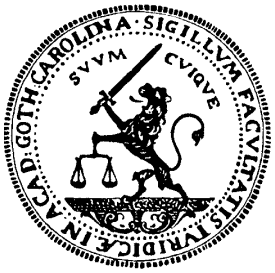

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The principle of Community loyalty and its impact on non-harmonised direct taxation

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20 credits

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“It is said with truth that this involves some sacrifice or merger of national sovereignty. But it is also possible and not less agreeable to regard it as the gradual assumption by all nations concerned of that larger sovereignty which can also protect their diverse and distinctive customs and characteristics all of which under totalitarian systems, whether Nazi, Fascist or Communist would certainly be blotted out for ever”.

Winston Churchill on European unification, 7 May 1948.

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Abstract

This master's thesis contends that although non-harmonised direct taxation unquestionably falls outside the Community's power to harmonise, the principle of loyalty in Article 10 EC implicitly brings non-harmonised direct taxation within the ambit of the EC Treaty and the four freedoms of the internal market. This position has been confirmed by case law from the ECJ regarding income taxation. In its application of Community law in matters of non-harmonised direct taxation, the ECJ has increasingly moved away from its traditional discrimination-based approach toward a more restriction-based analysis. It is submitted that the Court's stance is based on the principle of loyalty in Article 10 EC.

This thesis also contends that ECJ case law on non-harmonised taxation has created an important and logical paradigm. The Court's judgement in *Bachmann*, one of the key cases on non-harmonised direct taxation in Community law, can be interpreted to confirm the existence of a distinction between Treaty-based and ECJ-developed rules, in relation to non-harmonised direct taxation. *Discriminatory* national tax limitations of Community law can *only* be justified by Treaty-based exceptions, while *restrictive* national tax limitations may be justified by either Treaty-based *or* ECJ-developed exceptions. As the ECJ-developed exception of preserving fiscal coherence can *only* justify national limitations of *ECJ-developed prohibitions of restriction*, Member States must begin to embrace, not fear, the prohibition of restriction in Community law. Only by emphasising a measure's restrictive effect will a Member State be successful in protecting the fiscal coherence of its national tax system.

Abbreviations

CMLR	Common Market Law Reports
Dir.	Directive
EC	European Community
ECJ	European Court of Justice
ECR	European Court Reports
EC Treaty	Treaty establishing the European Community
EEC	European Economic Community
EMU	Economic and Monetary Union
EU	European Union
EU	Treaty on European Union
MEQR	Measures having Equivalent Effect to a Quantitative Restriction
O.J.	Official Journal of the European Communities
VAT	Value Added Tax
VC	Convention on the Law of Treaties of 1969

Introduction

Although the Member States of the EU undoubtedly have committed themselves to creating "an ever closer union among the peoples of Europe,"[1] they retain their national sovereignty within the EU. The process of creating European political unity thus lies solely in the hands of each individual Member State. Conversely, European economic integration has been the attention of the European Communities supranational first pillar, the EC, since 1957.[2]

According to Article 2 of the EC Treaty the economic objectives of the EC are to promote a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, an increased standard of living and quality of life, and economic and social cohesion and solidarity among Member States. To attain these objectives, the Member States have committed themselves to the establishment of a common market and an economic and monetary union. It is thought that a free market, with optimum allocation of resources within the territory of all 15 sovereign Member States, will lead to greater prosperity for all.[3]

To achieve this common market, the founders of the EC Treaty have established an internal market described in Article 14 EC:

> "The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty"

One of the most difficult tasks in completing the internal market is, of course, the removal of tax barriers within the Community.[4] The fact remains that the power to tax constitutes one of the basic instruments of sovereign rule. Taxation generates the revenue that enables governments to establish and maintain infrastructures and provide social benefits.[5] It is also a means for governments to spread the tax burden and benefits in a way considered fair by the taxpayers.[6] For this reason, Member States are reluctant to cede their power to impose non-harmonised direct taxation to the Community. (Indirect taxation power has already been transferred to the Community and

[1] Article 1 EU
[2] On the content of the three pillars of the EU see Craig, Paul/de Burca, Gráinne; EU Law, Text cases & materials, Second edition, Oxford University Press Inc., New York, 1998 p 3
[3] Craig/de Burca p 549
[4] Brokelind, Cécile; Towards an EC tax law, Institutionen för handelsrätt, Lund, 1993 p 9
[5] Monti, Mario; The Single Market and beyond: challenges for tax policy in the European Union, EC Tax Review 1997/1 p 2
[6] Williams, David W.; Asscher; the European Court and the Power to Destroy, EC Tax Rev 1997/1 p 4.

will only be mentioned here for purposes of clarity[7]). The Commission historically has maintained that non-harmonised direct taxation has to be dealt with in the context of the internal market.[8] However, logically, the idea of an internal market calls for some sort of harmonisation, or at least co-ordination, of the tax systems of Member States. This view forms an integral part of this thesis.

As the EU is an association of 15 Member States it has no federal powers or independent means of enforcement of its own.[9] The EU is thus at the mercy of individual Member States (and their national authorities) to carry out the policies of the Community.[10] To facilitate enforcement, the originators of the EC Treaty provided it with a principle of loyalty, expressed in Article 10, which reads:

> "Member States shall take all appropriate measures, weather general or particular, to ensure fulfilment of the obligations arising out of this Treaty or resulting from action taken by the institutions of the Community. They shall facilitate the achievement of the Community's tasks.
>
> They shall abstain from any measure which could jeopardise the attainment of the objectives of this Treaty."

This master's thesis will contend that although non-harmonised direct taxation unquestionably falls outside the Community's power to harmonise, the principle of loyalty in Article 10 EC implies that non-harmonised direct taxation falls within the context of the EC Treaty and the four freedoms of the internal market.[11] This has also been confirmed by case law from the ECJ regarding income taxation. This case law will be discussed in chapter 2. When the ECJ applies Community law in matters of non-harmonised direct taxation it has increasingly moved away from its traditional discrimination-based approach to a more restriction-based analysis. It is submitted that the Court, has supported this on the principle of loyalty in Article 10 EC.

This thesis has two primary objectives. Chapter 1 identifies and describes the principle of loyalty as expressed in Article 10 EC, and is mainly based on legal literature. Chapter 2 examines the deepening impact of Community law in matters of non-harmonised direct taxation. As the second objective largely concerns unsettled law, this chapter will be based on ECJ case law. A summary and evaluative conclusion follow at the end of the thesis.

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[7] For a further discussion on the differences between direct taxation (e.g. personal and corporate taxes) and indirect taxation (e.g. VAT) see Brokelind, Cécile.

[8] Brokelind, Cécile p 24. Although it must be emphasised that the Commission gave up all efforts of *harmonising* direct taxes long ago (see Williams; EC Tax Law p 97)

[9] Temple Lang, John; Community Constitutional law; Article 5 EEC Treaty, CMLR 27, 1990 p 647

[10] Ibid

[11] This line of thinking is inspired by Professor Sture Bergström, See Bergström, Sture; Restrictions on Free Movement and the Principle of Non-Discrimination in EC Law and their implications for Income Taxation, Festskrift till Mutén, 1998 p 45-57

1 The principle of Community loyalty

1.1 Article 10 EC

Article 10 EC, quoted in the introduction, imposes two positive obligations and one negative obligation on Member States. Together, these three obligations constitute the principle of Community loyalty.[12] This principle is essentially a clear example of a much older principle contained in international public law, namely the principle of loyalty expressed in Article 26 of the Vienna Convention on the Law of Treaties of 1969:[13]

> "Every Treaty in force is binding upon the parties to it and must be performed by them in good faith".

The wording of Article 26 VC shows that this Article expresses an obligation on each signatory to a Treaty to actually honour the spirit of the Treaty signed. As the EC Treaty is supranational in nature, the principle of loyalty in Article 10 EC has great implications on the different legal orders of the Member States.

By its nature, Article 10 EC is a supplementary provision, whose content can commonly be understood only in relation to obligations that are more specifically described in other provisions of the EC Treaty.[14] ECJ case law, however, suggests that under certain circumstances, Article 10 EC can actually transcend these obligations.[15] It is this dynamic ability inherent in the EC Treaty, through the principle of loyalty, which has made non-harmonised direct taxation subject to Community law in the first place. The general content and outer limits of the principle of loyalty in Article 10 EC are therefor of great significance in understanding current European Union tax law.

In order to best describe the principle of loyalty expressed in Article 10 EC, several scholars have found it necessary to divide that principle into parts quite different from that of the wording of Article 10 EC itself.[16] The author has chosen to follow their division. Thus, for purposes of clarity, the principle of loyalty in Article 10 EC will be described as consisting of three obligations:

1. the positive obligations imposed on Member States (1.2);

[12] Kapteyn, P.J.G/VerLoren van Themaat; Introduction to the law of the European Communities, Third edition, Kluwer Law, London, 1998 p 148
[13] EU-Karnov 1 1999; Redigeret af Jørgen Molde, Bo Vesterdorf, Nina Holst-Christensen og Karsten Hagel-Sørensen, Sjette udgave, Thomson A/S, København, 1999 p 52
[14] Kapteyn/VerLoren s 149
[15] Temple Lang, p 646
[16] See Kapteyn/VerLoren p 149 and Temple Lang p 647

2. the negative obligations imposed on Member States (1.3); and
3. the obligation of mutual co-operation between Member States and the Community (1.4).

The crucial question whether Article 10 EC constitutes a jurisdictional rule or a conflict principle will be addressed at the end of this chapter (1.5).

1.2 The positive obligations imposed on Member States

The two positive obligations imposed on Member States by Article 10 EC can also be seen as actually imposing the following three obligations[17]:

1. the obligation to give full effect to Community law (1.2.1);
2. the obligation to ensure judicial protection of the rights of individuals, which stem from EC law (1.2.2); and
3. the obligation on Member States to implement Community objectives (1.2.3):

1.2.1 The obligation to give full effect to Community law.

The obligation of Member States to give full effect to Community law is of fundamental importance to the Community. It also constitutes a logical consequence of the character and structure of the EU framework. As previously noted, the EU is an association of 15 sovereign States. As such the EU has no federal powers and no federal institutions of its own.[18] Even when collecting its own taxes[19] the EU is dependent on national authorities to carry out the actual work within the Member States.[20] National authorities thus seem to be caught in a conflict of interest when acting as loyal institutions both to their Member State and the Community, at large. Article 10 EC therefore obligates Member States to ensure that they have taken all administrative and constitutional measures necessary to give full effect to Community law.[21] In short, all institutions of a Member State must be loyal to the Community.[22] As this obligation clearly applies to all levels and branches of government national parliaments are obliged to repeal or amend any legislation contrary to Community law.[23] National, regional and local institutions, as well as private bodies entrusted with public powers, are obligated by Article 10 EC to give full effect to Community law.[24]

[17] This division has been inspired by Kapteyn/VerLoren p 149-155, who in their turn based their presentation on Durand and Due (Kapteyn/VerLoren, note 141, p 149)
[18] Temple Lang p 647
[19] On the funds of the EU see Williams; EC Tax Law, Addison Wesley Longman, New York, 1998 p 25
[20] Williams; EC Tax Law p 25
[21] Temple Lang p 645
[22] Ibid 646
[23] Kapteyn/VerLoren p 151
[24] Ibid

1.2.1.1 National courts as Community courts

National courts play a particularly important role in ensuring that Community law is given full effect. It is the national courts that ensure the application and respect of Community law in the Member States.[25] The obligation to give Community law full effect therefore obliges national courts to act as Community courts in matters within their jurisdiction.[26] In *Von Colson*[27] the ECJ made it quite clear that national courts are obliged by Article 10 EC to "interpret their national law in the light of the wording and purpose" of directives. [28] National courts are thus obliged to set aside national rules, including those not concerned with the direct implementation of a directive, when those rules can impair the effectiveness of EC law.[29] This requirement has definitely not been restricted to the implementation of directives.[30]

Nevertheless, the duty imposed on courts to interpret national law in a manner that conforms to Community law, is limited by the principles of legal certainty and the non-retroactivity of penal liability.[31] These limitations, however, stem from fundamental principles of law and not from the national sovereignty of Member States.

