DIRECT TAXATION AND THE INTERNAL MARKET:

Assessing Possibilities for a More Balanced Integration

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To my Family; and

In memory of my Grandparents

with love…

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Abstract

The role of the Court of Justice of the European Union in the process of direct tax integration in the European Union (EU) has been widely discussed in the academic literature, while another important actor, the European Commission, has attracted much less attention. The Commission's input is commonly perceived to be limited to the right of legislative initiative. This study questions such an oversimplified interpretation and draws a more nuanced picture of EU tax harmonisation by integrating an analysis of the complex regulatory approaches adopted by the Commission for the establishment and smooth functioning of the Internal Market.

It is argued that the past decade brought a notable change in the Court-dominated pattern of direct tax integration. This change is apparent first in the evolution of enforcement strategies under Articles 258 and 260 TFEU; and second, in the increased reliance upon non-binding regulatory measures. Both developments have strengthened the role of the Commission, supplying it with more possibilities for influencing national direct tax systems, despite the reluctance of Member States to agree upon legislative harmonisation. Against this background, the procedural and substantive problems associated with these instruments require closer examination.

The normative scope of this research covers the key procedural problems related to the infringement procedure and non-binding regulatory measures. The empirical component explores the Commission's enforcement and coordination practices, drawing particular attention to two case studies: the tax treatment of losses in cross-border situations and exit taxation. Following the analysis of enforcement and coordination in the field of direct taxation, the study argues the need and proposes potential solutions for (i) the developing of a more comprehensive procedural framework for the infringement procedure and non-binding regulatory acts; (ii) the strengthening of accountability mechanisms; and (iii) the enhancing of the effectiveness of their application.

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AG	Advocate General of the Court of Justice of the European Union
AGS	Annual Growth Survey
CHAP	Complaint Handling (‘Accueil des plaignants’) database of the European Commission
CJEU	Court of Justice of the European Union
DG Environment	Directorate-General for Environment of the European Commission
DG Internal Market and Services	Directorate-General for the Internal Market and Services of the European Commission
DG TAXUD	Directorate-General for Taxation and Customs Union of the European Commission
EC	European Community
EC Treaty	Treaty establishing the European Community
ECJ	Court of Justice of the European Union
ECOFIN	Council of Ministers for Economics and Finance
ECR	European Court Reports
ECSC	European Coal and Steel Community
EEA	European Economic Area
EEC	European Economic Community
EEC Treaty	Treaty establishing the European Economic Community

EFTA Court	Court of Justice of the European Free Trade Association States
EU	European Union
EUROATOM Treaty	Treaty establishing the European Atomic Energy Community
IP	Press release of the European Commission
M&S	Case C-446/03 *Marks & Spencer* [2005] ECR I-10837
MEMO	Memorandum of the European Commission
MEP	Member of the European Parliament
OECD	Organisation for Economic Cooperation and Development
OJ	Official Journal of the European Communities
OMC	Open method of coordination
OUP	Oxford University Press
PE	Permanent establishment
R&D	Research and development
SEA	Single European Act
SMEs	Small and medium-sized enterprises
TEU	Treaty on European Union (2007)
TFEU	Treaty of the Functioning of the European Union (2007)
TSCG	Treaty on Stability, Coordination and Governance in the Economic and Monetary Union

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PART I. Introduction

1. Harmonisation in the Field of Direct Taxation: Criticism of the Court and the Underestimated Role of the European Commission

Since the early steps of European integration, the question of harmonisation in the field of direct taxation has been controversial. The Treaties of Rome and the subsequent Treaty amendments were silent on the issue of whether and to what extent closer economic cooperation between the Member States embraces the harmonisation of direct tax systems.[1] Due to the lack of explicit reference, the legislative competence of the European Union (hereafter 'the EU', formerly the European Economic Community (EEC), the European Community (EC)) in this field has been constructed through its central objective of the establishment and smooth functioning of the Common Market.[2] However, the approximation

[1] Treaty establishing the European Economic Community (EEC Treaty, 1957); Treaty establishing the European Atomic Energy Community (EURATOM, 1957); followed by the Single European Act (SEA) [1987] OJ L169/1, the Treaty of Maastricht [1992] OJ C191/1, the Treaty of Amsterdam [1997] OJ C340/1, the Treaty of Nice [2001] OJ C80/1, and the Treaty of Lisbon [2008] OJ C306/1.

[2] 'It shall be the aim of the Community, by establishing a Common Market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increased stability, an accelerated raising of the standard of living and closer relations between its Member States' (Article 2 of the EEC Treaty, 1957). Initially defined in the Single European Act 1986, the Internal Market is understood as 'an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties' (ex Article 8a of the EC Treaty (pre-Amsterdam Treaty numbering), Article 14 of the EC Treaty (post-Amsterdam Treaty numbering), and now Article 26 TFEU). This thesis mostly refers to the 'Internal Market', but where EU acts are discussed, it keeps the original term used in the text ('Common Market', 'Single Market'). For a discussion on the difference between these terms see, eg, Kamiel Mortelmans, 'The Common Market, the Internal Market and the Single Market, What's in a Market?' (1998) 35 Common Market Law Review 101; Laurence W Gormley, 'Competition and Free Market: Is the Internal Market the Same as a Common Market?' (2002) 13 European Business Law Review 517; Dominik Hanf, 'Legal Concept and Meaning of the Internal Market' in Jacques Pelkmans and others (eds), *The EU Internal Market in Comparative Perspective: Economic, Political and Legal Analyses* (PIE Peter Lang 2008) 77; René Barents, 'The Single Market and National Tax Sovereignty' in Sjaak JJM Jansen (ed), *Fiscal Sovereignty of the Member States in an Internal Market: Past and Future* (Wolters Kluwer Law & Business 2011) 51.

of laws under Article 115 of the Treaty on the Functioning of the European Union (TFEU) requires a unanimity voting,[3] which has been reached only in the limited tax areas.[4]

The main progress has been made through the means of negative harmonisation. According to settled case law, although direct taxation falls under the competence of Member States, it must be exercised consistently with EU law.[5] The lack of political consensus for legislative harmonisation has not prevented the Court of Justice of the European Union (hereafter the 'Court' or 'CJEU', formerly the European Court of Justice (ECJ)) from abolishing the national tax measures that restrict the freedom of cross-border movement. Although the first direct tax case was only decided in 1986,[6] the pressure of negative harmonisation has been growing, accumulating over 200 rulings.[7]

The disproportionality of de-regulatory (negative) and re-regulatory (positive) actions at the European level has raised concerns about the legitimacy of judicial activism that undermines the fiscal sovereignty of Member States. While the Court has been widely

[3] Ex Article 100 of the EC Treaty (pre-Amsterdam Treaty numbering), Article 94 of the EC Treaty (post-Amsterdam Treaty numbering), and now Article 115 TFEU.

