission recognized that the obligation to use each Member State's different method of calculating the corporate tax base results in unnecessary compliance costs and administrative burdens for EU businesses.[84] Furthermore, the inability to offset losses from a subsidiary located in one Member State against the profits earned by the parent company in another Member State is a major obstacle to doing business in the European Union.[85] This issue has been the subject of much litigation in the European Court of Justice.[86] After setting forth its strategy to solve these problems in 2001,[87] the Commission formed a Working Group comprised of tax experts from the administrations of all Member States to provide it with technical assistance and advice.[88] Although not all of the Member States agreed with the implementation of the project, all twenty-seven participated in the working group responsible for evaluating the practical aspects of a common corporate tax base.[89] After extensive meetings, hearings, and academic conferences,[90] the

84. *See* Commission Communication: Tax Policy in the European Union, *supra* note 26, at 7, 16.

85. *See* Michael Niznik, *EU Corporate Tax Harmonization: Road to Nowhere?*, 44 TAX NOTES INT'L 975 (2006). Very few Member States allow for cross-border loss relief. *See id.*

86. *See, e.g.*, X Holding BV v. Staatssecretaris van Financiën, Case C-337/08, [2010] E.C.R. I-01215; Marks & Spencer plc v. Halsey, Case C-446/03, [2005] E.C.R. I-10866; Imperial Chem. Indus. plc v. Colmer, Case C-264/96, [1998] E.C.R. I-4711.

87. *See generally* Commission of the European Communities, Towards an Internal Market Without Tax Obstacles–A Strategy for Providing Companies with a Consolidated Corporate Tax Base for Their EU-Wide Activities: Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee, COM (2001) 582 Final (Oct. 2001).

88. *See* European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM (2011) 121/4, at 7 (Mar. 2011) [hereinafter CCCTB Proposal].

89. *See* Directorate-Gen., European Comm'n Taxation & Customs Union, *Summary Record of the Meeting of the Common Consolidated Corporate Tax Base Working Group*, ¶ 1, CCCTB/WP/037 (Aug. 31, 2006), *available at* http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/ccctbwp037summary_en.pdf.

90. *See, e.g.*, COMMON CONSOLIDATED CORPORATE TAX BASE (Michael Lang et al. eds., 2008); *see also, e.g.*, A COMMON CONSOLIDATED CORPORATE TAX BASE FOR EUROPE (Wolfgang Schön et al. eds., 2008); COMMON CORPORATE TAX BASE (CC(C)TB) AND DETERMINATION OF TAXABLE INCOME: AN INTERNATIONAL COMPARISON (Christoph Spengel & York Zöllkau eds., 2012).

Commission finally released its Proposal for a Council Directive on a Common Consolidated Corporate Tax Base ("CCCTB" or "Proposal") on March 16, 2011.[91]

The goal of the Proposal is to improve the efficiency of the Single Market and create a business-friendly tax environment by minimizing compliance costs resulting from cross-border activity.[92] The CCCTB creates a single tax base for all Member State group economic activity in an effort to "ensure consistency in the national tax systems."[93] As promised,[94] the Proposal does not harmonize tax rates, as "[f]air competition on tax rates is to be encouraged."[95] The Commission believes that the adoption of a single set of rules, as well as cross-border loss relief opportunities for the group, will result in reduced administrative costs in the range of seven percent.[96] Furthermore, tax experts estimated that the costs of establishing a subsidiary in a different Member State would decrease by sixty-two percent for a large company and sixty-seven percent for a medium-sized company.[97]

The CCCTB Proposal is extensive, as it applies not only to corporations located in the European Union but also to the branches of third country companies located in the Member States.[98] The list of eligible company forms in Annex I is broader than that found in the other corporate tax directive annexes.[99] Eligible corporations have the option to elect application of the common system and file a single consolidated return with the parent's country of residence on an initial five year basis.[100]

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91. *See* CCCTB Press Release, *supra* note 12; *see also* CCCTB Proposal, *supra* note 88.

92. CCCTB Proposal, *supra* note 88, at 4–5.

93. *Id.* at 4.

94. Commissioner Kovács stressed in an October 2009 speech before the ECON Committee that the proposed CCCTB "has no implication on tax rates which would remain in the competence of the Member States." László Kovács, European Comm'r for Taxation & Customs, Speech at ECON Committee Meeting 7 (Oct. 6, 2009), *available at* http://ec.europa.eu/archives/commission_2004-2009/kovacs/speeches/2009/ECONCommittee6oct.pdf.