1.2.1.2 The supremacy of Community law

The obligation to give Community law full effect clearly means that Community law must take precedence over national law. In the words of the Court in *Costa v ENEL*[32]:

> "The executive force of Community law cannot vary from one state to another in deference to subsequent domestic laws, without jeopardizing the attainment of the objectives of the Treaty…"

If Community law could be overridden by a domestic legal provision, the entire basis of the Community itself would be called into question.[33] By applying a purposive and contextual interpretation of the EC Treaty and by emphasising the objectives of the EC Treaty the ECJ consistently developed a doctrine of supremacy of Community law. [34] It did so by emphasising that the Member States, by creating a Community with institutions, personality, legal capacity and real powers had in fact:

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[25] Weatherill Stephen/Beaumont, Paul; EU Law, Third edition, Penguin Books, 1999 p 390
[26] Temple Lang p 646
[27] Case 14/83 *von Colson and Kamann v Land Nordrhein-Westfalen* [1984] ECR 1891.
[28] Ibid para. 26
[29] Kapteyn/VerLoren p 43 and Weatherill/Beaumont p 409
[30] Craig/de Burca 198-199
[31] Ibid
[32] Case 6/64 *Costa v ENEL* [1964] ECR 585 at 594
[33] Ibid
[34] Weatherill/Beaumont p 194

> "limited their sovereign rights, albeit within limited fields, and have thus created a body of law which binds both their nationals and themselves."[35]

The Courts statement in *Costa v ENEL* clearly shows the dynamic character of EC law. It also offers a brilliant example of the supranational nature of the EC pillar.[36]

1.2.2 The obligation to ensure judicial protection of the rights of individuals, which stem from EC law

Another positive obligation deduced from Article 10 EC is an obligation of Member States to protect the rights of individuals, which are derived from EC law.[37] This obligation is closely related to the obligation to give full effect to Community law as remedies and sanctions are necessarily entwined with other provisions of law to secure their observance.[38] This obligation is principally directed at the national courts.[39] It imposes an obligation to penalise infringements of Community law and to award compensation to an individual when a Member State has infringed his or her rights.[40] The obligation to ensure judicial protection of the rights of individuals, which stem from EC law will be further discussed in the following two subsections.

1.2.2.1 The obligation to penalise infringements of Community law

In its early case law, *Comet v Produktschap*[41] and *Rewe*[42], the ECJ identified a principle of national procedural autonomy in Article 10 EC.[43] From the very beginning, Community rights were thus a matter for the Community, while remedies remained the concern of each individual Member State.[44] This autonomy, however, was limited by two requirements in Community law. The first limitation was the principle of *equality and non-discrimination*, which requires a Member State to enforce Community law and domestic law with the same diligence.[45] Community law must not be treated less favourably than its domestic counterpart.[46] The second limitation was the principle of *practical possibility*, which prohibits domestic conditions from rendering it impossible, in practice, to exercise Community rights.[47] The latter of the two requirements implies that national

[35] *Costa v ENEL* [1964] ECR 585 at 593
[36] Cf. note 2
[37] Temple Lang p 651
[38] Craig/de Burca p 213
[39] Kapteyn/VerLoren p 152
[40] Weatherill/Beaumont p 226
[41] Case 45/76 *Comet v Produktschap* [1976] ECR 2043
[42] Case 33/76 *Rewe-Zentralfinanz v Landwirtschaftskammer* [1976] ECR 1989
[43] Craig/de Burca p 214
[44] Ibid
[45] Weatherill/Beaumont p 226
[46] Ibid
[47] Craig/de Burca p 215

courts are required to supply remedies even in cases where no national remedies exist.[48] Additionally, it is a fundamental requirement of Community law that any penalties must also be effective, proportionate and dissuasive.[49]

1.2.2.2 The liability of Member States for injury to individuals by infringements of Community law

In *Francovitch*[50], the ECJ held that the "full effectiveness of Community rules would be impaired and the protection of the rights which they grant would be weakened if individuals were unable to obtain compensation" when their rights where infringed by a Member State.[51] As no general provisions concerning compensation existed at the time of *Francovitch* (and still do not exist), the ECJ drew on Article 10 EC to impose an obligation on Member States to pay compensation for such injury.[52] It did so by pointing to the fact that State liability for injury caused to an individual was inherent in the Treaty.[53] Consequently, the obligation to pay compensation stems from the principle of loyalty in Article 10 EC.[54]

One of the most important consequences of the Court's decision in *Francovitch* was increasing the pressure on Member States to implement directives correctly.[55] The *Francovitch* case also marked a turning point in ECJ case law, as it made state liability compulsory, and no longer merely an optional national remedy.[56] In the joined cases of *Brasserie du Pêcheur* and *Factortame III*[57] the ECJ subsequently extended the scope of state liability to all breaches of Community law by a Member State.[58]

1.2.3 The obligation on Member States to implement Community objectives

Article 10 EC imposes a positive obligation on Member States to implement Community objectives in the absence of Community or national legislation. Naturally, this is conditioned on the identifiability of those objectives and the required action.[59] In *Thieffry*[60], a case concerning the free movement of workers and establishment, for example, the ECJ held that a person subject

[48] Weatherill/Beaumont p 933
[49] Ibid p 226
[50] Cases C-6/90, C-9/90 *Francovitch and Others v Italy* [1991] ECR I-5357
[51] Ibid para. 33
[52] Weatherill/Beaumont p 933
[53] Ibid
[54] *Francovich* para. 33
[55] Weatherill/Beaumont 426
[56] Craig/de Burca p 238
[57] Cases C-46/93, C-48/93 *Brasserie du Pêcheur SA v Germany and R v Secretary of State for Transport, ex parte Factortame Ltd and others* [1996] ECR I-1029
[58] Weatherill/Beaumont 426
[59] Temple Lang 657
[60] Case 71/76 *Thieffry v Conseil de l'Ordre des Advocates* [1977] ECR 765

to Community law could not be denied the practical benefit of Community law solely by the fact that directives had not yet been adopted on a Community level.[61] Member States where thus obliged by Article 10 EC to secure the free movement of workers and the right of business establishment even in the absence of Community or domestic legislation.[62] This has been confirmed in subsequent ECJ case law.[63] The following four subsections will further discuss the obligation to implement Community objectives.

1.2.3.1 The obligation to take temporary national measures in cases of Community inactivity[64]

The obligation to implement Community objectives compels Member States to take temporary national measures when a Community institution has failed to act as intended. This was evident in *Pluimveeslachterij Midden-Nederland BV et al.*[65], where the Council had failed to adopt measures to improve quality and fix standards for the Common organisation in slaughtered poultry. The ECJ held that no objection could be raised where a Member State maintains or introduces measures in order to realise the aims of the common organisation within its territory. However, the court characterised any such measure as the result of the principle of loyalty expressed in Article 10 EC, and not an exercise of a Member States own sovereignty. Thus, in taking these temporary measures, a Member State acts on behalf of the Community, and is no longer in the province of national acts.

1.2.3.2 The obligation to ratify conventions[66]

Yet another obligation deduced from the obligation on Member States to implement Community objectives is the obligation on Member States to ratify conventions negotiated by the Community. This only arises in cases where it is sufficiently clear that the convention in question actually relates to a Community policy or the completion of the single market.[67]

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[61] *Thieffry* para. 17
[62] Craig/de Burca p 736
[63] See Craig/de Burca 736-738 on Cases 222/86 *UNECTEF v Heylens* [1987] ECR 4090 and 340/89 *Vlassopoulou v Ministerium für Justiz, Bundes- und Europeangelegenheiten Baden-Würtemberg* [1991] ECR 2357
[64] Kapteyn/VerLoren p 153-154
[65] Case 47/83, 48/83 *Pluimveeslachterij Midden-Nederland BV et al. v Bedrijfschap voor de Pluimveehandel* [1984] ECR 1721
[66] Tempe Lang p 658
[67] E.g. The Bern Convention for the Protection of Literary and Artistic Works. (Temple Lang p 658)

1.2.3.3 The obligation of Member States outside the EMU to implement Community objectives[68]

In 1990, John Temple Lang submitted a (not so) hypothetical example of the potential impact of the obligation to implement Community objectives. This example is especially interesting in view of current discussions in Sweden and the UK, concerning the EMU. If a measure is taken by a Community institution to end distortions of competition, and such distortions arise from significant alterations in a Member State's exchange rate, Article 10 EC may impose an obligation on Member States to adopt counter-measures to adjust the situation. Thus, it is quite possible that Article 10 EC can oblige Member States formally outside the EMU to be loyal to the fundamental policies of the EMU, at least to the extent that such policies affect the internal market and Community law.

1.2.3.4 The obligation of Member States to adhere to principles of liberty, democracy and human rights

It is respectfully submitted that the positive obligation on Member to implement Community objectives also implies that Member States must remain loyal to the principles listed in Article 6 EU:

> "1. The Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms, and the rule of law, principles which are common to the Member States.
> 2. The Union shall respect fundamental rights, as guaranteed by the European Convention for the protection of Human rights and Fundamental Freedoms signed in Rome on 4 November 1950 and as they result from the constitutional traditions common to the Member States, as general principles of Community law"

The principle of Community loyalty expressed in Article 10 EC thus clearly obliges Member States to adhere to principles of democracy and human rights. This, of course, implies that a State aspiring to join the EU must be an actual democracy that respects human rights *before* it can join the EU.

If a Member State no longer wishes to comply with the fundamental requirements of Western Civilisation, that Member State can consequently not remain a Member State of the EU. In this context, the obligation to implement Community objectives in fact would appear to impose a duty on other Member States and on Community institutions to act jointly or severally against Member States that are in breach of fundamental principles common to the Member States. This has also been confirmed by recent developments concerning Austria in the EU, although the Austrian situation appears to constitute a political and diplomatic warning to forestall any factual breach of Article 6 EU.

[68] Temple Lang p 658

1.3 The negative obligation

The negative obligation in the second paragraph of Article 10 EC imposes an obligation on Member States to "abstain from any measures which could jeopardise" the attainment of the objectives of the Treaty. The scope and meaning of this obligation will be examined in the following chapter. The negative obligation in Article 10 EC has traditionally been described as consisting of three obligations[69]:

1. the obligation not to interfere with the operation of Community law (1.3.1);
2. the obligation not to interfere with the internal functioning of Community institutions (1.3.2); and
3. the obligation not to hinder the Community integration process (1.3.3):

1.3.1 The obligation not to interfere with the operation of Community law

This obligation obliges Member States not to maintain or adopt measures that conflict or interfere with the operation of Community law.[70] This was clearly the case in *Cullet*[71] where the ECJ stated that Member States are obliged not to detract from the "full and uniform application of Community law or from the effectiveness of its implementing measures".[72]

This obligation appears to imply that it is unlawful for a Member State to jeopardise the internal market by adopting measures in the field of non-harmonised direct taxation when such measures create obstacles to the internal market.[73] The impact of the principle of loyalty in matters of non-harmonised direct taxation will be discussed in depth in chapter 2.

1.3.2 The obligation not to interfere with the internal functioning of Community institutions[74]

In the words of Kapteyn and Verloren it is "a prerequisite for the proper functioning of the Community institutions" that Community institutions are protected from interference by Member States.[75] This offers an explanation as to why Community institutions are free to determine their own organisation. This also explains why Member States are obliged to respect payments to members of Community, as well as the special status given to Community officials.

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[69] Kapteyn/VerLoren p 155-158
[70] Ibid p 659
[71] Case 231/83 *Cullet v Centre Leclerc Toulouse* [1985] ECR 305
[72] Ibid para. 18
[73] also see Bergström p 46
[74] Kapteyn/VerLoren p 156-157
[75] Ibid p 156

Another interesting aspect of the obligation not to interfere with the functioning of Community institutions is the duty imposed on Member States not to enter into international agreements with third party states, if this threatens to make negotiations in the Council more difficult.[76] Pressuring a Community institution by means of back alley diplomacy is thus not permitted by the Treaty.

1.3.3 The obligation not to hinder the Community integration process[77]

A Member State is obliged not to act while Community measures are being prepared. This is clearly the case when a proposal is discussed in the Council of Ministers in the context of implementing a common policy. The ECJ has also made it quite clear that Member States must refrain from adopting any measures that might compromise the result of a directive between the adoption of the directive and its entry into force.

1.4 The principle of mutual co-operation[78]

Another important principle deduced from Article 10 EC by the ECJ is the principle of mutual co-operation. In order to identify this principle it is, Kapteyn and Verloren, opine that it is necessary to view Article 10 EC as an expression of a more general duty inherent in the EC Treaty.[79] This, of course, is due to the fact that Article 10 EC addresses itself to Member States and not to Community institutions. Any mutuality thus has to be found outside the wording of the article. It is convenient to illustrate the principle of mutual co-operation as consisting of three obligations:

1. The obligation of genuine co-operation between national authorities and Community institutions (1.4.1);
2. The obligation of mutual assistance among Member States (1.4.2); and
3. The obligation of sincere co-operation imposed on Community institutions (1.4.3):

1.4.1 The obligation of genuine co-operation between national authorities and Community institutions

This obligation might arise when a national authority is in doubt concerning the implementation of a Community act. It might also arise when a Member State is about to adopt a national measure that might affect a Community field or infringe on Community law.[80] In both these cases, the principle of

[76] Temple Lang p 663
[77] Kapteyn/VerLoren p 157-158
[78] Ibid p 159-162
[79] Ibid p 159
[80] Temple Lang p 672

mutual co-operation imposes a duty of genuine co-operation on both Community institutions and national authorities alike. Article 10 EC in other words obliges national authorities *and* Community institutions to avoid conflicts and to resolve differences in good faith. This obligation appears to be an excellent way of preventing problems before a Member State has actually adopted a measure.