[4] Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States [1990] OJ L225/1 as amended by Council Directive 2005/19/EC of 17 February 2005 [2005] OJ L58/19 (Merger Directive); Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [1990] OJ L225/6 as amended by Council Directive 2003/123/EC of 22 December 2003 [2004] OJ L7/41 (Parent–Subsidiary Directive); Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments [2003] OJ L157/38 (Saving Directive); Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49 (Interest and Royalty Directive); Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC [2011] OJ L64/1 (Administrative Cooperation Directive); Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures [2010] OJ L84/1 (Mutual Assistance in Recovery of Taxes Directive).

[5] See, inter alia, Case C-279/93 *Schumacker* [1995] ECR I-225, para 21; Case C-80/94 *Wielockx* [1995] ECR I-2493, para 16; Case C-107/94 *Asscher* [1996] ECR I-3089, para 36; Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, para 19; Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, para 37; Case C-446/03 *Marks and Spencer* [2005] ECR I-10837, para 29. For an analysis see, eg, Fabian Amtenbrink and Helena Raulus, 'Contribution to: Fiscal Policy in the European Union Context – The Semi-detached Sovereignty of Member States in the European Union' in Sjaak JJM Jansen (ed), *Fiscal Sovereignty of the Member States in an Internal Market: Past and Future* (Wolters Kluwer Law & Business 2011) 1.

[6] Case 270/83 *Commission v France* ('avoir fiscal') [1986] ECR 273.

[7] Based on DG TAXUD, 'CJEU Cases in the Area of, or Particular Interest for, Direct Taxation' (updated to 22 October 2012) <http://ec.europa.eu/taxation_customs/resources/documents/common/infringements/case_law/court_cases_direct_taxation_en.pdf> accessed 5 November 2012.

criticised for becoming a driving force for EU direct tax integration,[8] the role of another important actor, the European Commission (hereafter 'the Commission'), has attracted much less attention in academic debates. The Commission is frequently considered to be an institution that mostly *appeals* for closer legislative cooperation, and whose output is narrowed to the consideration of attempts to establish a common legislative framework for direct taxation.[9]

This study questions such an oversimplified interpretation and draws a more nuanced picture of EU tax harmonisation by integrating an analysis of the complex regulatory approaches adopted by the Commission in this field. It argues that the recent decade has brought a notable change in the Court-dominated pattern of direct tax integration, which has largely been overlooked by EU tax scholarship. This change is apparent first in the evolution of enforcement strategies under Articles 258 and 260 TFEU; and second, in the increased reliance upon non-binding regulatory measures. Both developments have strengthened the role of the Commission, supplying it with more possibilities for influencing national direct tax systems – despite the reluctance of Member States to agree upon legislative measures.

[8] See, eg, Paul Farmer, 'The Court's Case Law on Taxation: A Castle Built on Shifting Sands' (2003) 12 EC Tax Review 75; Malcolm Gammie, 'The Role of the Court of Justice in the Development of Direct Taxation in the European Union' (2003) 57:3 Bulletin for International Taxation 86; Servaas van Thiel, 'Removal of Income Tax Barriers to Market Integration in the European Union: Litigation by the Community Citizen instead of Harmonization by the Community Legislature?' (2003) 12 EC Tax Review 4; Melchior Wathelet, 'Direct Taxation and EU-Law: Integration or Disintegration?' (2004) 13 EC Tax Review 2; Joachim Englisch, 'The European Treaties' Implications for Direct Taxes' (2005) 33 Intertax 310; Dennis Weber, 'In Search of a (New) Equilibrium between Tax Sovereignty and the Freedom of Movement within the EC' (2009) 34 Intertax 585; Suzanne Kingston, 'A Light in the Darkness: Recent Developments in the ECJ's Direct Tax Jurisprudence' (2007) 44 Common Market Law Review 1321; Michael J Graetz and Alvin C Warren, 'Dividend Taxation in Europe: When the ECJ Makes Tax Policy' (2007) 44 Common Market Law Review 1577; Gianluigi Bizioli, 'Balancing the Fundamental Freedoms and Tax Sovereignty: Some Thoughts on Recent ECJ Case Law on Direct Taxation' (2008) 48:3 European Taxation 133; Eric CCM Kemmeren, 'ECJ should not Unbundle Integrated Tax Systems!' (2008) 17 EC Tax Review 4; Pasquale Pistone, 'European Direct Tax Law: *Quo Vadis*?' in Michael Lang and Frans Vanistendael (eds), *Accounting and Taxation & Assessment of ECJ Case Law* (IBFD 2007) 99; Michael Lang, 'Recent Case Law of the ECJ in Direct Taxation: Trends, Tensions, and Contradictions' (2009) 18 EC Tax Review 98; Mathieu Isenbaert, *EC Law and the Sovereignty of the Member States in Direct Taxation* (IBFD 2010).

[9] For a notable exception see Charles E McLure, 'Legislative, Judicial, Soft law, and Cooperative Approaches to Harmonizing Corporate Income Taxes in the US and the EU' (2007) 14 Columbia Journal of European Law 377.

This regulatory development was acknowledged in the Communication 'Tax Policy in the European Union – Priorities for the Years Ahead' (2001).[10] Seeking ways to address the increasing number of preliminary references from Member States' courts, the Commission stated that to reach the tax policy objectives '*all available mechanisms should be pursued*, in particular: a more pro-active, well-focused and even-handed use of infringement proceedings in the tax field is now required'.[11] In addition, 'careful consideration should be given to an increased use of nonlegislative solutions and to the mechanism of enhanced co-operation.'[12]

Following this declaration, the use of *infringement proceedings* has been intensified, making direct taxation the largest group of pending investigations in the Commission's portfolio.[13] The role of the Commission in shaping the agenda of the Court has increased. Judgments delivered in the framework of Articles 258 and 260 TFEU, which had previously been exceptionally rare, became much more frequent in the last decade. By 2001 the Court had published four judgments in response to the referrals made by the Commission (also known as 'the guardian of the Treaties'), a number that has since increased to 38.[14] In 2012 infringement cases constituted a quarter of all direct tax rulings that were decided in Luxembourg.[15] Furthermore, the 'hidden' power of Articles 258 and 260 TFEU is even wider, as on average only five per cent of all infringement cases are referred to the Court.[16] In most cases, changes in national laws are agreed at the administrative stage: in 2011, for instance, 68

[10] Commission, 'Tax Policy in the European Union – Priorities for the Years Ahead' (Communication) COM(2001) 260 final (hereafter 'Commission, COM(2001) 260 final').

[11] ibid, section 5 (emphasis added).

[12] ibid.

[13] Commission, 'Internal Market Scoreboard' (September 2012, No 25) 20.