95. CCCTB Proposal, *supra* note 88, at 4.

96. *See id.* at 5.

97. *See id.*

98. *Id.* arts. 2–3, at 15–16.

99. *See* Luca Cerioni, *The Commission's Proposal for a CCCTB Directive: Analysis and Comment*, 65 BULL. INT'L TAX'N 515, 517 (2011).

100. *See* CCCTB Proposal, *supra* note 88, arts. 104–05, at 55–56; *see also* Lee A. Sheppard, *European Union: 2011 Year in Review*, 64 TAX NOTES INT'L 882, 884 (2011).

Affiliates in which the group holds more than fifty percent of the voting rights and more than seventy-five percent of the value would be included in the return.[101]

The Proposal sets forth specific rules with respect to calculation of the tax base[102] as well as timing rules that address such items as bad debt deductions and transfers of assets to a third country.[103] There also are detailed rules with respect to depreciation[104] and consolidation,[105] as well as research and development expensing rules.[106] Although the tax base is broader than the corporate tax base of most Member States, the CCCTB rules facilitate the cross-border use of losses and ignore intragroup transactions.[107] This eliminates the "need for transfer pricing enforcement for transactions within the EU group."[108] Nevertheless, commentators have raised issues with respect to the scope of the applicability of the proposed rules and the application of the antiabuse provisions to third countries, among other issues.[109]

Besides the time spent working out all the technical details of the CCCTB Proposal, one of the major reasons for the delay in introducing this proposal was deciding on the apportionment formula to allocate the consolidated corporate tax base among the Member States.[110] It was important that the formula be designed to minimize tax-induced transfers of the factors from

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The European Parliament passed a resolution stating that the CCCTB system should become mandatory after a transition period. Parliament Press Release, IPR43390 (Apr. 18, 2012).

101. CCCTB Proposal, *supra* note 88, at 13. This two-part test of control and ownership must be met throughout the taxable year. *Id.*

102. *Id.* arts. 9–16, at 22–24.

103. *Id.* arts. 17–31, at 25–30.

104. *Id.* arts. 32–42, at 31–34.

105. *Id.* arts. 54–60, at 37–39. There also are technical provisions to address transition issues, business reorganizations, transactions between the group and other entities, such as associated entities, abusive transactions, and transparent entities. *Id.* arts. 61–85, at 39–49.

106. *Id.* art. 12, at 23.

107. *See* Sheppard, *supra* note 100, at 884.

108. *Id.* at 884.

109. *See, e.g.*, Cerioni, *supra* note 99, at 530.

110. *See* Michael K. Mahoney, Note, *Recommending an Apportionment Formula for the European Union's Common Consolidated Corporate Tax Base*, 34 SETON HALL LEGIS. J. 313, 314 (2010).

one Member State to another.[111] The Commission proposed a three-factor apportionment formula that includes evenly weighted labor, assets, and sales factors.[112] The labor factor equally comprises payroll costs and the number of employees.[113] Finally, there is a safeguard clause allowing for the use of an alternative method if a Member State asserts that the formula "does not fairly represent the extent of the business activity of that group member."[114]

For example, a UK multinational corporation with subsidiaries in France and Germany would not distinguish among its individual companies but would calculate group profits collectively. The Member States where these corporations are active would divide this consolidated profit based on an allocation formula. Each Member State then would have the ability to tax its portion of the joint consolidated profit at its own tax rate.[115] Thus, rather than having companies limit themselves to national operations in order to minimize costs of compliance with EU law, the CCCTB would facilitate cross-border operations and simplify EU taxation.[116]

Of course, now it is necessary for the Council to adopt this Proposal, which as described earlier, would require a unanimous vote. Getting agreement from all twenty-seven Member States is highly unlikely due to the strong resistance to the Proposal by Member States such as Ireland and the United Kingdom.[117] However, there is a possibility that a subset of the Member States could adopt the CCCTB Proposal using the enhanced cooperation framework.[118] Article 326 of the TFEU requires at least nine Member States to participate in the enhanced

111. *See* Cerioni, *supra* note 99, at 522.

112. CCCTB Proposal, *supra* note 88, art. 86, at 49.

113. *Id.* art. 90, at 50.