1.4.2 The obligation of mutual administrative assistance among Member States

The principle of mutual co-operation in Article 10 EC also imposes an obligation on Member States to co-operate with other Member States in order to achieve the objectives of the EC Treaty. This obligation of mutual administrative assistance, is particularly important in matters concerning the free movement of goods. This was evident in *Biologische Producten*[81], where the ECJ held that Member States, in general, are obliged to respect the testing facilities of other Member States.[82] The obligation of mutual assistance, however, is also important in other areas of Community law. In *Mattecucci*[83] the ECJ thus applied the obligation of mutual assistance to the field of free movement of workers and in *Athanasopoulos*[84] the obligation was applied to social security payments to migrant workers.

1.4.3 The obligation of sincere co-operation imposed on Community institutions[85]

In *Zwartveld*[86] the ECJ extended the principle of loyalty in Article 10 EC to also impose an obligation on Community institutions. The case concerned a Dutch court investigating an alleged infringement of Community law. The national court requested that the ECJ order the Commission to disclose evidence that the Commission previously had refused to disclose. The ECJ met the Dutch Courts request by extending both the principle of loyalty and its own jurisdiction.[87] The Court emphasised its duty according to Article 220 EC to uphold the rule of law in the interpretation and application of the EC Treaty. Based on Articles 10 and 220 EC, the ECJ thus defined an

[81] Case 272-80 *Frans-Nedelandse Maatchappij voor Biologische Producten* [1981] ECR 3277
[82] In *Biologische Producten* the ECJ accepted that an importing state could test a product already tested in another Member State if the importing state could prove that the exporting state's test was inadequate or defective in some way. This essentially means that a product carrying a certificate of adequate testing in one Member State is guaranteed free movement in the Community (Weatherill/Beaumont p 543)
[83] Case 235/87 *Mattecucci v Communauté française of Belgium et al.* [1988] ECR 5589
[84] Case C-251/89 *Athanasopoulos et al. v Bundsanstalt für Arbeit* [1991] ECR I-2797
[85] Weatherill/Beaumont 390-391
[86] Case C-2/88 *Imm Zwartveld* [1990] ECR I-3365
[87] Prior to *Zwartveld* the ECJ was not considered to have inherent jurisdiction to order Community institutions in this way (Weatherill/Beaumont 390-391)

obligation on Community institutions to assist national courts in investigations of infringements of Community law.[88]

Another duty derived from the obligation of sincere co-operation is the duty of Community institutions to supply the police with any information necessary to investigate a Community official suspected of a crime. Nevertheless, this duty does not entitle the institution to supply any information on the service of the institution as such.[89]

1.5 Jurisdictional rule or conflict principle?

Article 10 EC is undoubtedly caught in the middle of the controversial issue of *Kompetenze-Kompetenze*. In other words, the question of who actually holds the power to allocate power between Member States and the Community?[90] This question, unanswered by the EC Treaty, will be addressed in chapter 1.5.1. Another controversial and unanswered question is the actual borderline between the powers of the Community and the Member States. This question will be addressed in chapter 1.5.2. Naturally, Article 10 EC of course has great impact on both these core EU issues.

1.5.1 The allocation of Community and Member state powers

While the ECJ naturally considers itself as the arbiter in questions of jurisdiction and conflict arising from the EC Treaty, the highest national courts of the Member States seem to consider these matters from a somewhat different angle.[91] Recent European constitutional case law shows that the highest national courts in the Member States instead regard the constitutions of the individual Member States as the legal basis for all collaboration in the EU.[92] This is hardly surprising as the highest national courts of the Member States frequently are employed to safeguard the constitutions of their Member States. Any movement from the highest national courts in the Member States, however, is of great importance to the future of the Community. This was evident in two recent judgements from the Danish Supreme Court and the German Federal Constitutional Court where the two courts emphasised that German and Danish courts would not apply Community acts if these clearly exceeded the jurisdiction of the Community.[93] If we are to take the fundamental ideas and objectives of the

[88] A Community institution, however, can refuse to assist a national court if it can submit imperative reasons for its refusal. An example of an imperative reason is harm to the independent functioning of the institution. (Weatherill/Beaumont 390-391)
[89] Kapteyn/VerLoren p 161
[90] Craig/de Burca p 264
[91] Ibid
[92] Kirchhof, Paul; The Balance of Powers Between National and European Institutions, European Law Journal, Vol. 5, No. 3, September 1999 p 241
[93] *Carlsen and Others v Rasmussen*, 6 April 1998, *Brunner v European Union Treaty* [1994] (Weatherill/Beaumont p 197)

EC Treaty seriously, however, we must interpret this to mean that although the final power of interpretation and application of Community law remains with the ECJ, it is the constitutional courts of the Member States that protect the Member State constitutions.[94]

Article 10 EC, thus appears to mean that Member States remain obliged to repeal or amend any national provisions that impede the full effect of Community law, even in cases when Community law is considered unconstitutional within a Member State. What the Danish and German courts have developed seems more properly a principle of checks and balances in the Community, rather than a principle of jurisdiction.[95] If, for example, the ECJ finds that it has previously undiscovered inherent jurisdiction in a particular field, as it did in *Zwartveld*[96], Member States must accept the Court's decision as obligatory Community law. If a national court subsequently rejects the decision of the ECJ on the grounds that it is unconstitutional in that Member State, Article 10 EC will simply oblige that Member State to change its Constitution. This will trigger a political reaction in the Member State(s). As the Member States are in fact the masters of the Treaty, a discontent Member State faced with such a problem can chose to work towards changing the EU and/or the EC Treaty or to ultimately leave the EU. In the opinion of the author, however, this would be somewhat disloyal to the ideals of peace, prosperity and co-operation in Europe, and perhaps, even the world.

1.5.2 The borderline between Community and Member state powers[97]

John Temple Lang has submitted that case law from the ECJ suggests that Article 10 EC constitutes a jurisdictional rule in an area where:

(1) power has been transferred from the Member States to the Community; or
(2) a Community act can be interpreted as exhaustive or comprehensive.

If neither of these conditions has been satisfied Article 10 EC will instead constitute a rule of conflict.

If Temple Lang's conditions (1) or (2) have been satisfied this will consequently imply that a Member State no longer has any power to legislate concerning a specific subject. Any measures taken by a Member State would always interfere with the operation of Community law. If neither (1) nor (2) have been satisfied, a Member State will retain the power to legislate concerning a specific subject matter, provided of course that its

[94] On the division of power between the ECJ and the highest national Courts see Kirchhof p 233
[95] See Kirchhof p 241 for a similar opinion
[96] cited above, notes 86 and 87
[97] Temple Lang p 675-677

legislation does not conflict or interfere with the operation of Community law. An example of the latter submitted by Temple Lang is the Court's statement in *ERTA*[98], a case concerning external relations:

[Note ToA renumbering: Article 5 is now Article 10 EC]

> "Under Article 5, the Member States are required on one hand to take all appropriate measures to ensure fulfilment of the obligation arising out of the Treaty or resulting from action taken by the institutions and, on the other hand, to abstain from any measure which might jeopardise the attainment of the objectives of the Treaty.
>
> If these two provisions are read in conjunction, it follows that to the extent to which Community rules are promulgated for the attainment of the objectives of the Treaty, the Member State cannot, outside the framework of the Community institutions, assume obligations which might affect those rules or alter their scope."[99]

John Temple Lang's approach has considerable merit as it defines a simple and logical way of resolving any doubts on the meaning of Article 10 EC. The approach of John Temple Lang constitutes a prerequisite to the discussion in chapter 2 on the impact of Article 10 EC in matters of non-harmonised direct taxation.

[98] Case 22/70 *Commission v Council (ERTA)* [1971] ECR 263
[99] Ibid para. 21 and 22

2 EU Law and non-harmonised direct taxation

2.1 Non-harmonised direct taxation and the EC Treaty

According to Article 95 (2) EC fiscal provisions are excluded from the qualified majority voting procedure prescribed in Article 95 EC. Matters of non-harmonised direct taxation are thus subject to the principle of subsidiarity in Article 5 EC and the unanimous voting procedures of Article 94 EC. [100] Thus, Member States are free to veto any proposal to harmonise non-harmonised direct taxation within the Community. It is thus not surprising that, since 1958, Article 94 EC has led to only two directives in the field of direct taxation: the parent subsidiary directive[101] and the merger directive"[102] .[103]

Non-harmonised direct taxation undisputedly falls outside the Community's power to harmonise. As mentioned in section 1.3.1, however, this does not mean that non-harmonised direct taxation is altogether beyond the purview of the EC Treaty or the context of the internal market. This approach, consistent with the ideas of John Temple Lang (discussed in chapter 1.5.2), can also be traced in ECJ case law on national income taxation.[104] The sharpest definition of the ECJ's position in these matters is perhaps the Court's statement in *Schumacker*[105], which it has often reiterated[106]:

> "Although, as Community law stands at present, 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. [107]

[100] On the principle of subsidiarity see Weatherill/Beaumont p 27-29
[101] Dir. 90/435/EEC on the Common System of Taxation applicable in the Case of Parent Companies and subsidiaries of different Member States (O.J. 1990 L 225/6)
[102] Dir. 90/434/EEC on the common System of Taxation applicable to Mergers, Divisions, transfers of Assets and exchange of Shares concerning Companies of different Member States (O.J. 1990 L 225/1)
[103] Kapteyn/VerLoren p 614
[104] E.g. Case 270/83 *Commission of the European Communities v French Republic* [1986] ECR 273 para. 23 and 24; and Case C-246/89 *Commission of the European Communities v United Kingdom of Great Britain and Northern Ireland* [1991] ECR I-4585 para. 12.
[105] Case C-279/93 *Finanzamt Köln-Altstadt v Roland Schumacher* [1995] ECR I-225
[106] E.g Case C-80/94 *Wielockx v Inspecteur der Directe Belastigen* [1995] ECR I-2493 para. 16, Case 118/96 *Jessica Safir v Skattemyndigheten i Dalarnas län, formerly Skattemyndigheten i Kopparbergs län* [1998] ECR I-1897 para. 21,
[107] *Schumacher* para. 21

The Court clearly has drawn on the principle of loyalty in Article 10 EC, which implies that non-harmonised direct taxation falls within the scope of Community law. The ECJ has not hesitated to apply the fundamental prohibitions of discrimination and restriction even to this controversial field of Community law.[108]

While the prohibition of discrimination is based on the principle of equal treatment in Article 12 EC, the prohibition of restriction stems from the principle of loyalty in Article 10 EC. This chapter will focus on legislative provisions and case law regarding this issue in order to investigate the impact of the latter principle on matters of non-harmonised direct taxation. Nevertheless, it is useful to first examine the prohibition of discrimination in relation to non-harmonised direct taxation. This also reflects the way the Court applies these two prohibitions.

Although, the prohibition of discrimination in Community law is Treaty-based, while the prohibition of restriction has been developed in ECJ case law, both sets of rules consist of two layers of objective justification. The ECJ will always begin an investigation of alleged violations of Community law by applying the Treaty-based prohibition of discrimination.[109] If the Court is able to identify unjustified discrimination (the first layer of objective justification), it will continue to consider whether that particular discrimination can be justified by a Treaty-based exception (second layer of objective justification).[110] Only in cases where the Court is unable to identify discrimination, or where such a finding would be unreasonable, will the Court apply the ECJ developed prohibition of restriction.[111] In such cases, the Court will first attempt to identify a non-discriminatory restriction (first layer of objective justification). If the Court is successful in doing so, it will continue to consider whether that particular restriction can be justified by a Treaty-based *or* an ECJ-created exception. (second layer of objective justification).[112] This chapter will discuss the Court's dual analysis, the distinctions between its different stages, and the implications on non-harmonised direct taxation.

2.2 The prohibition of discrimination in matters of non-harmonised direct taxation

In order to combat unequal treatment on the grounds of nationality, the founders of the EC Treaty armed Article 12 of the EC Treaty with a general prohibition of discrimination. The general character of this Article, however, has led to its independent application solely in situations where no other

[108] *Schumacher* para 21
[109] Bergström p 48
[110] Ibid
[111] Farmer, Paul; EC law and national rules on direct taxation; a phoney war? EC Tax Review 1998/1 p 28-29. However, the Court has applied both sets of rules on more than one occasion. (ibid)
[112] see Bergström p 48

provisions of Community law can be applied.[113] Accordingly, Article 12 EC has not yet been applied in the field of non-harmonised direct taxation.[114] Instead the ECJ has focused on the more specific rules of Articles 39 (workers), 43 (establishment), 49 (services) and 56 (Capital) EC.[115]

2.2.1 The principle of equal treatment

According to the ECJ, all Community provisions concerning discrimination on the grounds of nationality, including Article 12 EC, originate from the principle of equality in Community law.[116] This fundamental principle requires Member States and Community institutions to treat similar cases similarly (and different cases differently) unless the opposite can be objectively justified.[117] The actual assessment of whether a particular differentiation is objectively justified constitutes the first layer of objective justification within the Court's discrimination-based analysis. (The first layer of objective justification must not be confused with the second layer of objective justification, where the Court considers whether *identified* discrimination can be objectively justified by an overriding public interest in Community law).