[14] Based on DG TAXUD, 'CJEU Cases in the Area of, or Particular Interest for, Direct Taxation' (updated to 22 October 2012) <http://ec.europa.eu/taxation_customs/resources/documents/common/infringements/case_law/court_cases_direct_taxation_en.pdf> accessed 5 November 2012.

[15] Ibid cf Court of Justice, 'Annual Report of the Court of Justice 2011: D – Statistics Concerning the Judicial Activity of the Court of Justice', tables 2 and 3.

[16] Based on Commission, 'Statistical Annexes I to III' (Staff Working Paper) SEC(2011) 1094 accompanying '28th Annual Report on Monitoring the Application of EU Law (2010)' (Report) COM(2011) 588 final, table 2.4.

cases were closed after the Member States modified their direct tax provisions to comply with EU law.[17] According to the Commission's reports, a consensus with national authorities is frequently reached even before the opening of a formal investigation,[18] in particular with the introduction of the alternative problem-solving procedures such as SOLVIT and EU Pilot. The Commission admits that due to the lack of positive harmonisation the infringement procedure remains 'the best instrument to provide a correct application of Community law'.[19]

The involvement of *non-binding measures* to encourage tax cooperation has also evolved. The Commission introduced the practice of publishing interpretative and steering communications, which had been in very limited use in the field of direct taxation before 2001. One of the key initiatives in this respect was launched in 2006: the Commission published a complex plan of 'soft' regulatory actions aimed at coordinating Member States' direct tax systems in several priority areas.[20] The core idea was to respond to the increasing pattern of litigation in the field of direct taxation, to ensure a more consistent application of the principles established by the Court and to stimulate coordinated policy responses from national authorities. Another important development followed the banking and sovereign debt crisis, when the Member States agreed to a closer coordination of budgetary and economic policies by introducing 'the European Semester'.[21] In 2011 this new model of governance instigated 'structured discussions on tax policy issues' between national governments, in particular those participating in the Euro Plus Pact.[22] The Commission thus currently employs

[17] Based on Commission, 'Situation in the Different Sectors' (Staff Working Paper) SEC(2011) 1093 final accompanying '28th Annual Report on Monitoring the Application of EU Law (2010)', section 13.3.1.2.

[18] ibid.

[19] Commission, 'Situation in the Different Sectors' (Staff Working Paper) SEC(2007) 975 accompanying '24th Annual Report on Monitoring the Application of Community Law (2006)' COM(2007) 398 final, section 1.3.

[20] Commission, 'Co-ordinating Member States' Direct Tax Systems in the Internal Market' (Communication) COM(2006) 823 final (hereafter 'Commission, COM(2006) 823 final').

[21] Commission, 'Enhancing Economic Policy Coordination for Stability, Growth and Jobs – Tools for Stronger EU Economic Governance' (Communication) COM(2010) 367/2.

[22] The Euro Plus Pact was endorsed by the European Council on 24–25 March 2011. It states that '[p]ragmatic coordination of tax policies is a necessary element of a stronger economic policy coordination in the Euro area to support fiscal consolidation and economic growth. In this context, Member States commit to engage in

a variety of non-binding instruments to coordinate Member States' direct tax policies, ranging from explanatory guidelines on the case law of the Court to the *ex ante* coordination of national fiscal reforms.

The *enhanced cooperation procedure*, which the Commission found important to be considered for the purpose of advancing tax integration in 2001,[23] has now become a much more feasible prospect. In April 2012 the common consolidated corporate tax base (CCCTB) proposal was approved with some amendments by the European Parliament (hereafter 'the Parliament') under the consultation procedure. The Parliament explicitly stated that the alternative procedural arrangement under Article 20 of the Treaty on European Union (TEU) should be initiated 'without delay' if the legislative proposal fails to gain unanimous political support.[24] The decision of the Council is still awaited.

This evolution of EU direct tax harmonisation, specifically in terms of the changes in the Commission's regulatory approaches in the recent decade, has not been comprehensively assessed in the academic literature, and this study attempts to address this omission.

2. Research Questions and Hypotheses

This research project focuses on the exercise of enforcement powers under Articles 258 and 260 TFEU and the use of non-binding measures by the Commission in the context of direct taxation since 2001. It critically analyses the key procedural and substantive problems associated with these instruments, discussing the implications of this regulatory choice for attaining progress towards the objectives of the Internal Market.

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structured discussions on tax policy issues, notably to ensure the exchange of best practices, avoidance of harmful practices and proposals to fight against fraud and tax evasion'. See also Commission, 'Growth Friendly Tax Policies in Member States and Better Tax Coordination' (Annex IV to the Annual Growth Survey 2012) COM(2011) 815 final.

[23] Commission, COM(2001) 260 final, sections 4.4 and 5.

[24] European Parliament Legislative Resolution 2011/0058(CNS) of 19 April 2012 on the proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), recital 4a (new).

In the context of this examination, the following aspects are of particular interest: (i) the normative scope of this research covers the key procedural problems related to the infringement procedure and non-binding instruments; (ii) the empirical component aims at examining how the Commission has followed the action plan indicated in the Communication 'Tax Policy in the European Union – Priorities for the Years Ahead' (2001) and whether this strategy has been subject to any modification or revision; and finally, (iii) the analytical conclusion synthesises the outcomes of the normative and case-based examination, proposing legal and regulatory changes. This assessment should also assist in verifying the hypothesis that the role of the Commission in the context of direct tax integration has been (and could further be) strengthened through these developments.

This analysis has been framed into a more general discussion on the distinct nature of the harmonisation process in the field of direct taxation. The study starts by taking the reader through 60 years of European tax integration, discussing the evolution of the regulatory tools. It explains the departure from the model of maximum legislative harmonisation towards the dominance of Market-led negative harmonisation under Article 267 TFEU,[25] then moves on to less explored areas. Analysing the 2001 priorities, it demonstrates how the strategy of direct tax harmonisation has changed towards more flexible modes of integration. The enhanced cooperation procedure, which could eventually be applied to introduce the CCCTB, will complete the U-turn towards the differentiated model of integration. Anticipating this change, the study opens up the discussion on the potential benefits and risks of this choice for the EU in the context of direct tax policy. However, the in-depth analysis of these forward-looking questions and the enhanced cooperation procedure has been left for future research.

[25] Ex Article 177 of the EC Treaty (pre-Amsterdam Treaty numbering), Article 234 of the EC Treaty (post-Amsterdam Treaty numbering).

3. Structure of the Analysis

This study consists of five substantive parts, which are structured as follows:

Part I (Introduction) sets the background for this research project. It introduces the recent changes in the process of European tax integration, explaining what makes this study a timely response. Then, it summarises the research questions and hypotheses, presenting the key directions that the study will take. This outline assists navigation through the structure of the thesis, and explains in which order and how the research questions will be addressed.