114. *Id.* art. 87, at 49.

115. *See* Paulus Merks, *Europe: The World's Most Competitive Economy by 2010?*, 55 TAX NOTES INT'L 729 , 731 (2009).

116. *See* Directorate-Gen., European Comm'n Taxation and Customs Union, Common Consolidated Corporate Tax Base Working Group (CCCTB WG), Brussels, Belg., Dec. 12–13, 2006, *Progress to Date and Future Plans for the CCCTB*, ¶¶ 76–77, CCCTB\WP\046 (Nov. 20, 2006) [hereinafter *Progress to Date*].

117. *See* Kristen A. Parillo, *Subset of EU Members May Adopt CCCTB, Academic Says*, 64 TAX NOTES INT'L 173, 173 (2011).

118. *See id.*

cooperation procedure to implement the CCCTB.[119] Professor Michael Lang noted that"[m]ost people think between 15 and 20 countries will participate," but some observers believe the proposal will never be implemented.[120] Christian Comolet-Tirman of the French Ministry of Economy has predicted that the CCCTB Proposal will be implemented in three years.[121]

III. *EUROPEAN COURT OF JUSTICE JURISPRUDENCE*

Most of the tax coordination thus far in the area of direct taxation has resulted from what has been termed "negative integration," the effects of the ECJ judgments regarding discrimination.[122] As pointed out by the former Commissioner for Taxation and Customs, "[t]he ECJ . . . case law 'illustrates how the tax treatment of losses in cross-border situations, exit taxation, taxes on transfer of assets, withholding taxes on cross-border income, anti-abuse rules as well as inheritance taxes can all constitute tax obstacles to the internal market.'"[123] It is settled case law that the Member States must exercise their competence in the income tax area in accordance with EU law.[124] Thus, the ECJ's interpretations of the Treaty have set limits on the sovereignty that national tax jurisdictions can exercise.[125]

Article 18 of the TFEU explicitly states that "any discrimination on grounds of nationality shall be prohibited."[126]

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119. TFEU, *supra* note 2, art. 326, 2010 O.J. C 83, at 189; *see* Treaty of Lisbon amending the Treaty on European Union and the Treaty Establishing the European Community art. 1(22), 2007 O.J. C 306/01, at 22.

120. Parillo, *supra* note 117, at 173–74.

121. *See* Lee A. Sheppard, *France, Germany Push Europe Closer to CCCTB*, 62 TAX NOTES INT'L 269, 269 (2011).

122. *See* van Thiel, *supra* note 17, at 169, 192 & n.252 (noting that taxation changes "arise mostly from 'negative integration' measures (in the areas where the . . . judiciary [is] active)").

123. Kaye, *supra* note 31, at 195 (quoting László Kovács, former European Commissioner for Taxation and Customs).

124. *See* van Thiel, *supra* note 17, at 148; *see also* Finanzamt Köln-Altstadt v. Schumacker, Case C-279/93, [1995] E.C.R. I-225, ¶ 21 ("Although . . . direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law.").

125. *See* Lukasz Adamczyk, *The Sources of EU Law Relevant for Direct Taxation*, *in* INTRODUCTION TO EUROPEAN TAX LAW: DIRECT TAXATION, *supra* note 20, at 13, 24.

126. TFEU, *supra* note 2, art. 18, 2010 O.J. C 83, at 56. *See generally* Kaye, *supra* note 39 (discussing the general prohibition found in the Treaty against discrimination on the basis of nationality).

Generally speaking, Member States are not permitted to enact national legislation that distinguishes between domestic and foreign persons, goods, services, or capital.[127] These limitations are part of the Treaty's fundamental freedoms: free movement of goods,[128] free movement of workers,[129] freedom of establishment,[130] freedom to provide services,[131] and free movement of capital and payments.[132] According to the jurisprudence of the ECJ, these freedoms are directly applicable.[133] "A provision of Community law is considered directly applicable only if it need not be incorporated into domestic legislation before becoming an element of the national legal order."[134] This means that individuals may challenge the validity of a national law, including a tax law.[135] "While European Union governments do their best to avoid harmonizing taxation, the EU's court of justice is busy doing it for them."[136]

Servaas van Thiel describes the period from the 1990s until 2005[137] as a time when the ECJ was rigorously enforcing a "constitutionally guaranteed minimum of economic integration in the form of directly applicable private sector rights to equal treatment and free movement."[138] Up until 2005, out of approximately one hundred direct tax cases, in all but seven

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127. A number of provisions within the EC Treaty prohibit measures that discriminate or otherwise restrict these fundamental freedoms as between nations. *See* Wolfgang Schön, *State Aid in the Area of Taxation*, *in* LEIGH HANCHER ET AL., EC STATE AIDS 241, 244 (3d ed. 2006).