Nationality can never constitute an objective justification in the Court's first layer of objective justification.[118] A taxpayer's place of habitual residence (or registered office) may, in certain circumstances, however, constitute an objective justification. This is based on an assumption in international tax law that residents and non-residents, as a rule, are not in comparable situations.[119] In *Schumacker*, the ECJ abided by this principle when it found that residents and non-residents in *comparable* situations were to be treated similarly by Member States.[120] This interpretation is quite logical, as Member States would not be able to advance an objective ground if the situations of residents and non-residents are comparable.[121] This principle has subsequently been confirmed by the Court in *Asscher*[122] and in *Wielockx*[123].[124]

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[113] Kapteyn/VerLoren p 163
[114] Bergström p 47
[115] Ibid p 48
[116] Weatherill/Beaumont p 294
[117] Ibid
[118] Bergström p 47
[119] In most cases a major part of a resident's income is derived from his State of residence. It is therefore considered appropriate that this State also determine the taxpayer's overall tax liability. (In most cases, it is possible for the State of residence to take personal and family circumstances into consideration in a way another State cannot). A tax benefit granted a resident and refused a non-resident, thus, as a rule, is non-discriminatory. (*Schumacher* para 32-34).
[120] *Schumacher* para. 32, 34 and 37. *Schumacher* is further discussed in 2.3.2.
[121] According to the ECJ a non-resident and a resident will be in objectively comparable situations if the non-resident receives all, or almost all, of his income in his State of employment and none in his State of residence. Discrimination arises from the fact that the taxpayer's personal and family circumstances are not taken into account in either Member State. (*Schumacher* para. 36, 37 and 38)
[122] Case C-107/94 *Asscher v Staatssecretaris van Financiën* [1996] ECR I-3089, further discussed in 2.3.3.
[123] cited above, note 106, further discussed in 2.3.3.

2.2.2 Covert and indirect discrimination

Discriminatory treatment based directly on nationality is clearly incompatible with Community law.[125] To prevent Member States from adopting rules, which, while facially appearing unconnected with nationality, still blatantly favours the Member State's own nationals,[126] the ECJ has extended the prohibition of discrimination to also cover disguised (covert) discrimination.[127] Thus, Member States may not disguise discrimination behind objective criteria, such as engine power or vessel length, when such criteria, in fact, lead to the discrimination of foreign nationals.[128] The ECJ will simply see through a Member State's attempts to hide such breaches of Community law.[129]

Indirect discrimination can also be unlawful, particularly where ostensibly nationality-neutral rules tend to operate mainly to the detriment of nationals of other Member States.[130] However, these cases often concern trans-border workers, and merely constitute exceptions to the general rule of 2.2.1, that allows objectively justified differentiation between residents and non-residents, at least, in principle.[131] Thus, the prohibition of indirect discrimination is quite limited.

2.2.3 Reverse discrimination and disparities between the laws of different Member States

If a Member State treats its own nationals less favourably than it treats nationals of other Member States, such treatment may constitute reverse discrimination. However, this does not violate the prohibition of discrimination in Community law,[132] as this prohibition only applies to unequal treatment of another Member States nationals (or residents) by *one* Member State. A distortion resulting from differences in legislation between *two or more* Member States will consequently not infringe the prohibition of discrimination in Community law. This is quite logical, because, although differences between two legal systems will often cause divergent results, this

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[124] Bergström p 52
[125] Weatherill/Beaumont p 473
[126] E.g. the 1968 French attempt to establish rules on compulsory blanket size, which "happened to" coincide with the blanket size already used by French manufacturers, but not by foreign ones. (Quitzow, Carl Michael; Fria varurörelser i den Europeiska Gemenskapen, Fritze, Stockholm, 1995, p 146)
[127] Kapteyn/VerLoren p 168
[128] Ibid
[129] Ibid
[130] Craig/de Burca p 367
[131] Bergström p 53
[132] Kapteyn/VerLoren p 170

does not constitute discrimination.[133] Thus, resulting distortions detrimental to the functioning of the single market must be combated with other rules than those prohibiting discrimination.

2.3 The prohibition of restriction in matters of non-harmonised direct taxation

The prohibition of restriction is a fundamental Community principle implying that even a non-discriminatory national measure which restricts freedom of movement or investment may be countered by Community law, unless it can be justified by a Treaty-based overriding public interest *or* a mandatory requirement, developed by the ECJ, in its second layer of objective justification.[134]

The prohibition of restriction has not yet been *explicitly* applied in the field of direct taxation.[135] However, in the words of Professor Sture Bergström, it is probable that in the future, "income tax rules that jeopardise the functioning of the internal market without discriminating against the tax-payer on grounds of nationality, will be declared void by the ECJ, at least to a greater extent than they are today"[136] Case-law from the ECJ suggests that Professor Bergström is correct in his predictions. The relevant case law and the applicable rules will be examined and discussed in the following chapters (2.3.1-2.3.5).

2.3.1 The prohibition of restriction and the free movement of goods

The provisions in the EC Treaty concerning the free movement of goods have essentially been designed to establish a customs union in the EU. This entails, *inter alia*, a prohibition against customs duties on imports and exports between Member States, and the adoption of a common customs tariff in relation to other nations.[137] Naturally, the free movement of goods is interwoven with other Community freedoms in the creation of the single market.[138] The Court's case law on the free movement of goods, however, has always been a primary factor in achieving European economic integration. Thus, it is appropriate to begin a discussion on the prohibition of

[133] Kapteyn/VerLoren p 170. Domestic and foreign subjects are subject to the same distortions without any distinction being made between them.
[134] Farmer p 13 note 13.
[135] Bergström p 13
[136] Ibid
[137] Article 23 EC
[138] Craig/de Burca p 551

restriction in Community law with a succinct presentation of the prohibition of restriction in relation to the free movement of goods.[139]

2.3.1.1 Quantitative restrictions on imports

Article 28 EC, the main Treaty provision concerning quantitative restrictions on imports in the Community, provides:

> "Quantitative restrictions on imports and all measures having equivalent effect shall be prohibited between Member States."[140]

The first part of Article 28 EC has never caused the European legal profession any severe headaches. It has always been assumed that quantitative restrictions (or quotas) on imports are unlawful.[141] The second part of Article 28 EC, which extends the ban on restriction to measures having "equivalent effect," (MEQRs), however, has been the focus of a voluminous body of case law and academic thought. This stems from the classic ECJ *Dassonville*[142] judgement, which developed a definition of MEQRs that completely altered the scope of Article 28 EC:

> "All trading rules enacted by Member States which are capable of hindering, directly or indirectly, actually or potentially, intra-Community trade are to be considered as measures having an effect equivalent to quantitative restrictions."[143]

The scope of the Court's definition is indeed breathtaking. According to the Dassonville formula, *any* rule affecting commercial freedom may actually constitute a MEQR.[144] As the Dassonville formula concentrates on the *effect* of a national rule and not its *legal form*, the crucial element in proving the existence of a MEQR is not whether the measure is discriminatory, *per se*, but rather whether the national measure has had a restrictive *effect*.[145] The Dassonville formula constitutes a brilliant example of an ECJ-developed prohibition of restriction in Community law.

2.3.1.2 Quantitative restrictions on exports[146]

The Court's sweeping definition of MEQRs in Dassonville has not been correspondingly applied to the concept of exports in Article 29 EC. In

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[139] Please note that taxation in relation to the free movement of goods concerns indirect (and not direct) taxation. The provisions on taxation and the free movement of goods will thus not be further discussed in this thesis.
[140] Article 28 EC
[141] Weatherill/Beaumont p 517
[142] Case 8/74 *Procureur du Roi v Dassonville et al.*[1974] ECR 837
[143] Ibid para. 5
[144] Weatherill/Beaumont p 505
[145] Craig/de Burca p 585
[146] Oliver, P; Some further reflections on the scope of Articles 28-30 (ex 30-36) EC, CMLR, Vol. 36, No. 4, August 1999 p 799-803

Groenveld[147], the leading case on exports, the ECJ stated that Article 29 EC in fact:

> ”concerns national measures which have as their specific object or effect the restriction of patterns of exports and thereby the establishment of a difference between the domestic trade of a Member State and its export trade in such a way as to provide a particular advantage for national production or for the domestic market of the State in question at the expense of the production or of the trade of other Member States.”[148]

According to this 1979 formula, production and marketing can be held to fall outside the purview of Article 29 EC. In recent years, several Advocates General, however, have called for a reappraisal of the Court's restrictive approach to Article 29 EC. The Court, itself, has indicated, albeit only in cases concerning other fields of Community law, that great changes may be on their way.[149]

One of the great weaknesses of the *Groenveld* test is that it focuses solely on the relationship between a (potential) exporter and his State of domicile. This clearly does not accord with recent case law on the right of recipients to import goods and receive services without hindrances. In view of the close relationship between goods and services in Community law, the discrepancy between the *Groenveld* test and recent case law becomes even more apparent in *Alpine Investements*[150], where the ECJ stated that:

[Note ToA renumbering: Article 59 is now Article 49 EC]

> “Article 59 prohibits not only restrictions laid down by the state of destination but also those of the state of origin”[151]

Peter Oliver has therefore suggested that the ECJ reword the *Groenveld* test to cover *all* measures whose object or effect is to treat exports less favourably than goods destined for the domestic market. The crucial element in such a case would be whether intra-Community trade is *restricted*. It would thus not be necessary to show that “particular advantages” to one State at the expense of another have resulted in a given situation. According to Oliver, ECJ case law implicitly suggests that this shift has already taken place. If Oliver is correct in his assessment, all national requirements on exports will fall under Article 29 EC, subject to the second layer of objective justifications.

However, to avoid making Article 29 EC as extensive as Article 28 EC, Oliver has mentioned a dual approach advocated by Roth. According to

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[147] Case 15/79 *Groenveld v produktshap voor Vlee en Vlees* [1979] ECR 3409
[148] Ibid
[149] E.g. Case C-415/93 *Union Royale Belge des Sociétés de Football Association ASBL et al. v Bosman* [1995] ECR I-4921 where the ECJ held that Belgian rules preventing football players from signing contracts with foreign clubs constituted a restriction in violation of Article 39 EC, despite the fact that transfers between Belgium clubs were subject to the exact same rule. (Bergström p 54)
[150] Case C-384/93 *Alpine Investments BV v Minister van Financiën* [1995] ECR I-1141
[151] Ibid para. 30

Roth, all measures relating to the environment in which goods are produced (e.g. labour and environmental law) should continue to be governed only by the discrimination rules, while measures relating to marketing and product-bound measures (composition and presentation) should be governed by the restriction rules. However, there is ample reason to question the increasingly popular use of dual approaches in Community law. (Cf. 2.3.1.4 where cited criticism is discussed).

2.3.1.3 Exceptions to the principle of free movement of goods

The ECJ acknowledges the need, in Community law, to limit the free movement of goods in certain situations, when it applies a second layer of objective justification when investigating alleged breaches of Community law. The main Treaty-based exceptions to the free movement of goods can be found in Article 30 EC, which states:

> "The provisions of Articles 28 and 29 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States."

The first sentence of Article 30 EC thus lists the major categories of justifications of national limitations of the free movement of goods. The second sentence of Article 30 EC emphasises that any such limitations also will be thoroughly scrutinised to ascertain whether they are necessary, legitimate and proportionate for the achievement of their aims. The idea behind Article 30 EC is consequently not (and has never been) to protect Member States against the full impact of the single market.[152] Article 30 EC merely implies that certain limitations of trade may be justified when they are genuinely required to protect the categories of justifications listed in Article 30 EC.