Part II (The 'Transformation of Europe' from a Direct Tax Perspective[26]) discusses the history of EU tax integration from the adoption of the Treaties of Rome (1957) to the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (2012). The study distinguishes five stages, observing the changes in the regulatory instruments used by EU institutions. Following this retrospective overview, Part II summarises the major problems that have been created by Article 267 TFEU, which has become a central harmonisation tool, and draws several potential directions that EU direct tax integration may take in the future. It concludes that the programme documents of the Commission promote the proactive use of enforcement tools and a non-binding coordination for balancing the drawbacks of the preliminary rulings procedure and contributing to the establishment of the Internal Market. This creates the need to explore this regulatory strategy in greater detail, building the bridge to Parts III and IV, which offer the procedural and substantive examination of infringement proceedings and non-binding coordination in the context of EU direct tax policy.

Part III (The Infringement Procedure and its Role in the Elimination of Fiscal Barriers in the EU) first introduces the infringement procedure and discusses the recent developments in the enforcement strategy of the Commission. Next, it analyses the key procedural problems

[26] The title refers to the seminal contribution by Weiler. See Joseph HH Weiler, 'Transformation of Europe' (1991) 100 Yale Law Journal 2403.

that are associated with the use of Articles 258 and 260 TFEU. Following this normative insight, Part III focuses on the tax issues targeted by the infringement proceedings in 2005–2012. This study constitutes the first attempt to review the enforcement actions of the Commission in the area of direct taxation from both quantitative and qualitative perspectives. It draws particular attention to the tax treatment of losses and exit taxation as two distinct examples of enforcement approaches.

Part IV (Non-Binding Coordination of Member States' Direct Tax Systems) explores the legal nature of non-binding measures and their progressive involvement in the context of direct tax policy. Similar to Part III, it discusses the key procedural problems that are related to these instruments. It then moves to the empirical analysis and examines two communications in areas where the Commission found 'a need for concerted action',[27] namely the tax treatment of losses (COM(2006) 824 final) and exit taxation (COM(2006) 825 final). Part IV analyses both communications, asking whether the declared objectives have been reached.

Part V (Concluding Remarks) summarises the main conclusions of the theoretical analysis and case-based examination in relation to the regulatory approaches that have been employed by the Commission for reaching a more balanced tax integration. This study draws attention to the most critical aspects, such as the profound uncertainty of procedural framework and the weakness of accountability mechanisms applicable to the infringement procedure and non-binding instruments, and advocates the need for improvements. It also raises some important institutional problems: the complexity and variety of the regulatory instruments involved in the elimination of fiscal barriers to the Single Market requires that more attention is given to their coherence and consistency. By examining this scope of questions, the thesis contributes to the wide debate on the effectiveness of EU law in non-harmonised areas.

[27] Commission, COM(2006) 823 final, section 3.

4. Methodological Approach

The theoretical argument builds upon the academic literature in the field of EU law and EU tax law. With some noted exceptions, these two academic groups appear quite isolated: EU law academics rarely choose tax policy examples as case studies due to the distinct nature of this field, while EU tax scholars often disregard how the tax-related problems fit into a broader context of European integration. This study promotes an integrated approach. The reasons for this choice go beyond the enriching outcomes of such a combination: the scope of institutional and procedural questions covered by this examination can be regarded as an established area of EU law scholarship. Considering the limited coverage in tax law academia, this study attempts to integrate the theoretical arguments generated by EU law scholarship.

The legal substance of the infringement procedure was widely discussed at the earliest stages of European integration by Evans, Dashwood and White, and other distinguished academics.[28] More recent studies reflected upon the procedural problems related to the exercise of the Commission's discretion,[29] accountability problems[30] and the strengthening of the enforcement mechanisms brought about by the Treaty of Lisbon,[31] in particular in relation

[28] Andrew C Evans, 'The Enforcement Procedure of Article 169 EEC: Commission Discretion' (1979) 4 European Law Review 442; Alan Dashwood and Robin White, 'Enforcement Actions under Articles 169 and 170 EEC' (1989) 14 European Law Review 388; Ami Barav, 'Failure of Member States to Fulfil Community Obligations' (1975) 12 Common Market Law Review 369.

[29] Alberto G Ibáñez, *The Administrative Supervision and Enforcement of EC Law: Powers, Procedures and Limits* (Hart Publishing 1999); Jan Komárek, 'Infringements in Application of Community Law: Some Problems and (Im)Possible Solutions' (2007) 1 Review of European and Administrative Law 87; Stine Andersen, 'Procedural Overview and Substantive Comments on Articles 226 and 228 EC' (2008) 27 Yearbook of European Law 121.

[30] Richard Rawlings, 'Engaged Elites Citizen Action and Institutional Attitudes in Commission Enforcement' (2000) 6 European Law Journal 4; Carol Harlow and Richard Rawlings, 'Accountability and Law Enforcement: The Centralized EU Infringement Procedure' (2006) 31 European Law Review 447; Melanie Smith, 'Enforcement, Monitoring, Verification, Outsourcing: The Decline and Decline of the Infringement Process' (2008) 33 European Law Review 777.

[31] Luca Prete and Ben Smulders, 'The Coming of Age of Infringement Proceedings' (2010) 47 Common Market Law Review 9.

to the application of financial sanctions.[32] The seminal contributions by Snyder and Senden provide a starting point for the analysis of non-binding instruments used in EU governance.[33]

Two recent publications of EU tax law scholars should be mentioned, as they have set the scene for this analysis. The first collection of articles was published in 2009, and included a procedural analysis of the infringement procedure in the tax context by Bariatti and Pistone,[34] and of soft law by Roccatagliata.[35] The second book was published in 2010, and discussed various instruments that enable the EU to attain the objectives of tax integration, including an overview of Articles 258 and 260 TFEU by Zalasiński, and non-binding instruments by Gribnau, Kemmeren, Pistone and Sarmiento.[36]

The empirical component of this study involved building a database of direct tax infringement cases that reached the second stage of the infringement procedure and beyond since 2005. Almost 200 cases were classified and reconciled with the priority areas for enforcement actions declared by the Commission. Two cases studies, the tax treatment of

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[32] Pål Wennerås, 'A New Dawn for Commission Enforcement Under Articles 226 and 228 EC: General and Persistent (GAP) Infringements, Lump Sums and Penalty Payments' (2006) 43 Common Market Law Review 31; Ian Kilbey, 'The Interpretation of Article 260 TFEU (ex 228 EC)' (2010) 35 European Law Review 370; Melanie Smith, 'Inter-institutional Dialogue and the Establishment of Enforcement Norms: A Decade of Financial Penalties under Article 228 EC (now Article 260 TFEU)' (2010) 16 European Public Law 547; Pål Wennerås, 'Sanctions against Member States under Article 260 TFEU: Alive, but not Kicking?' (2012) 49 Common Market Law Review 145.