128. TFEU, *supra* note 2, arts. 28–32, 2010 O.J. C 83, at 59–60 (prohibiting intra-EC customs duties).

129. *Id.* art. 45, at 65–66.

130. *Id.* arts. 49–55, at 67–69.

131. *Id.* arts. 56–62, at 70–71.

132. *Id.* arts. 63–66, at 71–73.

133. Van Gend en Loos v. Nederlandse Administratie der Belastingen, Case 26/62, [1963] E.C.R. 1, at 12–14.

134. Kaye, *supra* note 34, at 123 n.87 (citing GEORGE BERMAN ET AL., CASES AND MATERIALS ON EUROPEAN COMMUNITY LAW 180 (1993)).

135. SERVAAS VAN THIEL, 1 EU CASE LAW ON INCOME TAX 5 (2001).

136. *Corporate Tax and the EU Court: Taxing Judgments*, ECONOMIST, Aug. 26, 2004, at 67.

137. *See* van Thiel, *supra* note 17, at 147.

138. Servaas van Thiel, *Removal of Income Tax Barriers to Market Integration in the European Union: Litigation by the Community Citizen Instead of Harmonization by the Community Legislature?*, 12 EC TAX REV. 4, 4–5 (2003).

cases the ECJ found that the national tax provision involved violated a Treaty freedom.[139]

The *Marks & Spencer* case, however, demonstrates the more nuanced approach now being taken by the Court. Marks & Spencer plc sought to deduct the losses incurred by its Belgian, French, and German subsidiaries against its taxable UK profits.[140] Although the denial of the group loss relief rules was a restriction on the freedom of establishment,[141] the ECJ decided that it was justified based on "a balanced allocation of the power to" tax between the Member States, concern over the double deduction of such losses, and the risk of tax avoidance.[142] Nevertheless, upon applying the proportionality test, the Court found that this UK group loss relief restriction went beyond what was necessary given that the nonresident subsidiary had exhausted all possibilities for deduction of the losses in its state of residence.[143] The ECJ also noted that Member States were allowed to have rules to prevent tax evasion.[144]

As another example, the ECJ issued a landmark decision affecting corporations operating in the European Union in November 2011.[145] The *National Grid Indus* case held that a Dutch exit tax that must be paid immediately upon a corporation's transfer of effective management to another Member State violated Article 49 of the TFEU, but an option to defer the tax payment with administrative requirements would make the tax provision acceptable.[146] This judgment continues the ECJ's efforts to conceptualize the Member States' obligations with respect to the freedom of establishment that began with the *Daily Mail* case in 1988.[147]

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139. Kaye, *supra* note 39, at 52–53.

140. Marks & Spencer plc v. Halsey, Case C-446/03, [2005] E.C.R. I-10866, ¶ 2.

141. *Id.* ¶¶ 33–34.

142. *Id.* ¶¶ 43–51.

143. *Id.* ¶¶ 55–56.

144. *Id.*¶ 57.

145. Nat'l Grid Indus BV v. Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, Case C-371/10, [2011] E.C.R. I____ (delivered Nov. 29, 2011) (not yet reported); *see* Tom O'Shea, *Dutch Exit Tax Rules Challenged in National Grid Indus*, 65 TAX NOTES INT'L 201, 201 (2012).

146. *See National Grid Indus*, [2011] E.C.R. I____, ¶ 87.

147. *See* Queen v. Treasury & Comm'rs of Inland Revenue, *ex parte* Daily Mail & Gen. Trust plc, Case 81/87, [1988] E.C.R. 5483, ¶ 2 [hereinafter *Daily Mail*]; *see also* O'Shea, *supra* note 145, at 204.