As Article 30 EC, by its nature militates against what is essentially the core of the single market – free trade – that Article must be interpreted strictly.[153] As explained below, justifications that are not explicitly listed in Article 30 EC are consequently not allowed as justifications for the fundamental and Treaty-based, prohibition of discrimination in Article 28 EC.[154]

[152] Kapteyn/VerLoren p 652-656
[153] Weatherill/Beaumont p 525
[154] Kapteyn/VerLoren p 657

Cassis de Dijon[155] and the rule of reason

The meaning of the Court's classic judgement in *Cassis de Dijon* is twofold. First, the Court affirmed the *Dassonville* formula by extending the scope of MEQRs to also cover non-discriminatory restrictions that result from disparities between the laws of different Member States. To combat such disparities, the Court developed the principle of mutual recognition, which implies that a product, lawfully produced and marketed in one Member State, should be entitled to free circulation within the whole Community. As Weatherill and Beaumont have observed, the ECJ in *Cassis de Dijon* thus came very "close to establishing a presumption in favour of free trade throughout the Community."[156]

Secondly, the ECJ in *Cassis de Dijon* developed the rule of reason. This rule essentially means that a (non-discriminatory) restrictive measure, resulting from disparities between the laws of different Member States, may be justified by certain "mandatory requirements" [157]:

> "Obstacles to movement within the Community resulting from disparities between the national laws relating to the marketing of the products in question must be accepted in so far that those provisions may be recognised as being necessary in order to satisfy mandatory requirements relating in particular to the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defence of the consumer."[158]

Unlike Article 30 EC, the justifications developed by the ECJ under the rule of reason do not constitute a closed group. The needs and changing conditions of society may create additional justifications in time.[159] Justifications under the rule of reason, of course, must always be necessary, legitimate and proportionate.[160]

The rule of reason is clearly not an extension of the Treaty-based-exception of Article 30 EC. Instead, the rule of reason is said to be based on Article 28 EC itself.[161] While the justification categories of Article 30 EC are Treaty-based exceptions to a Treaty-based rule (i.e. Article 28 EC), the rule of reason constitutes an ECJ developed exception to a rule developed by the ECJ, i.e. the Dassonville formula.[162] The main differences between the application of Article 30 EC and that of the rule of reason are displayed in Table I.

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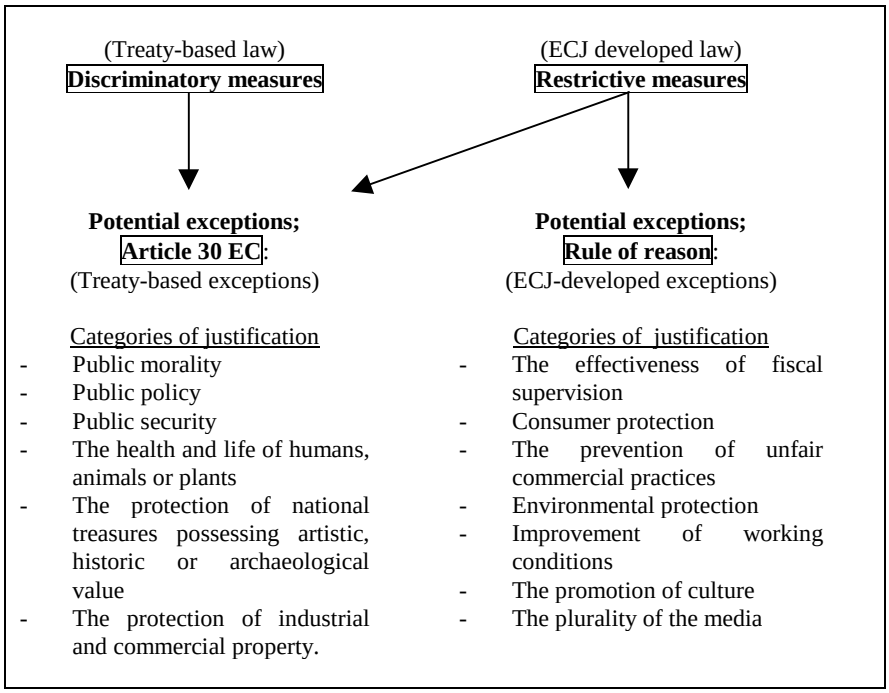
[155] Case 120/78 *Rewe-Zentrale v Bundesmonopolverwaltung für Branntwein* [1979] ECR 649
[156] Weatherill/Beaumont p 569
[157] Oliver note 87
[158] *Cassis de Dijon* para. 8
[159] Kapteyn/VerLoren p 678-679
[160] Ibid
[161] Oliver p 804
[162] Kapteyn/VerLoren p 652

Table I. The differences of application between Article 30 EC and the rule of reason[163]



2.3.1.4 Limitations of the principle of free movement of goods

The joined cases of *Keck and Mithouard*[164] (*Keck*) clearly represent an attempt by the ECJ to limit the scope of Article 28 EC.[165] It has been suggested that the *Dassonville* formula "left the ECJ riding a tiger".[166] Traders were increasingly asking the ECJ to apply Article 28 EC to all measures that in any way limited their commercial freedom. To tame the beast, as Weatherill and Beaumont so eloquently put it, the ECJ proposed a two-step test for the application of Article 28 EC:[167]

1. Product requirements, i.e. "requirements as to designation, form, size, weight, composition, presentation, labelling, packaging"[168] remain subject to Article 28 EC in the same way as before. (The *Dassonville* formula and the principle of mutual recognition were consequently not overruled or altered by the ECJ.)
2. Certain selling arrangements, i.e. "requirements on when, where, and by whom, goods may be sold, advertising restrictions and price controls" remain subject to Article 28 EC only if they are discriminatory in fact or in law. (Non-discriminatory restrictions fall outside the scope of Article 28 EC altogether).

[163] As indicated by the arrows in Table I the categories of justification under Article 30 EC can justify both discriminatory and restrictive measures. The categories of justification under the rule of reason, however, may only justify restrictive measures.
[164] Joined Cases C-267 and C-268/91 *Keck and Miithouard* [1993] ECR I-6097
[165] Oliver p 793
[166] Weatherill/Beaumont p 608
[167] Oliver p 793-794
[168] *Keck* para 15

Although *Keck* solved many of the Court's pre-*Keck* problems the Court's dual approach has been criticised for creating new ones. One of the most authoritative criticisms has come from Advocate General Jacobs in *Leclerc-Siplec,*[169] where he opines that:

> "[i]t is inappropriate to make rigid distinctions between different categories of rules, and to apply different tests depending on the category to which particular rules belong. The severity of the restriction imposed by different rules is merely one of degree."[170]

Jacobs thus emphasises that a severe restriction on selling arrangements could prove as fatal to a product as any outright ban.[171] The Court's formalistic distinction in *Keck* may mean that a marketing campaign displayed on a product clearly falls under Article 28 EC, while a marketing campaign removed physically from the same product does not.[172] Jacobs comments on the inconsistency between the Court's *application* of Article 28 EC and the fundamental aims of the EC Treaty, namely the establishment of the single market:

> "If an obstacle to inter-State trade exists, it cannot cease to exist simply because an identical obstacle affects domestic trade." [173]

These problems have prompted many legal academics to advocate that the Court place greater emphasis on market access as an independent criterion in determining whether or not Article 28 EC is applicable.[174] If this is correct (as the author believes it to be), *Keck* essentially means that once a product has gained *unhindered access* to a domestic market it will become subject to the same national selling arrangements as domestic products.[175] A non-discriminatory selling arrangement constituting an absolute ban on trade will thus *per se* fall under Article 28 EC, subject, of course, to justification.[176] This, however, remains to be confirmed by the ECJ.

2.3.2 The prohibition of restriction and the free movement of workers

The free movement of workers is as fundamental to the single market as the free movement of goods. Consequently Article 39 EC must be interpreted extensively, while any exceptions to it must be given a narrow

[169] Case C-412/93 *Société d'Importation Édouard Leclerc-Siplec v TF1 Publicité SA and M6 Publicité SA* ECR [1995] ECR I-179
[170] Mr Jacobs opinion at 194 para. 38
[171] Oliver p 795
[172] Weatherill/Beaumont p 616
[173] Ibid para 39
[174] Craig/de Burca p 627, See also Weatherill/Beaumont p 618
[175] Kapteyn/VerLoren p 636-637
[176] Oliver p 795

interpretation.[177] There is a need for a distinction in relation to workers, similar to that which exists between Article 30 EC and the rule of reason, in relation to goods.

The main Treaty-based exceptions in relation to the free movement of workers have been expressed in Article 39 (3) EC. According to that provision the only justified limitations to the free movement of workers are the need to protect public policy, public security and public health. (These Treaty-based grounds have been co-ordinated in Directive 64/221[178] and are equally applicable to the right of establishment and the free movement of services.[179]).

Logically, the Court's well known judgement in *Bosman*[180], read in conjunction with other case law on the free movement of workers[181], could serve as an example of the general distinction between Treaty-based exceptions and the rule of reason in Community law. In *Bosman*, the ECJ stated that although the relevant national rules did not discriminate, they nevertheless:

> "directly affect players' access to the employment market in [another] Member State and are thus capable of impeding freedom of movement for workers."[182]

In its judgement, the Court thus stressed that Article 39 EC constitutes a prohibition of restriction, and not just discrimination. The Court also emphasised that the dual approach it employed in *Keck and Mithouard* could not be applied in relation to workers.[183] A non-discriminatory restrictive measure affecting a worker's *access* to employment in another Member State, thus constitutes an unequivocal breach of the free movement of workers within the meaning of Article 39 EC.[184] After having extended the scope of Article 39 EC, the Court discussed possible justifications of the restriction in *Bosman*. When reflecting on these matters the Court explicitly referred to *Gebhard*[185] and *Kraus*[186]. These two cases concerning the right to establishment are an expression of well settled case law in these matters. The Court's adoption, in *Gebhard*, of a four-stage test to determine whether a *restrictive* measure is justified, in conjunction with other case law (e.g. *Schumacher, infra*), therefor appears to confirm the existence of a distinction between Treaty-based and ECJ-developed exceptions, in relation

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[177] See Kapteyn/VerLoren p 723
[178] Dir. 64/221/EEC on free movement of workers (1963-4 O.J. Spec. Ed. 117)
[179] Craig/de Burca p 786 They also constitute Community definitions and must not be confused with identical terms used in the different Member States (Kapteyn/VerLoren p 711).
[180] *Bosman* concerned transfer fees (and quotas on match participation) on a professional football player employed in Belgium and seeking employment in France. Cited above, note 149.
[181] E.g. *Schumacher*, infra
[182] *Bosman* para. 103
[183] Ibid
[184] Craig/de Burca p 672
[185] Case C-55/94 *Reinhard Gebhard v Consiglio dell`Ordine degli Avvoccati e Procuratori di Milano*[1995] ECR I-4165
[186] Case C-19/92 *Kraus v Land Baden-Würtemberg* [1993] ECR I-1663

to the free movement of workers. Following the *Gebhard* test, all justified restrictive measures must:

> "be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it" [187]

In *Schumacher*, a case concerning non-harmonised direct taxation and the free movement of workers, a Belgian national, Mr Schumacher, resided in Belgium while receiving his income from Germany. According to German law, Mr Schumacher was only partially liable for German taxes, as he was not a German resident. As his personal situation was not considered in matters of German income taxation Mr Schumacher was therefore unable to receive tax allowances granted to similarly situated German residents. Following a DTC between Belgium and Germany, Mr Schumacher was exempt from income tax in Belgium. He was consequently also unable to receive personal allowances in Belgium. Mr Schumacher was thus caught in a rather disadvantageous situation. Both Member States refused to take his personal situation into consideration! After having considered the first layer of objective justification the Court found that there was no objective difference between the situation of Mr Schumacher and that of a German resident. As the national measure in question also was found to operate mainly to the detriment of foreigners, it was held to constitute indirect discrimination. The German government's attempt to justify its national tax measure by the need to preserve the coherence of the German tax system, however, was completely rejected by the ECJ, without further comment.[188] (It is interesting to note that the Court clearly chose *not* to follow the lead taken by Advocate General Léger, who had fervently supported the idea that a discriminatory tax measure could be justified by the rule of reason.[189]).

Thus, the Court's judgement in *Bosman*, read in conjunction with the Court's judgement in *Schumacher*, suggests that wherever the Court has justified a national measure regarding the free movement of workers, using the ECJ-developed rule of reason, the Court has characterised the measure as a non-discriminatory restriction.[190]

In view of the foregoing, the traditional interpretation of the Court's case law on non-harmonised direct taxation becomes somewhat confusing. The conventional interpretation of the Court's judgement in *Bachmann*[191] (see *infra*), has been that a *discriminatory* national tax measure may be justified by the ECJ-developed need to protect the coherence of the tax system of a Member State (i.e. a rule of reason exception).[192]

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[187] *Gebhard* para. 37
[188] *Schumacher* para 40, 41 and 42
[189] Opinion of Mr Léger para 45, 47-49 at I-236
[190] For a similar point of view see Opinion of Mr Tesauro in *Safir*, para 33 at I-1915. The *Safir* judgement is further discussed in 2.3.4.
[191] Case 204/90 *Bachmann v Belgium* [1992] ECR I-249
[192] E.g. Williams; EC Tax Law, p 107

Bachmann concerned a German national employed in Belgium. One year before moving to Belgium, Mr Bachmann had joined a pension scheme in Germany. When filing his tax return in Belgium Mr Bachmann claimed a deduction on his Belgian income for premiums he had paid to German insurance companies while he resided in Belgium. The Belgian authorities denied the deduction, asserting that Belgian law allows deductions only for premiums paid to insurance companies established in Belgium. The Brussels Cour d'Appel asked the ECJ whether the Belgian rules were unlawful under, *inter alia*, Articles 39 and 49 EC. After a rather haphazard opinion of the Advocate General and an unstructured judgement of the Court, the Belgian rules were held contrary to Community law. Without explicitly referring to discrimination or restriction, the Court, however, found that the national restriction could be justified by the "need to preserve the cohesion of the tax system." [193] As the Belgian rules where considered both proportionate and necessary, they were upheld by the Court.