[33] Francis Snyder, 'The Effectiveness of European Community Law: Institutions, Processes, Tools and Techniques' (1993) 56 Modern Law Review 19; Francis Snyder, 'Soft law and Institutional Practice in the European Community' in Stephen D Martin (ed), *The Construction of Europe – Essays in Honour of Emile Noel* (Kluwer Academic Publishers 1994) 197; Linda Senden, 'Soft Law and Its Implications for Institutional Balance in the EC' [2005] 1 Utrecht Law Review 79.

[34] Stefania Bariatti, 'Outline of the Infringement Procedure and Its Relationship with Preliminary Interpretation Proceedings' in Pasquale Pistone (ed), *Legal Remedies in European Tax Law* (IBFD 2009) 169; Pasquale Pistone, 'Ensuring the Effective Primacy of European Law beyond Preliminary Ruling Procedures: Some Thoughts on Strengthening the Function of Letters of Complaint and Infringement Procedures in the Field of Direct Taxes' in Pasquale Pistone (ed), *Legal Remedies in European Tax Law* (IBFD 2009) 191. A starting point was provided by a brief overview on the abolition of fiscal barriers through the infringement procedure, which was published by Schonewille in 2006. See Peter Schonewille, 'Eliminating Tax Barriers via the Infringement Procedure of Article 226 of the EC Treaty' (2006) 15 EC Tax Review 147.

[35] Franco Roccatagliata, 'The European Commission's Soft-Law Approach and its Possible Impact on EC Tax Law Interpretation' in Pasquale Pistone (ed), *Legal Remedies in European Tax Law* (IBFD 2009) 69.

[36] Adam Zalasiński, 'Contribution of Infringement Procedures to European Tax Integration' 117; Hans Gribnau, 'The Code of Conduct for Business Taxation: An Evaluation of an EU Soft Law Instrument' 67; Eric CCM Kemmeren, 'Sources of EU Law for European Tax Integration: Well-known and Alternative Legal Instruments' 29; Pasquale Pistone, 'Soft Tax Law: Steering Legal Pluralism towards International Tax Coordination' 97; Daniel Sarmiento, 'The Function of EU Soft Law' 53: in Dennis Weber (ed), *Traditional and Alternative Routes to European Tax Integration* (IBFD 2010).

losses and exit taxation, were then examined in greater detail. The Commission's enforcement actions in these fields were linked to the relevant case law of the Court and the non-binding coordination initiatives.[37] Some selected samples of infringement cases were obtained for analysis under Council Regulation No 1049/2001 regarding public access to European Parliament, Council and Commission documents.[38] The operation with infringement cases was further clarified through interviews with representatives of the Commission.

[37] A more detailed explanation is provided in Part III Section 4.1 and Part IV Section 4.1.

[38] Council Regulation (EC) No 1049/2001 of 30 May 2001 regarding public access to European Parliament, Council and Commission documents [2001] OJ L145/43.

PART II. The 'Transformation of Europe' from a Direct Tax Perspective

1. Outline

Describing the history of European integration in 'Transformation of Europe', Weiler pointed to one of its most vital features: created as an innovative institutional arrangement, the union of European states has been subject to constant changes.[39] The legal and political history of the EU consists of endless developments that in their scale and dynamics can hardly be compared to any other state or intergovernmental organisation in the modern world. Part II aims at exploring this evolution through the prism of direct tax policy. It draws a macro-picture of the integration process, focusing on the change of regulatory instruments that have been used to make progress towards the elimination of fiscal barriers in the Internal Market.

In its first harmonisation programme for direct taxation (1967), the Commission acknowledged that harmonisation measures in this field 'must be limited to what is *really necessary* either for the establishment or for the smooth functioning of the Common Market'.[40] The interpretation of the required scope of harmonisation measures in the field of direct taxation, as well as the regulatory toolbox, has significantly changed over time, reflecting the failures and successes of European integration. The initial programme of far-

[39] Joseph HH Weiler, 'Transformation of Europe' (1991) 100 Yale Law Journal 2403.

[40] Commission Memorandum to the Council of 8 February 1967 on Tax Harmonization Programme [1967] Supplement to the Bulletin of the EEC 8/3; Commission Memorandum to the Council of 26 June 1967 on Programme for the Harmonization of Direct Taxes [1967] Supplement to the Bulletin of the EEC 8/5, 3 (emphasis added) (hereafter Commission, 'Programme for the Harmonisation of Direct Taxes' (1967)).

reaching tax harmonisation through legislative actions, which was proposed by the Commission in the 1960s, has been substituted by less intrusive modes of integration, with more flexibility left to Member States. On the contrary, the pressure of negative harmonisation has evolved from fairly infrequent cases found in the 1960s–1980s to a current steady flow of preliminary rulings requested by Member States' courts, and infringement proceedings initiated by the Commission.

These transformations are discussed as follows: Section 2 constructs a timeline of EU tax harmonisation for the period between 1957 and 2012, demonstrating the dynamics of positive and negative harmonisation paths. The history of tax integration has been divided into five major stages, which are addressed in chronological order. Section 3 then provides an overview of the key problems created by the dominance of Article 267 TFEU in the process of European tax integration, and potential ways of addressing them.

2. The Dynamics of European Direct Tax Integration

This analysis is built upon the key programme documents of the Commission on market harmonisation and tax policy strategies. In this way, developments in the field of direct taxation are reconciled with the general context of European integration. In most cases, the successes and failures of tax policies have resembled the evolution or crisis of the integration project. At times, however, this field appears as a distinct case in the development of the Single Market. Both types of observations are valuable, as they help to draw a more objective picture of direct tax harmonisation in the EU.

2.1. The First Phase (the 1960s to the mid-1980s): From Maximum Tax Harmonisation to 'Absolutely Indispensable' Legislative Measures

In 1951, Belgium, Germany, France, Italy, Luxembourg and the Netherlands signed the Treaty establishing the European Coal and Steel Community. This cooperation was furthered by the treaties establishing the European Economic Community (EEC Treaty, 1957) and the European Atomic Energy Community (EURATOM Treaty, 1957), where Member States committed to the idea of the Common Market and the progressive approximation of economic policies.[41] Chapter 2 of EEC was fully dedicated to fiscal matters, but its scope was limited to the harmonisation of indirect taxes. There was no treaty reference to direct taxation.