Article 49 of the TFEU sets forth a company's right to establish branches and subsidiaries in the other Member States;[148] however, the right to transfer a company seat to other Member States is not clearly addressed in the Treaty.[149] Transferring a company seat involves either the transfer of its real seat (place of effective management) or the transfer of its statutory seat (place of incorporation), depending on the company law of the Member State in which it began its legal existence.[150] In *Daily Mail*, the ECJ confronted this issue of corporate emigration when asked whether the right of freedom of establishment guaranteed a company's right to transfer its seat without the consent of its national authorities.[151]

Daily Mail, incorporated in the United Kingdom, sought to transfer its central management to the Netherlands to avoid capital gains taxation.[152] UK corporate tax law required consent from the Treasury for such a transfer and the tax authority refused to grant consent unless Daily Mail paid some capital gains tax before the transfer.[153] The ECJ held that given the differences between national company legislation, the Treaty confers no right on a company incorporated under the legislation of a Member State and having its registered office there to transfer its central management and control to another

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148. Article 49 bars the Member States from limiting the freedom of establishment, setting up an agency, branch, or subsidiary of one Member State in the territory of another Member State. TFEU, *supra* note 2, art. 49, 2010 O.J. C 83, at 67. Companies "formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union" must "be treated in the same way as natural persons who are nationals of Member States." *Id.* art. 54, at 69.

149. *See* SVEN H.M.A. DUMOULIN ET AL., THE EUROPEAN COMPANY: CORPORATE GOVERNANCE AND CROSS-BORDER REORGANISATIONS FROM A LEGAL AND TAX PERSPECTIVE 8–9 (2005).

150. *See* Marek Szydlo, *Emigration of Companies Under the EC Treaty: Some Thoughts on the Opinion of the Advocate General in the Cartesio Case*, 6 EUR. REV. PRIVATE L. 973, 974–75 (2008).

151. *Daily Mail*, [1988] E.C.R. 5483, ¶ 11.

152. *Id.* ¶¶ 6–7. The UK holding company was anticipating a sale of stock and wanted to avoid UK capital gains tax. The Netherlands would have granted a step-up to fair market value of the basis of the company's holdings upon transfer. Peter J. Wattel, *Exit Taxation in the EU/EEA Before and After* National Grid Indus, 65 TAX NOTES INT'L 371 (2012).

153. Mitchell A. Kane & Edward B. Rock, *Corporate Taxation and International Charter Competition*, 106 MICH. L. REV. 1229, 1276 (2008).

Member State.[154] Thus, the ECJ upheld the UK restrictions, noting that, "unlike natural persons, companies are creatures of the law and, in the present state of Community law, creatures of national law."[155] Because "the legal consequences of a transfer, particularly in regard to taxation, vary from one Member State to another,"[156] the Court held that the freedom of establishment could not resolve this issue; rather, EU harmonizing legislation was necessary.[157] According to the *Daily Mail* judgment, freedom of establishment could not be invoked to justify a company's transfer of seat in an emigration situation.[158]

The treatment of the company by the host Member State to which it moved—the immigration situation—was dealt with differently by the ECJ. The Court's judgments in *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*,[159] *Überseeing BV v. Nordic Construction Co. Baumanagement GmbH(NCC)*,[160] and *Kamer van Koophandel en Fabriekenvoor Amsterdam v. Inspire Art Ltd.*[161] require all host Member States to accept the company incorporated in another Member State without a loss of its legal identity.[162] The ECJ interprets the freedom of establishment in the immigration case to hold that the receiving Member State cannot impede the

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154. *Daily Mail*, [1988] E.C.R. 5483, ¶¶ 23–24.

155. *Id.* ¶ 19.

156. *Id.* ¶ 20 ("Certain States require that not merely the registered office but also . . . the central administration of the company, should be situated on their territory, and the removal of the central administration from that territory thus presupposes the winding-up of the company with all the consequences that winding-up entails in company law and tax law. The legislation of other States permits companies to transfer their central administration to a foreign country but certain of them, such as the United Kingdom, makes that right subject to certain restrictions, and the legal consequences of a transfer, particularly in regard to taxation, vary from one Member State to another.").

157. *Id.* ¶ 23.

158. *See* Szydlo, *supra* note 150, at 983–94.

159. Centros Ltd. v. Erhvervs-og Selskabsstyrelsen, Case C-212/97, [1999] E.C.R I-1484 (describing how a company registered in the United Kingdom sought to enter Denmark by opening a branch).