The conventional interpretation of the Court's judgement in *Bachmann*, as allowing the justification of a *discriminatory* national tax measure by means of the ECJ-developed "need to preserve the cohesion of the tax system" appears to be logically flawed. The Court's judgement in *Bachmann* should instead be viewed as an important and logical part of the Court's general case law on the four freedoms and the right to establishment. Under such an interpretation, *Bachmann* would instead mean that while a non-discriminatory *restrictive* tax measure may be justified by the need to preserve fiscal coherence, a *discriminatory* tax measure may not. Several matters can be submitted in support of this view. First, if one applies the Court's traditional modus operandi[194] to the *Bachmann* judgement itself, the Court's own words tend to corroborate the latter interpretation of *Bachmann.* Thus, the Court's judgement in *Bachmann* should be interpreted in the following way:

In *Bachmann*, the Court, following its traditional method of reasoning, first considered whether discrimination had actually taken place, and found that:

> "there is a risk that the provisions in question may operate to the particular detriment of those workers who are, as a general rule, nationals of other Member States [195]

The Court then considered whether such a case of indirect discrimination could be objectively justified by an explicit Treaty-based exception in the second layer of justification. The Court appears to have found that "the effectiveness of fiscal controls" constituted a justification, since, as the Court has stated in *Bouchereau*, it served to protect society against a "genuine and sufficiently serious threat to the requirements of public

[193] *Bachmann* para. 28
[194] i.e. a dual analysis consisting of each of the two layers of objective justification. (Cf. 2.1.)
[195] *Bachman* para. 9

policy"[196]. The Court, when concluding its discrimination-based analysis, however, found that the relevant national tax measure was disproportionate and unnecessary.[197]

After having successfully applied the prohibition of discrimination, the ECJ surprisingly moved on to apply the prohibition of restriction in Community law. The Court began its restriction-based analysis by considering whether a restriction had actually taken place in *Bachmann*. It found that the *effect* of the national tax measure constituted an unlawful restriction.

> "To be obliged to terminate a contract concluded with an insurer based in one Member State, in order to be eligible for a tax deduction provided for in another Member State, in circumstances where the person concerned considers the continuation of such a contract to be in his interests, constitutes, by reason of the arrangements and the expense involved, a restriction on his freedom of movement."[198]

The Court then proceeded to consider whether a Treaty-based exception *or* the rule of reason could justify such an identified restriction. While the Court did not change its apparent view on the former of the two exceptions (fiscal controls), it did recognise the need to preserve fiscal coherence of the Member States tax system, i.e. the linkage between the previous tax deduction and subsequent tax revenue. The Court concluded its restriction-based analysis by finding the relevant tax measure proportionate and necessary:

> "It follows that, as Community law stands at present, it is not possible to ensure the cohesion of such a tax system by means of measures which are less restrictive than those at issue".[199]

Having submitted this new interpretation, it appears as if the Court, interestingly, actually applied a restriction-based analysis *after* it had already found a discriminatory tax measure unjustified. From a Community point of view, such an action would be both unnecessary and unorthodox. The national measure, after all, had already been considered unlawful by the Court. The reason for the Court's action (or lack thereof) with respect to indirect discrimination in *Bachmann* is not entirely easy to determine. One possible explanation is that even the ECJ, from time to time, realises the existence of a political speed limit for Community integration. After all, Rome was not built in one day. Thus, the Court might simply have ignored the existence of indirect discrimination in *Bachmann* and carried on with its restriction-based analysis in order to protect the Member States from the full impact of the EC Treaty. This, however, does not seem very likely, as the ECJ has consistently been loyal to the aims of the EC Treaty.

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[196] Case 30/77 *R v Bouchereau* [1977] ECR 1999 at 2014
[197] *Bachmann* para. 20
[198] Ibid para 13
[199] Ibid para 27

A different, and more likely, explanation is that the ECJ simply did not find the Belgian rule in *Bachmann* discriminatory at all. This would indeed shed some light on the confusing sections of *Bachmann*. The Court would consequently have ignored its discrimination-based analysis and immediately applied a restriction-based analysis in line with its traditional methods of application. After having identified a restriction in its first layer of objective justification, it would have analysed whether such a restriction could be justified by a Treaty-based exception (fiscal control) *or* by the rule of reason (fiscal coherence). The Court would have rejected the former exception while accepting the latter on the same grounds as cited above. As intriguing as the outcome of this question is, it would in no way alter the Court's distinction between Treaty-based restrictions and the rule of reason. in relation to direct taxation and the free movement of workers. It would merely have served to add some logic to the Court's judgement.

Thus, the ECJ in *Bachmann* may (or may not) have found indirect discrimination. If it did find discrimination, the Court surprisingly applied its restriction-based analysis *after* it had found a discriminatory national tax measure unjustified. However, the Court also identified an unlawful restriction in *Bachmann*. According to the ECJ, such a restriction could be justified by a Treaty-based exception *or* by the ECJ-developed rule of reason. Although the Court in *Bachmann* could justify the restrictive measure by the Treaty-based need to protect public policy, it did not consider the measure proportionate or necessary. The national need to preserve fiscal coherence, however, was so deemed. In the absence of harmonisation, the ECJ upheld the restrictive national tax measure.

Although the facts cited above are highly significant, the author’s interpretation of *Bachmann* is also supported by previous and subsequent ECJ case law. Thus, as will be developed below, the Court's rigid distinction between Treaty-based exceptions and the rule of reason has consistently been applied in matters of non-harmonised direct taxation, with respect to Community law. This distinction appears to be so fundamental that it can be used to ascertain whether the ECJ has spoken of discrimination and/or restriction in its judgements regarding non-harmonised direct taxation.

2.3.3 The prohibition of restriction and the right to establishment

Article 43 EC prohibits all restrictions on the establishment of agencies, branches and subsidiaries by nationals or companies of one Member State in the territory of another Member State. The right to establishment includes the freedom to set up enterprises of all kinds within the meaning of Article 48 EC, under the same conditions applied by Member States to their own nationals. Article 43 EC thus constitutes a Treaty-based prohibition of

discrimination. In *Daily Mail*[200] the ECJ, however, stated that article 43 EC also can be applied to rules that restrict a Member State's own nationals (or companies) in conducting intra-Community business transfers.[201]

The right to establishment is as fundamental to the single market as any of the freedoms in the EC Treaty. Consequently, the free movement of business establishments must be interpreted extensively while exceptions must be narrowly construed.[202] The rigid distinction between Treaty-based exceptions and the rule of reason in relation to goods, and (as submitted) workers, also applies in relation to the right to establishment in Article 43 EC. This is confirmed by the Court's judgement in *Gebhard*[203], where the Court clearly emphasised that principles concerning goods, workers, establishment and services should be interpreted similarly.[204] (The *Gebhard* test, concerned with the identification of non-discriminatory restrictive measures, has already been cited in chapter 2.3.2).

The same case law that confirms the Court's rigid distinction between Treaty-based law and ECJ-developed law in relation to establishment, also illuminates the evolution of a prohibition against restriction in matters of non-harmonised direct taxation.

In *Wielockx* a Belgian national, Mr Wielockx, was residing in Belgium while receiving income from self-employed work in the Netherlands. The Dutch authorities refused to allow a tax deduction for the premiums he paid to a voluntary pension scheme, as the Netherlands only grants tax deductions to persons residing in that country. The ECJ, cited its judgement in *Schumacher* and held that Mr Wielockx was in an objectively similar situation to that of a Dutch resident.[205] (first layer of objective justification). According to the ECJ Mr Wielockx was a victim of discrimination, as his personal situation was not taken into account in any of the Member States. To justify this case of discrimination, the Dutch government relied on the principle of fiscal cohesion laid down in *Bachmann*. However, the Court clearly rejected the Dutch government's line of defence.[206] In short, the Court's judgement in *Wielockx* thus confirms that a discriminatory tax measure cannot be justified by the rule of reason.[207]

In *Asscher*[208], a Dutch national resident in Belgium, Mr Asscher, worked in the Netherlands as the director of a Dutch company in which he was the sole

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[200] Case 81/87 *Daily Mail and General Trust* [1988] ECR 5483 paragraph 16
[201] As *Daily Mail*, however, concerned company law it will not be further discussed.
[202] Craig/de Burca p 729
[203] cited in note 185
[204] Craig/de Burca p 746
[205] as Mr Wielockx received "all or almost all" of his income in the Netherlands (*Wielockx* para. 22)
[206] *Wielockx* para. 19-27
[207] It appeared that the Court, at some point, had been considering characterising Mr Wielockx's disadvantageous tax burden as resulting from disparities between laws, and therefore, as a restriction rather than as discrimination, as it did discuss a rule of reason exception in the case. (See *Wielockx* para 25).
[208] Case C-107/94 cited above, note 122

shareholder. Mr Asscher's income in the Netherlands was less than 90% of his worldwide income, as Mr Asscher also worked in Belgium as the director of a Belgian company. Following the applicable rules, Mr Asscher was not considered a Dutch resident, and was therefore taxed in Belgium on his entire income, except for his income in the Netherlands. Under Regulation 1408/71[209] Mr Asscher was insured under the compulsory social security scheme for self-employed persons in Belgium. According to the same regulation, he was excluded from the social security scheme in the Netherlands. As social security schemes and income taxation are closely related in the Netherlands, Mr Asscher was thus not liable to pay full income tax in that country. However, although only 13% of the 30% tax actually constituted income tax, the Netherlands still required Mr Asscher to pay 25% tax on his income in the Netherlands. The ECJ, applying the first layer of objective justification, held that Mr Asscher was in a similar situation to that of a Dutch resident.[210] The ECJ also found that the national rules tended to act mainly to the detriment of foreigners, and consequently constituted indirect discrimination.[211] When the Court considered whether such discrimination could be justified, in the second layer of objective justification, it rejected the Dutch government's argument that the measure was necessary to prevent an advantage for Mr Asscher over a person paying both social security contributions and income tax in the Netherlands.[212] The Court also quickly disposed of the Dutch government's attempt to justify discrimination by asserting the need to ensure fiscal coherence of the Dutch tax system.[213] Again the Court thus confirmed its distinction between Treaty-based justifications and the rule of reason.

In *Futura*[214] the Court's reasoning was sharper than in any of the previous cases. Here, the Court partially applied a restriction-based analysis. *Futura* concerned the offset of losses carried forward by a French company's permanent establishment in Luxembourg. To carry forward its losses the permanent establishment was subject to two requirements in national law: the existence of an economic link between losses and income and the existence of accounts duly maintained in Luxembourg. The Court did not find it very difficult to decide on the lawfulness of the first requirement, probably as none of the parties actually doubted that the requirement of a link between losses and income was compatible with Community law.[215] (As emphasised by Farmer the quality of the Court's reasoning is dependent on the quality of the submissions made to it.[216] The reliability of the Court's reasoning in this particular instance is thus debatable, to say the least. The

[209] Council Regulation (EEC) of the 14 June 1971 on the application of social security schemes to employed persons and their families moving within the Community (*Asscher* para 60)
[210] *Asscher* para. 48
[211] Ibid para. 38
[212] The ECJ held that Mr Asscher was in fact being penalised by the Dutch government for not paying social security contributions and full income tax in the Netherlands. (*Asscher* para 51-53)
[213] *Asscher* para 55-57
[214] Case 250/95 Futura Participations and Singer [1997] ECR I-2471
[215] Opinion of Mr Lenz para 27 at I-2479
[216] Farmer p 14

Court's answer appears to imply just about anything, and it is hardly worth discussing further).