Although the Commission did not have explicit competence in this field, however, it was able to intervene through its associated functions, such as its responsibility for the abolition of obstacles to the free cross-border movement of persons, services and capital (Article 3(c) of the EEC Treaty), the establishment of a system ensuring that the competition between Member States is not distorted (Article 3(f) of the EEC Treaty) and the approximation of national laws to the extent necessary for the functioning of the Common Market (Article 3(h) of the EEC Treaty). The legislative basis for harmonisation measures was to be found in Article 100 of the EEC Treaty: a general clause provided for the approximation of laws with 'a direct incidence on the establishment or functioning of the Common Market', which was subject to a unanimous vote. Article 93 of the EEC Treaty contained a prohibition of state aid able to obscure trade between Member States.[42]

[41] 'It shall be the aim of the Community, by establishing a Common Market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increased stability, an accelerated raising of the standard of living and closer relations between its Member States' (Article 2 of the EEC Treaty).

[42] The scope of this examination does not cover the prohibition of state aid, but focuses instead on the application of the fundamental freedoms in the context of direct taxation, predominantly Article 49 TFEU (ex Article 52 of the EC Treaty (pre-Amsterdam Treaty numbering), Article 43 of the EC Treaty (post-Amsterdam

Despite this limited treaty coverage, the initial vision of direct tax harmonisation was ambitious. The Report on EEC Tax Harmonization (hereafter, 'the Neumark Report') was prepared by the committee chaired by Fritz Neumark in 1962, and contained a number of far-reaching proposals for the coordination of Member States' tax regimes.[43] The Neumark Report called for: (i) partial harmonisation through a split-rate corporate tax system with a flat rate of 50 per cent on retained profits and a rate of 15–25 per cent on distributed profits, which was based on the German model; (ii) harmonisation of withholding tax provisions for dividends and interest payments, as well as a uniform taxation of capital gains; (iii) the revision of double taxation treaties between Member States, and the conclusion of a multilateral convention to eliminate double taxation; and (iv) the establishment of common information services to ensure efficient tax administration.[44] These measures were envisaged for adoption in several stages, reflecting the gradual development of fiscal cooperation. Although the harmonisation goals were set quite high, the absolute unification of tax systems was not considered to be a feasible objective, 'since experience proves that on many grounds *moderate* differences *limited to* the nature (structure) and to the rate of taxes do not hinder the free play of competition'.[45] The next study, the Segré Report (1966), developed recommendations for the better integration of capital markets, including some measures related to the elimination of fiscal obstacles that may distort investment decisions.[46] Among other proposals, the Segré Report supported the adoption of a multilateral convention between Member States, changes in withholding taxes on interest payments and tax credits provided to domestic shareholders to remove the discrimination of cross-border operations.

Treaty numbering)) and Article 63 TFEU (ex Article 56 of the EC Treaty (post-Amsterdam Treaty numbering)), as well as secondary legislation in this field.

[43] H Thurston (tr), *The EEC Reports on Tax Harmonization: The Report of the Fiscal and Financial Committee and the Reports of the Subgroups A, B, and C* (IBFD 1963) (Neumark Report).

[44] ibid 154-156.

[45] ibid 102 (emphases added).

[46] Commission, 'The Development of a European Capital Market: Report of a Group of Experts Appointed by the EEC Commission' (November 1966) (Segré Report).

The first tax harmonisation programme, which was published by the Commission in 1967, largely reflected the conclusions drawn in these studies.[47] In the long term, it aimed 'to arrive at an approximation of the structures, at a certain approximation of the rates and at the total elimination of double taxation.'[48] In the short term, the programme focused on the approximation of tax liabilities of parent companies and their foreign subsidiaries, cross-border company mergers and acquisitions, and the harmonisation of withholding taxes on dividends and interests. Should these measures leave any room for double taxation, the adoption of a multilateral convention was proposed to address the problem.[49] The Commission also acknowledged the need for establishing administrative cooperation between tax authorities.

These far-reaching harmonisation objectives should be seen as part of the general evolution of the process of European integration. The Common Market was expected to be established within twenty years, by 1 January 1970.[50] The 1960s are often described as the golden era, which saw significant progress in removing the obstacles to cross-border trade, for instance, by setting a common VAT system.[51] The tax harmonisation programme was presented as a tool to ensure fair competition between Member States: the costs of production and capital income should not be determined by differences in taxation that were 'too wide', investment decisions should not be solely defined by fiscal considerations, and the structural changes in enterprises that adjust their activities to the Common Market should be facilitated rather than hampered by tax provisions.[52]

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[47] Commission, 'Programme for the Harmonisation of Direct Taxes' (1967).

[48] ibid 7.

[49] ibid 9.

[50] Article 8 of the EEC Treaty, see also Case 2/74 *Reyners* [1974] ECR 631.

[51] A common VAT system was established in 1967 (Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes [1967] OJ 71 1301 (First VAT Directive). For a comprehensive historical overview see Rita de la Feria, *The EU VAT System and the Internal Market* (IBFD 2009) 45-88. For a description of other important developments initiated at this stage refer to, eg, Laurence W Gormley, 'The Internal Market: History and Evolution' in Nic N Shuibhne (ed), *Regulating the Internal Market* (Edward Elgar Publishing 2006) 14.

[52] Commission, 'Programme for the Harmonisation of Direct Taxes' (1967) 7.

Pursuing this agenda, the Commission proposed the Merger Directive and the Parent–Subsidiary Directive (1969) for adoption.[53] These two proposals were considered to be components of the wider harmonisation of corporate tax systems. Since disagreement with the proposal made by the Neumark Report was evident, the Commission invited Professor AJ van den Tempel to investigate other potentially acceptable models. The Tempel Report (1970) considered three options: the classic system, the system of a double rate and the system of credit; it recommended the classical approach as the most appropriate choice.[54] None of these proposals, however, found political support at this early stage of integration.

In 1975 the Commission published a new action programme for taxation, expressing its frustration with the lack of cooperation in fiscal matters.[55] Seeking a solution, the Commission changed its strategy and decided to concentrate on measures that were 'absolutely indispensable'.[56] The long-term projects, such as the harmonisation of corporate tax bases, were suspended. The priority measures concerned: (i) the tax treatment of mergers, divisions and contributions of assets between companies located in different Member States; (ii) the tax liabilities of parent companies and their foreign subsidiaries; (iii) the withholding of taxes on dividend and interest payments; and (iv) the exchange of information between tax authorities. Pursuing these priorities, the Commission proposed several new legislative initiatives.[57] All but one directive failed to reach the unanimity threshold. The successful

[53] Commission, 'Proposal for a Directive on Cross-Border Company Mergers' COM(69) 5 final [1969] OJ 39/1; Commission, 'Proposal for a Directive on the Tax Treatment of Parent Companies and Subsidiaries from Different Member States' COM(69) 6 final [1969] OJ 39/7. In 1968, the Commission also prepared a preliminary draft of the multilateral treaty, but due to political disagreement further work was not undertaken.

[54] AJ van den Tempel, *Corporation Tax and Individual Income Tax in the European Communities* (Commission of the European Communities 1970) (Tempel Report) 41.

[55] Commission, 'Action Programme for Taxation' (Communication) COM(75) 391 final.