160. Überseering BV v. Nordic Constr. Co. Baumanagement GmbH(NCC), Case C-208/00, [2002] E.C.R. I-9943 (detailing how a Dutch company intended to enter Germany).

161. Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., Case C-167/01, [2003] E.C.R. I-10195 (explaining that a UK-registered company was going to operate in the Netherlands).

162. *See* Marie-Louise Lennarts, *Company Mobility Within the EU, Fifty Years on: From a Non-Issue to a Hot Topic*, 4 UTRECHT L. REV. 1, 1–2 (2008).

transfer and must recognize the legal identity of the transferring company.[163] However, the *Cartesio* case was necessary to raise the issue again of whether the freedom of establishment gives a company the right to transfer its operational headquarter to another Member State while retaining its status under the law of the home Member State.[164]

Cartesio was a limited partnership registered under Hungarian law that sought to transfer its operational headquarters from Hungary to Italy, while retaining its legal status as a company governed by Hungarian law.[165] The application was rejected[166] and eventually an appellate court asked the ECJ for a preliminary ruling as to whether the freedom of establishment precluded national laws that prevent a Hungarian company from transferring its operational headquarter to another Member State.[167] In its judgment, the ECJ held that a Member State has the power to preclude a company from retaining its legal status under its law if the company intends to reorganize itself in another Member State by transferring its seat.[168] According to the Court, a Member State has the power to define the connecting factors required for a company to be regarded as incorporated under its national law.[169] Furthermore, the Member State has the power to preclude the company from retaining its legal status "if the company intends to reorganise itself in another Member State by moving its seat to the territory of the latter, thereby breaking

163. Wolf-Georg Ringe, *No Freedom of Emigration for Companies?*, 16 EUR. BUS. L. REV. 621, 623 (2005). The host Member States are concerned that the transferred companies incorporated under their home Member State law will avoid the minimum capital requirements and other rules required by the host Member State. *Id.* at 622.

164. *See* Cartesio Oktató és Szolgáltató bt, Case C-210/06, [2008] E.C.R. I-09641, ¶ 40(4)(a).

165. *Id.* ¶¶ 21, 23–24.

166. *Id.* ¶ 24. Cartesio appealed to the Regional Court of Appeal, Szeged. *Id.* ¶¶ 25–26.

167. *Id.* ¶ 40.

168. *Id.* ¶ 124. The Court stated that whether the freedom of establishment "applies to a company which seeks to rely on the fundamental freedom enshrined in that article—like the question [of] whether a natural person is a national of a Member State, hence entitled to enjoy that freedom—is a preliminary matter which, as Community law now stands, can only be resolved by the applicable national law." *Id.* ¶ 109.

169. *Id.* ¶ 110.

the connecting factor."[170] Thus, Hungary did not need to justify its liquidation requirement because the company did not have the right to enjoy the fundamental freedom in the first place.[171]

Consequently, a Member State can require a company to liquidate when it transfers its real seat to another Member State. This has ramifications for tax purposes because the liquidation of a corporation is a taxable event whether or not there is a transfer of seat involved.[172] Thus, Member States can impose what is essentially an exit tax if that Member State's company law requires liquidation prior to transferring its seat. This is in contrast to the situation of an emigrating company that does not have its legal existence terminated when it transfers its management abroad.[173] The ECJ addressed this situation in one of the "Court's most significant judgments of 2011 and a landmark case in the Court's jurisprudence."[174]

National Grid Indus BV, a limited liability company incorporated in the Netherlands, transferred its place of effective management to the United Kingdom (the exact opposite of the fact pattern in the *Daily Mail* case).[175] The company's only asset in contention was a receivable from

170. *Id.* The Court distinguished the situation of a company that moves its seat to another Member State while retaining its status as a company under the law of the home Member State from the situation where a company moves to another Member State and is governed by the law of the host Member State. *Id.* ¶ 111. In the latter situation, the Court held that the freedom of establishment allows a company to convert "itself into a company governed by the law of [another] Member State" "without being liquidated in the Member State of incorporation, to the extent that the law of the host Member State allows such conversion. *Id.* ¶ 112–13. The home Member State's prevention of such conversion would constitute a restriction on the freedom of establishment "unless it serves overriding requirements in the public interest." *Id.* ¶ 113.

171. Wolfgang Schön, Speech at Seton Hall University School of Law: Free Movement in the European Union; A Business and Tax Perspective Conference–Mobility of Companies in the European Union (Apr. 8, 2009).