Thus, after having allowed the first national requirement in *Futura,* the Court turned its attention to the requirement of duly maintaining accounts in Luxembourg. Although the Court found that such a requirement restricted the freedom of establishment in Article 43 EC, no mention was made of which form of restriction the Court actually was referring to. When reflecting on possible justifications to this anonymous restriction, the Court, however, cited *Bosman*, *Kraus*, *Gebhardt* and even *Cassis de Dijon*.[217] (Incidentally these four cases concern non-discriminatory restrictions, and are excellent arguments for the traditional distinction between Treaty-based exceptions and the rule of reason in Community law). After having thus implicitly concluded that restrictive measures may only be justified by the rule of reason, the Court found that the relevant national tax measure was unnecessary and disproportionate.[218]

The Court's judgement in *Futura* was followed by an even sharper restriction- based analysis in *ICI*[219]. In that case, the U.K. had refused to grant tax relief to ICI for losses incurred by a subsidiary of a holding company beneficially owned by ICI and another company, through a consortium. According to the applicable statute, the subsidiaries of the holding company were required to be domiciled in the U.K. in order for ICI to benefit from the relevant tax relief. However, of 23 subsidiaries, only 4 subsidiaries where resident in the U.K. (and only 6 in other Member States). The ECJ stated:

[Note ToA renumbering: Article 58 is now Article 48 EC]

> "even though, according to their wording, the provisions concerning freedom of establishment are directed mainly to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation which comes within the definition contained in Article 58 (Case 81/87 *Daily Mail and General Trust* [1988] ECR 5483 paragraph 16).[220]

The test used by the national tax authority in order to impose differential tax treatment (i.e. whether or not a subsidiary's situs was in the U.K.), thus clearly constituted a violation of the right to establishment.[221] The national measure clearly *dissuaded* British companies from establishing themselves in other Member States. After thus having identified the national measure as restrictive, the ECJ discussed possible justifications submitted by the U.K. The Court rejected both the need to ensure effective fiscal control and the

[217] *Futura* para 26 and 31
[218] Ibid para 40
[219] C-264/96 *ICI v Her Majesty's Inspector of Taxes*, available at http://curia.eu.int/en/index.htm
[220] *ICI* para. 21. The Court thus confirmed its statement in Daily Mail, that article 43 EC is applicable to restrictions on a Member States own nationals.
[221] *ICI* para. 23, 24 and 30

need to preserve fiscal coherence. The latter rejection was based on the grounds that there was no direct linkage between the tax relief in question and national tax revenue.

In *X and Y*[222] the ECJ cited its judgement in *ICI*. The Court repeated its statement in *Daily Mail* and *ICI*, that national tax rules, hindering the establishment in other Member States of its own nationals or companies, clearly was contrary to Article 43 EC.[223] In *X and Y*, the Swedish Revenue Law Commission, Skatterättsnämnden, refused to give a binding advance decision concerning tax relief for transfers within a Group. According to Swedish law, intra-Group transfers were treated as deductible expenses for the transferor, and taxable income for the transferee, provided both companies were established in Sweden, and one of the companies owned at least nine tenths of the shares in the other company.[224] One of the companies in *X and Y*, however, was owned by a Swedish parent company and its Dutch and German subsidiaries.[225] The ECJ, clearly applying a discrimination-based analysis within an ECJ-developed prohibition of restriction[226], found that differential treatment based on a subsidiary's situs clearly was contrary to Article 43 EC.[227] The Court duly noted that the Swedish government openly acknowledged that the Swedish legislation in question was unlawful according to Community law.[228] Thus, even national governments seem to acknowledge the prohibition of restriction in matters of non-harmonised direct taxation and the right to establishment.

2.3.4 The prohibition of restriction and the free movement of services

The free movement of services in Article 49 EC prohibits restrictions on the right of individuals and companies to provide and receive services within the Community.[229] In *Säger*[230] and *Alpine Investements*[231] the ECJ extended the free movement of services to also prohibit rules laid down by both the importing and the exporting state.[232] Thus, it is clearly possible to combat reverse discrimination with the aid of Article 49 EC.

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[222] Case-200/98 *X AB, Y AB v Riksskatteverket*, available at http://curia.eu.int/en/index.htm
[223] Ibid para. 26
[224] Ibid para. 4
[225] Please note that *X and Y* also concerned two other situations of ownership. (*X and Y* para. 7). As the relevant tax relief however was granted in those two situations they will not be examined further
[226] i.e. a Treaty-based prohibition of discrimination (subsequently extended by the ECJ to a prohibition of restriction) - Article 48 EC as interpreted in *Daily Mail* and *ICI* (*X and Y* para. 26-28). (Cf. table II in chapter 3).
[227] *X and Y* para. 28
[228] Ibid para. 29. The Swedish government did not even submit any possible justifications.
[229] Craig/de Burca p 727
[230] Case C-76/90 *Säger v Dennemayer & Co. Ltd.* [1991] ECR I-4221
[231] Case C-384/93 cited above, note 150
[232] Craig/de Burca p 784

The free movement of services in Article 49 EC is quite essential to the single market and must be interpreted extensively. Consequently, any limitations to the fundamental free movement of services must be interpreted strictly. The Court's general distinction between Treaty-based exceptions and the rule of reason has also been consistently upheld in relation to the free movement of services.[233] This is confirmed by ECJ case law. In *Bond*[234] the Court stated, for example that:

> "national rules which are not applicable to services without distinction as regards their origin and which are therefore discriminatory are compatible with Community law only if they can be brought within the scope of an express derogation"[235]

In *Bachmann*, discussed in relation to the free movement of workers in 2.3.2, the Court on the other hand held that a national rule requiring an insurer to be established in a particular Member State, in order for its customers to benefit from tax deductions, was contrary to the free movement of services.[236] The Court stated that such restrictive measures could:

> "deter those seeking insurance from approaching insurers established in another Member State"[237]

However, according to the ECJ such a restriction could be justified by the need to preserve fiscal coherence, i.e. a rule of reason exception. As the national tax measure in *Bachmann* was considered both proportionate and necessary by the Court, it was consequently allowed.

Surprisingly, the same public-interest justification (and even the same facts) held to justify discriminatory tax measures in relation to workers, have been held to *only* justify ECJ-developed non-discriminatory restrictive measures in relation to services.[238] Notwithstanding this apparent inconsistency, it remains an undisputed fact that a distinction between Treaty-based restrictions and the rule of reason also exists in relation to the free movement of services. This is important to bear in mind when discussing the Court's judgement in *Safir*[239]:

In *Safir*, a Swedish national and resident, Jessica Safir, took out life assurance with an insurance company established in the U.K. Unlike policyholders who had taken out capital life assurance (i.e. endowment assurance) with companies established in Sweden Jessica Safir was obliged to register herself and to declare her premium payments to a central body, Skattemyndigheten. Jessica Safir was also obliged to pay the applicable tax,

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[233] Cf. Kapteyn/VerLoren p 757-760
[234] Case 352/85 *Bond van Adverteerders v Netherlands* [1988] ECR 2085
[235] Ibid para. 32, i.e. public policy, public security or public health (Article 46 EC)
[236] *Bachmann* para. 31-32
[237] Ibid para 31
[238] on the latter see Kapteyn/VerLoren p 758-760
[239] Case C-118/96 cited above, note 106

otherwise levied on the insurer, and for this purpose had to find the necessary funds. The ECJ stated:

> "It is true that such obligations cannot in themselves be regarded as being contrary to Community law. However, those obligations, combined with the need to follow a centralised procedure, may dissuade interested persons from taking out life assurance with companies not established in Sweden,"[240]

The Court's statement in *Safir* appears to indicate a restriction-based analysis. The choice of the word "dissuade" confirms that the national tax rule had a restrictive *effect*. Thus, after having emphasised the non-discriminatory character of the restriction in question, the Court continued to discuss other effects of the national tax measure. The Court pointed to the fact that Jessica Safir was subject to a higher cost if she chose to surrender her foreign policy after a short time, compared what would have been the case, had she held a domestic policy. Unlike policyholders who had policies with domestic insurance companies, Safir was also required to provide the national tax authority with a burdensome body of information concerning her insurer. The ECJ also found that the assessment of the tax levied was liable to create uncertainty[241].[242] The Court summarised this rather curious elaboration, on measures caught between discrimination and restriction, by simply observing that:

> "legislation such as that in question in the main proceedings contains a number of elements liable to dissuade individuals from purchasing capital life assurance with companies not established in Sweden and liable to dissuade insurance companies from offering their services on the Swedish market.[243]

The Court's judgement in *Safir* appears to constitute a clear application of a restriction-based analysis in Community law. This is also confirmed by the fact that the ECJ discussed the Swedish governments submitted justification, namely the need to "fill the fiscal vacuum" arising from non-taxation of savings deposited with companies not established in Sweden.[244]

The only paragraph in the Court's judgement that, in the opinion of the author, even suggests that the Court's analysis in *Safir* concerns discrimination and not restriction, is paragraph 32:

> "legislation such as the Swedish legislation makes it difficult, if not impossible, for the national court called upon to determine whether the tax regime is discriminatory to compare, on the one hand, the yield tax on insurance policies taken out with companies established in Sweden and, on the other hand, the tax on insurance premiums paid to companies not established in Sweden."

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[240] *Safir* para 26
[241] The tax could be reduced by half if the insurer was subject to a foreign revenue tax constituting at least one quarter of the Swedish revenue tax, or an exemption allowed, if the foreign tax constituted at least half of the Swedish tax. (*Safir* para. 11)
[242] *Safir* para. 26-29
[243] Ibid para 30
[244] *Safir* para 34

Thus, this statement does not constitute a declaration of identified discrimination, but is merely an explanation of why the Court ignored its discrimination-based analysis and instead applied a restriction-based analysis in *Safir*. The Court simply seems to have emphasised that it would be untenable or practically impossible, to apply the traditional discrimination-based analysis on the different (and complex) Swedish tax regimes, applied to foreign and national insurers.

2.3.5 The prohibition of restriction and the free movement of capital

Article 56 EC provides that, within the framework of Chapter 4 of the EC Treaty, all restrictions on the movements of capital between Member States, and between Member States and other countries are prohibited. [245] As submitted by Kapteyn and Verloren the word "all" indicates that Article 56 EC covers both discriminatory *and* non-discriminatory restrictions.[246] Before addressing this matter, however, it is appropriate to first address one of the essential questions concerning the free movement of capital. Is the free movement of capital coeval with other Community freedoms, or must the free movement of capital give way to other freedoms in the Treaty.

Advocate General Tesauro in his opinion in *Safir*[247], explains that the ECJ has adopted three main principles[248]:

1. A national measure that *directly* affects the transfer of capital, but only indirectly affects other Community freedoms, will only be subject to provisions concerning the free movement of capital (see, e.g. *Sanz de Lera*[249], where the ECJ found that restrictions on the transfer of money considered to be legal means of payment were subject to Article 56 EC.).
2. A national measure that *directly* affects another Community freedom, but only indirectly affects the free movement of capital, will only be subject to the provisions of that other Community freedom. (see, e.g. *Luisi and Carbone*[250], where the Court found that restrictions on means of payment for tourist purposes, business trips, studies and medical treatment constituted payments and not movements of capital).
3. A national measure, which *directly* affects both the free movement of capital and another Community freedom, will consequently be subject to

[245] Rules concerning capital movements between Member States and non-member states, however, will not be discussed in this thesis. See Kapteyn/VerLoren p 770-771 for such a discussion.
[246] Kapteyn/VerLoren p 767
[247] Opinion of Mr Tesauro para 17 at I-1906
[248] For the same point of view in relation (only) to the freedom of establishment see Eicker, Klaus; The ECJ is likely to decide in a case relating to direct taxes on the relationship between freedom of establishment and free movement of capital. Intertax, Volume 28, Issue 1, 2000, p 51
[249] Case C-163/94 *Criminal proceedings against Sanz de Lera and Others* [1995] ECR I-4821
[250] Cases 286/82, 26/83 *Luisi and Carbone v Ministero del Tesero* [1984] ECR 377

> both sets of rules coevally. In *Svensson and Gustavsson*[251], for example, because a loan was deemed as both a movement of capital and as a service, a restriction on lending was thus subject both to the provisions concerning the free movement of capital, as well as to those concerning the free movement of services [252]).

The present scope of the free movement of capital is subject to the Treaty-based exceptions contained in Articles 58-60 EC:

According to Article 58 (1) (a) EC Member States retain the right:

> (a) to apply the relevant provisions of their tax law which distinguish between tax payers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested;

This justification however only applies to tax laws already in force at the end of 1993.[253]

It has been argued in legal literature that Article 58 (1) (a) EC reinforces the principle of international tax law discussed in 2.2.1, that discrimination on the grounds of nationality is prohibited, while discrimination on the grounds of residence in principle is allowed.[254] Martine Peters, however, asserts that this argument only can be viewed as logical if Article 56 EC constitutes a prohibition of restriction.[255] The writer agrees with Peters that there appears to be no practical need to codify the principle expressed in Article 58 (1) (a) EC if the free movement of capital is subject to a discrimination-based analysis. This is based on the fact that the principle in question otherwise, rather inevitably, would be applied in the first layer of objective justification in *all* cases concerning alleged breaches of Community law (Cf. 2.1.1). Cases of discrimination between residents and non-residents, in objectively different situations, would consequently never reach the second layer of justification in Article 58 (1) (a) EC. Thus, the existence of Article 58 (1) (a) EC apparently confirms that Article 56 EC and the free movement of capital in fact constitutes a *Treaty-based prohibition of non-discriminatory restriction*.

This conclusion would imply that the Court's dual analysis (first discrimination- and then restriction-based) consequently has become obsolete in relation to the free movement of capital. It is simply unnecessary to apply a discrimination-based analysis when the crucial element in determining a breach of Article 56 EC always is whether a measure has *a restrictive effect*. This also appears to be confirmed by the Court's judgement

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[251] Case C-484/93 *Svensson and Gustavsson v Ministre du Logement et de L'Urbanisme* [1995] ECR I-3955

[252] Ibid para 10 and 12. This judgement has been severely criticised precisely because of its double assessment (Tesauro in *Safir* note 15 at I-1906)

[253] Weatherill/Beaumont 761

[254] Williams p 164

[255] Peters, Martine; Capital movements and taxation in the EC, EC Tax Review 1998/1, p 12

in *Svensson and Gustavsson*[256], where the Court clearly and exclusively applied a restriction based analysis in relation to the free movement of capital.