[56] ibid, para 4.

[57] The following four initiatives were under consideration: (i) company taxation and withholding taxes on dividends: Commission, 'Proposal for a Council Directive concerning the Harmonization of Systems of Company Taxation and of Withholding Tax on Dividends' COM(75) 392 final [1975] OJ C253/2. It aimed at tackling economic double taxation on dividends by proposing a partial imputation system of company taxation, which allowed shareholders to claim a credit against personal tax liabilities for taxes paid at the corporate level. The statutory rates were set at the level of 45–55 per cent, and a tax credit at the rate of 45–55 per cent for dividend recipients. Member States should apply a 25 per cent withholding tax on dividends distributed by their resident companies. This proposal was received with strong criticism and was subsequently withdrawn in 1990;

directive provided grounds for the cross-border exchange of information between tax authorities, but it can hardly be considered as a dramatic breakthrough and was rarely invoked.[58] Member States continued to rely upon the double tax treaties.[59]

This lack of progress can be explained by the legal and economic context. The EU decision-making process was fully controlled by national governments: any harmonisation measures were subject to a cost-and-benefits analysis. The abolition of tariffs and quantitative restrictions was prioritised and pursued more actively than the elimination of non-tariff barriers to trade.[60] The Court was demonstrating a proactive approach towards market integration by establishing the key principles of interaction between EU law and national legal systems, such as direct effect and supremacy.[61] Governments were slow in digesting these fast-moving and complex transformations of legal systems, which made legislative developments in directions that were not considered essential for the operation of the Common Market much harder. The position of the Commission – the only participant in the legislative process that could potentially see the advantages for the Common Market as a whole behind the curtain of national fiscal interest – was too weak to change this perception.

(ii) arbitration procedure: Commission, 'Proposal for a Council Directive on the Elimination of Double Taxation in connection with the Adjustment of Transfers of Profits between Associated Enterprises (Arbitration Procedure)' COM(76) 611 final [1976] OJ C301/4. It was substituted by the Arbitration Convention, which was adopted in 1990; (iii) collective investment: Commission, 'Proposal for a Council Directive on the Application to Collective Investment Institutions of the Council Directive concerning the Harmonization of Systems of Company Taxation and of Withholding Taxes on Dividends' COM(78) 340 final [1978] OJ C184/8, withdrawn in 1993; and (iv) income tax: Commission, 'Proposal for a Council Directive concerning the Harmonization of Income Taxation Provisions with respect to Freedom of Movement for Workers within the Community' COM(79) 737 final [1980] OJ C21/6. It was withdrawn in 1992.

[58] Acting upon the proposal from the Commission, the Council adopted a resolution of 10 February 1975 on the measures to be taken by the Community in order to combat international tax evasion and avoidance [1975] OJ C35/1 and subsequently voted for Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance of tax authorities in the field of direct taxation and taxation of insurance premiums [1977] OJ L336/15 (repealed by Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation [2011] OJ L64/1).

[59] Charles M Harris, 'The European Community's Parent–Subsidiary Directive' (1994) 9 Florida Journal of International Law 111, 124.

[60] See, eg, Michelle Egan, 'Single Market' in Erik Jones and others (eds), *The Oxford Handbook of the European Union* (OUP 2012) 407, 408-409.

[61] See, eg, Joseph HH Weiler, 'Transformation of Europe' (1991) 100 Yale Law Journal 2403; Alex Easson, 'Legal Approaches to European Integration: The Role of Court and Legislator in the Completion of the European Common Market' (1989) 12 Journal of European Integration 101.

Besides, soon after the Commission published its tax harmonisation programme, Europe faced the difficulties of enlargement and was hit by the economic recession of the 1970s.

To summarise, the first two decades of European direct tax integration can be described as a period of ambitious plans for maximum legislative harmonisation with very limited success. This stage demonstrated a remarkable mismatch between what was desirable and what was achievable through the legislative route in the given legal, political and economic conditions. It was obvious that either the scope of the harmonisation measures or the regulatory instruments needed to be adjusted. Since then, progress has been made in both areas.

2.2. The Second Phase (the mid-1980s to 1992): Reinforcing the Internal Market – A Breakthrough in Positive and Negative Harmonisation

The Report on the Scope for Convergence of Tax Systems (1980) reflected the failure of fiscal integration at the initial stage. The Commission acknowledged: 'a further lesson that experience has taught is that the Community interest is generally disregarded when national tax policies are being framed.'[62] This pessimistic conclusion reflected the general state of affairs with the European project: the progress towards the Community objectives was hampered by differences in the state of national economies and policy objectives. As Craig describes,

> [i]t was (…) this very sense that the Community was falling behind its agenda which generated a feeling of pessimism in the Community in the late 1970s and early 1980s. There seems to be no ready way in which the Community would ever attain its goals, and the reality of single-market integration appeared to be as far away as ever.[63]

[62] Commission, 'Report from the Commission to the Council on the Scope for Convergence of Tax Systems in the Community' (Communication) COM(80) 139 final [1980] 1/80 Supplement to the Bulletin of the European Communities, para 109.

[63] Paul Craig, 'The Evolution of the Single Market' in Catherine Barnard and Joanne Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Hart Publishing 2002) 1, 11.

The Commission made an attempt to strengthen its Internal Market strategy, rethinking the steps that were required to create one global market with its participating countries, providing impetus for its growth and stimulating competition.[64] The action plan, prepared by the Commission in 1985 (hereafter the 'White Paper on the Internal Market'), contained approximately 280 items of legislation that would be required to establish the Internal Market.[65] The Single European Act (1986) set some institutional changes that were vital for this development.[66] In particular, Article 100a of the EEC Treaty Commission introduced a qualified majority voting system for measures that have as their objective the establishment and functioning of the Internal Market, and Article 7a of the EEC Treaty stated that this ambitious project should be completed by the end of 1992. Subsequently, all items included in the White Paper on the Internal Market were adopted.[67]

The harmonisation of national direct tax systems, however, found very limited attention in the programme of legislative actions required for completing the integration project. The removal of barriers for cross-border trade was at the centre of attention. The White Paper on the Internal Market distinguished three types of barriers: physical (part I), technical (part II) and fiscal (part III); yet the fiscal section dealt solely with indirect taxation. The latter was viewed as an essential component that *directly affected the trade* between Member States and thus also the Internal Market.[68] The discussion on direct taxes was limited to two paragraphs in the context of facilitating cooperation between businesses, where the Commission called for the adoption of the Merge and Parent–Subsidiary Directives that had been under

[64] Commission, 'White Paper on Completing the Internal Market' (Communication) COM(85) 310 final, para 8.

[65] Commission, 'White Paper on Completing the Internal Market' (Communication) COM(85) 310 final.