172. *See* Lee A. Sheppard, *Exit Taxes on European Restructuring*, 65 TAX NOTES INT'L 7, 9 (2012).

173. Wattel, *supra* note 152, at 371.

174. O'Shea, *supra* note 145, at 204. The ECJ delivered its decision in *National Grid Indus* on November 29, 2011. *See* Nat'l Grid Indus BV v. Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, Case C-371/10, [2011] E.C.R. I___ (delivered Nov. 29, 2011) (not yet reported). Nine Member States made submissions to the Court in addition to the Netherlands. *See* Harm van den Broek & Gerald Meussen, *National Grid Indus Case: Re-Thinking Exit Taxation*, 52 EUR. TAX'N 190, 190 (2012).

175. *National Grid Indus*, [2011] E.C.R. I____, ¶ 2.

National Grid Company plc, established in the United Kingdom, which contained an unrealized currency gain due to "the rise in value of the pound sterling against the Dutch guilder."[176] Although there were no company law consequences as both the Netherlands and the United Kingdom use the incorporation system,[177] the Netherlands would lose its taxing jurisdiction after the transfer pursuant to its income tax treaty with the United Kingdom.[178] Thus, the Netherlands sought to impose a capital gains tax at the time of the transfer.[179]

The Court held that because the transfer of its effective place of management did not affect National Grid Indus BV's status as a Dutch company, it could "rely on its rights under Article 49 TFEU" to challenge the lawfulness of the exit tax imposed by the Netherlands.[180] The Court acknowledged that National Grid Indus BV was placed at a disadvantage with respect to cash flow when comparing its situation with that of a similar company that remained in the Netherlands.[181] The exit tax only applied to a company that moved its place of effective management to another Member State.[182] A company would not face the tax if it simply moved its place of effective management to another location within the Netherlands.[183] Thus, the Court interpreted the freedom of establishment as precluding legislation that required an immediate tax on unrealized gains when a company transferred its place of effective management.[184]

However, it did not preclude legislation fixing definitively the amount of tax owed on the unrealized gains at the time of transfer and a choice between immediate payment of the tax

176. *Id.* ¶ 11–12.

177. *See* Eric Kemmeren, *The Netherlands: Infringement Procedure on Exit Taxes on Businesses (C-301/11)*, *in* ECJ-RECENT DEVELOPMENTS IN DIRECT TAXATION 2011, at 183, 198 (Michael Lang et al. eds., 2012) ("[U]nder an incorporation system, a corporation continues to exist and to function under the company law rules of a state, as long as the statutory seat is situated in the state concerned, even if the real seat is transferred outside that state.").

178. *National Grid Indus*, [2011] E.C.R. I____ (delivered Nov. 29, 2011), ¶ 13.

179. *Id.* ¶¶ 13–14.

180. *Id.* ¶ 32.

181. *Id.* ¶ 37.

182. *Id.*

183. *Id.*

184. *Id.* ¶ 87.

and deferred recovery of the tax with interest.[185] The tax was justified by the "fiscal principle of territoriality linked to a temporal component" meaning that the Netherlands had a right to tax the capital gains generated in its territory before the transfer.[186] This line of reasoning follows settled ECJ case law where "preservation of the allocation of powers of taxation between the Member States" evidenced by the negotiation of bilateral tax treaties has been widely accepted as a justification.[187] Thus, exit taxes are allowed as long as the collection of the tax is deferred until the gains are actually realized. On December 16, 2011, the Netherlands State Secretary of Finance issued a decree that provides for the deferred collection of exit taxes in exchange for bank guarantees and corresponding interest charges.[188]

This judgment differs from the ECJ jurisprudence with respect to exit taxes on natural persons.[189] While a company must either pay an immediate tax or be subject to administrative burdens and interest charges, the *N.* case prohibited the exit state from requiring security in order to receive a deferred payment option.[190] Furthermore, the *N.* case requires that the exit state take into account any declines in value after emigrating while *National Grid Indus* does not make that requirement for companies.[191] Natural persons can be distinguished from companies, but *National Grid Indus* may also be just an example of a more cautious ECJ.