Svensson and Gustavsson concerned a Swedish couple resident in Luxembourg that had borrowed money from a bank established in Belgium to purchase a house in Luxembourg. As the Swedish couple's loan was not concluded with a bank established in Luxembourg, they were unable to enjoy interest subsidies otherwise granted by Luxembourg. The ECJ stated with regard to the free movement of capital:

> "Provisions implying that a bank must be established in a Member States in order for recipients of loans residing in its territory to obtain an interest rate subsidy from the State out of public funds are liable to dissuade those concerned from approaching banks established in another Member State and therefore constitute an obstacle to movements of capital such as bank loans."[257]

It is quite apparent that the Court is speaking in terms of restriction and not discrimination.

Another Treaty-based justification in the second layer of objective justification can be found in Article 58 (1) (b). As submitted by Paul Craig and Gráinne de Búrca, Article 58 (1) (b) includes two parts. The first part implies that national measures taken by a Member State for the effective administration of the tax system or, *inter alia*, the effective supervision of financial institutions, may justify prior reporting requirements of capital movements within the Community. However, it does not justify prior authorisation requirements. This is because an authorisation requirement suspends the transaction in question and thereby makes the free movement of capital illusory. [258] A prior declaration requirement, however, does not suspend the transaction, even though it provides a Member State with a means of national control.[259] The second part of Article 58 (1) (b) concerns public policy and public health. These exceptions have apparently been inspired by Article 30 EC, and must therefore be strictly interpreted.[260]

The reference in Article 43 EC preserving the free movement of capital in relation to the right to establishment is mirrored by a reference in Article 58 (2) EC. This means that a justified national restriction on the free movement of capital cannot be considered unlawful by instead referring to the right to establishment.[261]

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[256] *Svensson and Gustavsson* cited above, note 251
[257] Ibid para 10
[258] *Sanz de Lera* cited above, note 249
[259] Ibid para. 19-30
[260] Kapteyn/VerLoren p 769
[261] This consequently implies that a justified national restriction on the free movement of establishment cannot be considered unlawful by instead referring to the free movement of capital. (Restrictions can be justified on grounds of public policy, public security or public health, i.e. Treaty-based exceptions to the free movement of establishment (Article 46 EC)

Article 58 (3) EC stipulates that restrictions justified by Article 58 (1) and (2) EC must not constitute a means of arbitrary discrimination or disguised restriction. It has been convincingly argued[262] that arbitrary discrimination can be interpreted as measures directed only at non-nationals or foreign products, when there are no national measures with the same effect. In the same way, disguised restrictions can be interpreted as measures affecting non-residents more than residents, although the measures are applicable to non-residents and residents alike.[263] One of the consequences of this interpretation is that the Court's case-law on objectively justified discrimination, as expressed in *Schumacher*, *Wielockx* and *Asscher*, has been codified in relation to the free movement of capital. It is submitted that this "safeguard", in relation to laws not existing at the end of 1993, will be of no practical use if the Court's dual analysis remains intact (i.e. a Treaty-based prohibition of discrimination, subsequently extended by the ECJ to a prohibition of restriction. (cf. Table 2 in chapter 3).

Articles 119 and 120 EC contain possible justifications for restrictions when a Member State is threatened with a difficult balance of payments situation or a crisis.[264] While Article 119 EC, on one hand, is built on the idea of Community co-operation, Article 120 EC, on the other hand, consists of unilateral measures in cases of sudden crisis or Community inactivity. Both articles, however, cease to exist from the beginning of the third stage of the EMU for the 11 euro-zone countries. Member States with a derogation from the third stage of EMU, i.e. Denmark, Greece, Sweden and the United Kingdom, will consequently be able to assert these articles if they are faced with payment difficulties or crisis in the future.[265]

[262] Peters p 12
[263] Ibid p 11
[264] Weatherill/Beaumont 761
[265] Kapteyn/VerLoren p 770

3 Conclusion

To achieve the objectives of the EC Treaty, the Member States have established a single market within the territory of the EU. The single market constitutes an area without internal frontiers in which the free movement of goods, persons, services and capital is guaranteed by the EC Treaty. To facilitate enforcement of the EC Treaty, the Member States have equipped the EC Treaty with a principle of loyalty in Article 10 EC. This fundamental principle, inherent in the EC Treaty, is quite essential to European economic integration.

Article 10 EC requires Member States to take all measures necessary to ensure fulfilment of obligations arising from the EC Treaty. This implies that Community law must always take precedence over national law and that Member States are bound to implement Community objectives in their national laws. Paragraph 2 of Article 10 EC requires Member States to abstain from adopting or maintaining any measures which might jeopardise the attainment of Community objectives. If these two provisions are read together, it becomes quite apparent that Article 10 EC in fact constitutes a *conflict principle* in relation to non-harmonised fields of national law. Applied to matters of non-harmonised direct taxation, this implies that Member States remain free to legislate, as long as such legislation does not jeopardise the objectives of the EC Treaty.

Non-harmonised direct taxation thus falls well within the purview of Community law. Consequently, the ECJ has not hesitated to apply Community law even in matters of non-harmonised direct taxation. Treaty-based provisions establishing the single market, however, have traditionally been interpreted as *Treaty-based* prohibitions of discrimination. This was also intended by the founders at the time of adoption. Differential treatment on the grounds of nationality is thus contrary to Community law *per se*. Differential treatment of residents and non-residents, however, may be justified if residents and non-residents are in objectively different situations. Member States consequently remain free to discriminate against non-residents and their own nationals, despite the prohibition of discrimination in Community law.

The concept of a single market, however, calls for action beyond the limited scope of non-discrimination. It would otherwise be possible for Member States to protect their domestic markets simply by adopting or maintaining formally non-discriminatory rules, or rules that only discriminate against their own nationals. To prevent this, the ECJ has developed a prohibition of non-discriminatory restriction. In doing so, the Court has used the principle of loyalty as *a rule of jurisdiction*. Applied to non-harmonised direct taxation this implies that a national tax measure, affecting an explicit

Community field, always will interfere or conflict with the operation of Community law. Consequently, national legislation on non-harmonised direct taxation will be unlawful if it affects explicit Community law, unless it can be justified by an objective justification in Community law.

Community law has thus been divided into two different types of law: Treaty-based law and ECJ-developed law. It is quite possible to identify this distinction in the Court's dual analysis in relation to Treaty-based prohibitions of discrimination (subsequently extended by the ECJ to prohibitions of restriction). The Court will always apply the Treaty-based prohibition of discrimination first. If the Court is able to identify discrimination it will continue to examine whether such a discrimination may be justified by a Treaty-based justification. If the Court, however, is unable to identify discrimination, or such a finding would be untenable, the Court will apply the ECJ-developed prohibition of restriction. As argued throughout Chapter 2, a violation of an ECJ-developed prohibition may be justified both by a Treaty-based *or* an ECJ-developed exception. The apparent differences between Treaty-based rules and ECJ-developed rules are shown in Table II.

Table II. The distinction between Treaty-based and ECJ-developed rules in Community law[266]

Free movement of:	**Treaty-based prohibition of *discrimination*:**	**Treaty-based exception:**	**ECJ-developed prohibition of *restriction*:**	**ECJ-developed exception:**
Goods	Article 28	Article 30	*Dassonville* formula	*Cassis de Dijon*
	Article 29	Article 30	N/A	N/A
Workers	Article 39	Article 39 (3)	*Bosman*	*Bosman/ Bachmann*
Establishment	Article 43	Article 46	*Daily Mail (and ICI)*	*Gebhard*
Services	Article 49	Article 46	*Alpine Investments*	*Bachmann*
	Treaty-based prohibition of *restriction*	**Treaty-based exception:**	N/A	N/A
Capital	Article 56	Articles 58 – 60, 119-120	N/A	N/A

Only in relation to *Treaty-based prohibitions of restriction* will the Court's dual analysis be obsolete. This is due to the fact that the discrimination

[266] The Courts dual analysis is only employed in relation to Treaty-based prohibitions of discrimination (subsequently extended by the ECJ to prohibitions of restriction). The discrimination-based first stage of the dual analysis consequently becomes obsolete when the provision in the Treaty becomes a *Treaty-based* prohibition of restriction. This has been the case with Article 56 EC and the free movement of capital.

based dual analysis, employed within Treaty-based prohibitions of discrimination (subsequently extended by the ECJ to prohibitions of restriction), becomes completely unnecessary where there are Treaty-based prohibitions of restriction. There is simply no need to determine a measure's discriminatory status when the crucial element within a Treaty-based prohibition of restriction always consists of a measure's restrictive *effect*. The broader rule (prohibition of restriction) will thus always subsume the more narrow one (prohibition of discrimination) within a *Treaty-based* prohibition of restriction (cf. Table II).

It has been submitted in this thesis that ECJ case law on non-harmonised direct taxation constitutes an important and logical part of the Court's case law, in general. The Court's judgement in *Bachmann*, one of the key cases on non-harmonised direct taxation in Community law, interpreted in such a light will confirm the existence of a distinction between Treaty-based and ECJ-developed rules in relation to non-harmonised direct taxation, as well. *Discriminatory* national tax limitations of Community law can thus *only* be justified by Treaty-based exceptions, while *restrictive* national tax limitations can be justified by Treaty-based *or* ECJ-developed exceptions.

As the ECJ-developed need to preserve fiscal coherence *only* can justify national limitations of *ECJ-developed prohibitions of restriction*, Member States must begin to embrace, not fear, the prohibition of restriction in Community law. Only by emphasising a measure's restrictive effect will Member States be successful in protecting the fiscal coherence of their national tax systems. If Member States, in other words, continue to submit fiscal coherence as a justification to discriminatory national tax measures they will continue to be unsuccessful. (Although full acceptance of the ECJ-developed prohibition of restriction in Community law might be perceived by some as a loss of a certain degree of sovereignty, each Member State, after all, decided to hand over that particular sovereignty to the Community on the day it ratified the EC Treaty.

In addition, the free movement of capital in Article 56 EC is, in actuality, a *Treaty-based prohibition of restriction*. The Treaty-based exception in Article 58 (1) (a) EC, allowing discriminatory restrictions on the free movement of capital existing before the end of 1993, would otherwise appear to be purposeless. There is simply no reason to codify the exception in question within a *Treaty-based prohibition of discrimination*! (Differential treatment by Member States of residents and non-residents in objectively different situations, simply does not constitute discrimination).

As the free movement of capital thus constitutes a *Treaty-based prohibition of restriction*, national limitations to Article 56 EC may only be justified by Treaty-based exceptions. Consequently, Member States are unable to assert the ECJ-developed fiscal coherence justification in relation to the free movement of capital. The broader rule (prohibition of restriction) will simply subsume the narrower rule (prohibition of discrimination) within any

Treaty-based prohibition of restriction at all times (Cf. Table II). If Member States were in fact free to submit exceptions developed by the ECJ within the dual analysis, when that analysis has become obsolete due to changes in legislation, the very basis of Community law would be called into question. (National limitations to Community law must fade away at the same rate as Community law extends its Treaty-based scope. The ultimate objective, after all, is to achieve a *single* market).

This thesis has shown that the rapid liberalisation of trade and investments within the single market is eroding the effective sovereignty of Member States. Member States are simply incapable of stopping the step by step loss of revenue brought on by parties exercising their Community rights. Additionally, tax competition between Member States threatens to increase tax burden on less mobile factors of production as more mobile ones take advantage of the single market.[267] National tax systems are consequently challenged by rules designed to increase growth, employment, trade and competitiveness. Because national tax systems are in fact loosing the struggle, Member States are faced with an imminent need to harmonise or in some other way co-ordinate matters of non-harmonised direct taxation.

However, the political price for harmonisation on a Community level appears to be very high. As noted by David Williams, the battle cry of the American Revolution, "taxation without representation is tyranny", cannot be ignored in this context.[268] Once legislative powers concerning non-harmonised direct taxation have been transferred from national parliaments to what is essentially an inter-governmental Community, the peoples of Europe will be inclined to demand direct representation. The location of such representation (local, national or supra-national), however, is a matter for future electorates to decide. At the present stage of European economic and political integration, Member States are likely to co-ordinate matters of non-harmonised direct taxation within their own national tax systems.

[267] As emphasised by Commissioner Monti, the average implicit tax rate on employed labour in the EU rose from 34.7 per cent to 40.5 percent between 1980 and 1994. During the same period, the implicit tax rate on more mobile factors of production fell from 44.1 per cent to 35.2 per cent. (Monti p 3).
[268] Williams p 1

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