The Commission as guardian of the Treaties continues to play an important role in enforcing EU law with respect to direct taxation through its use of the infringement procedure.[192] This

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185. *Id.* ¶¶ 73, 87. The tax legislation could also provide for a bank guarantee with respect to the deferred tax. *Id.* ¶ 74

186. *Id.* ¶ 46.

187. *Id.* "Preserving the allocation of powers of taxation is a legitimate objective recognised by the Court." *Id.* ¶¶ 43, 46; *see* Kemmeren, *supra* note 177, at 202.

188. van den Broek & Meussen, *supra* note 174, at 195.

189. *See, e.g.*, Wattel, *supra* note 152, at 371–72.

190. N. v. Inspecteur van de Belastingdienst Oost/kantoor Almelo, Case C-470/04, [2006] E.C.R. I-7409. "[R]equirement of a bank guarantee for deferred payments was considered to be a disproportional restriction of the freedom of establishment." Kemmeren, *supra* note 177, at 207.

191. *Compare N.*, [2006] E.C.R. I-7409, *with National Grid Indus*, [2011] E.C.R. I____, ¶¶ 53–56.

192. TFEU, *supra* note 2, art. 258, 2010 O.J. C 83, at 160.

procedure can be used whenever a Member State has domestic tax provisions that are incompatible with EU law.[193] When this situation arises, the Commission is obligated to notify the offending Member State of the issue and, after receiving its observations, to send a reasoned opinion to that Member State.[194] If no satisfactory response is received within two months, the Commission may bring an action before the ECJ.[195] For example, in 2010, the Commission formally requested that Belgium,[196] Denmark,[197] and the Netherlands change their restrictive corporate exit tax provisions, citing incompatibility with the freedom of establishment.[198] Denmark and the Netherlands have been referred to the ECJ because of their unsatisfactory explanations and inability to justify their exit tax rules.[199] The Danish case was brought before the Court on May 26, 2011.[200] Commentators predict that the ECJ will hold the Danish provisions to be justified but a disproportionate response "to the need to preserve the balanced allocation of taxing powers between the Member States."[201] Similar cases are pending with respect to Portuguese and Spanish exit taxes.[202]

CONCLUSION

This cursory overview of the direct tax harmonization since the Maastricht Treaty demonstrates that significant progress has been made despite the obstacle of the unanimous voting requirement. The Commission has been extremely active in

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193. Adamczyk, *supra* note 125, at 15. The Commission also can use the infringement procedure if the Member State has not implemented a directive appropriately. *Id.*

194. *Id.* at 18; *see* TFEU, *supra* note 2, 2010 O.J. C 83, art. 258, at 160.

195. TFEU, *supra* note 2, arts. 260(2), 265, 2010 O.J. C 83, at 161, 163.

196. The Belgian tax requires immediate taxation of capital gains when a corporation transfers it fiscal residence. Commission Press Release, IP/10/299 (Mar. 18, 2010).

197. *Id.* ("The Danish tax la[w] provides for immediate taxation of capital gains on assets transferred outside of Denmark.").

198. *Id.*

199. Soren Friis Hansen, *Denmark: Exit Tax on Companies' Transfer of Assets (Commission vs. Denmark, Case-261/11)*, *in* ECJ-RECENT DEVELOPMENTS IN DIRECT TAXATION 2011, *supra* note 175, at 63.

200. *Id.*

201. *Id.* at 68.

202. *See* Sheppard, *supra* note 170, at 10; *see also* van den Broek & Meussen, *supra* note 174, at 195.

pursuing amendments to its existing directives in order to enable them to function more efficiently as well as proposing new directives such as the CCCTB directive. The proactive use of the infringement procedure is helping to ensure that Member States' national tax laws are in compliance with EU law.

Thus, the ECJ remains a major player in the development of EU tax law with the explosion of direct tax cases (twenty-two decisions in 2011 alone). The example of the *National Grid Indus* case demonstrates the far reaching effects of these cases. The problem, of course, is the legal uncertainty that results both for taxpayers as well as the national treasuries from such negative integration. Another consideration is the amount of time and resources that are expended in order to accomplish tax harmonization or coordination of tax laws in this manner. Both the legislative route as well as the judicial route is excruciatingly slow in practice. If there is ever a chance to reconsider the tax legislative process, the Member States must rethink their opposition to qualified majority voting even if only for a small subset of corporate tax issues. In the meantime, the CCCTB project will hopefully provide an opportunity to experiment with the enhanced cooperation procedure.