[66] See, inter alia, Renaud Dehousse and Giandomenico Majone, 'The Institutional Dynamics of European Integration: From the Single Act to the Maastricht Treaty' in Stephen Martin (ed), *The Construction of Europe – Essays in Honour of Emile Noël* (Kluwer Academic Publishers 1994) 91; Stephen Weatherill, 'Supply of and Demand for Internal Market Regulation: Strategies, Preferences and Integration' in Niamh Nic Shuibhne (ed), *Regulating the Internal Market* (Edward Elgar Publishing 2006) 29, 32.

[67] Commission, *XXVIth General Report on the Activities of the European Communities 1993* (Office for Official Publications of the European Communities 1994) 35; Commission, *XXVIIth General Report on the Activities of the European Communities 1993* (Office for Official Publications of the European Communities 1994) 36.

[68] Commission, 'White Paper on Completing the Internal Market' (Communication) COM(85) 310 final, para 17.

consideration since the late 1960s.[69] The qualified majority voting set by Article 100a of the EEC Treaty was not applicable to fiscal matters. The article contained the explicit restriction that it could not be used in relation to fiscal provisions, provisions relating to the free movement of persons and those relating to the rights and interests of employed persons. This provision was introduced because some Member States preferred to retain ultimate control over sensitive policy areas: the special status of fiscal matters became even more apparent with this amendment.

Christiane Scrivener, the European Commissioner at that time, stated that the European tax strategy needed to be 'ambitious', but kept 'realistic'.[70] The Guidelines for Company Taxation (1990, hereafter 'the Guidelines') demonstrated a clear departure from the uniform approach and vision of a tax neutral Internal Market, which had been strongly present in its first harmonisation programme.[71] The Commission admitted that 'any form of company taxation is liable to bring about economic distortions (lack of neutrality) because it may give rise to decisions on the location, nature and financing of investment'.[72] The investor's choice may depend on a Member State's tax base, rate and other characteristics of the tax system and this could explain the need for the harmonisation of Member States' tax systems to safeguard 'complete tax neutrality'.[73] Discussing it further, however, the Commission concluded that the principle of subsidiarity holds back such comprehensive measures: 'Member States should remain free to determine their tax arrangements, *except* where these would lead to *major distortions*'.[74] Admitting the importance of tax neutrality, the Commission did not see the possibility of considering it to be an ultimate goal and decided to focus on the gradual elimination of key fiscal obstacles. This balancing exercise, which was described by Graetz

[69] ibid, paras 142-143.

[70] Christiane Scrivener, 'Corporate Taxation in Europe and the Single Market' (1990) 18 Intertax 207, 207.

[71] Commission, 'Programme for the Harmonisation of Direct Taxes' (1967).

[72] Commission, 'Guidelines on Company Taxation' (Communication) SEC(90) 601 final, para 3 (hereafter 'Commission, SEC(90) 601').

[73] ibid, para 4.

[74] ibid, para 5 (emphasis added).

and Warren as 'somewhat schizophrenic',[75] was inescapable. The new tax strategy acknowledged in the Guidelines fitted well into wider European debates on the division of competences between the EU and its Member States – as a result of which the principle of subsidiarity was formalised in the Treaty of Maastricht (1992).[76] Considering the lack of consensus between the Member States, the high appraisal of subsidiarity concerns was also a matter of practical necessity.

Declaring that the coordination and approximation of policies should prevail over the 'systematic use of harmonization', the Guidelines largely repeated the priorities articulated previously by the White Paper on the Internal Market (1985), namely: (i) the proposal for a directive on a common system of taxation applicable to mergers, divisions and contributions of assets involving companies from different Member States; (ii) the proposal for a directive on a common system of taxation applicable to parent companies and subsidiaries from different Member States; and (iii) the proposal for a directive introducing an arbitration procedure for eliminating double taxation in the event of the adjustment of profits between associated enterprises.[77] Drafted by the Commission at the first stage of the integration process, all three proposals were revised to have a more modest scope, and they were subsequently adopted.[78]

The new version of the Merger Directive provided the possibility of deferring capital gains taxes paid upon some cross-border transactions associated with the restructuring of groups, but it excluded the possibility of the relief (or deferral) of taxes to be paid upon the

[75] Michael J Graetz and Alvin C Warren, 'Income Tax Discrimination and the Political and Economic Integration of Europe' (2006) 115 Yale Law Journal 1186, 1228.

[76] For some reflections on the Treaty of Maastricht, which explain the historical context and changes, see a special issue of the Journal of European Integration, 'The Maastricht Treaty: Second Thoughts after 20 Years', in particular on the legitimacy problems discussed by Joseph HH Weiler, 'In the Face of Crisis: Input Legitimacy, Output Legitimacy and the Political Messianism of European Integration' (2012) 34 Journal of European Integration 825.

[77] Commission, SEC(90) 601 final, para 17-22.

[78] Refer to a brief overview in Ben JM Terra and Peter J Wattel, European Tax Law (5th edn, Wolters Kluwer Law & Business 2008) 475-477 (Parent–Subsidiary Directive), 517-518 (Merger Directive), 563-567 (EU Arbitration Convention).

transfer of immovable property between two companies located in different Member States in an exchange of shares.[79] The Parent–Subsidiary Directive dealt with the double taxation of cross-border dividend payments between parent companies and subsidiaries that meet certain substantive requirements (e.g. ownership criteria), and regulated the taxation of income received by a parent company from its foreign subsidiaries.[80] The new version of the Directive did not require a Member State to introduce an exemption method, but provided a choice between two internationally accepted practices: exemption or credit. Another important exclusion concerned the tax treatment of losses: the old version allowed optional fiscal consolidation for foreign subsidiaries by a domestic parent company, making the status of a subsidiary comparable to that of a branch. The 1976 proposal for a directive on the elimination of double taxation in the case of transfers of profits between associated enterprises in different Member States was replaced by the intergovernmental convention.[81] Unlike EU legislative acts, the EU Arbitration Convention cannot be enforced by means of EU law.[82]

The Guidelines also suggested two forthcoming proposals for closer examination, on the carry-over of losses and the withholding of taxes on interest and royalty payments between parent companies and subsidiaries.[83] These draft directives were less successful: published in 1990, they were subsequently withdrawn.[84] The Commission's initiative for the

[79] Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States [1990] OJ L225/1, later amended by Council Directive 2005/19/EC of 17 February 2005 [2005] OJ L58/19 (Merger Directive).

[80] Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [1990] OJ L225/6, later amended by Council Directive 2003/123/EC of 22 December 2003 [2004] OJ L7/41 (Parent–Subsidiary Directive).

[81] Commission, 'Proposal for a Council Directive on the Elimination of Double Taxation in connection with the Adjustment of Transfers of Profits between Associated Enterprises (Arbitration Procedure)' COM(76) 611 final [1976] OJ C301/4; Convention 90/436/EEC of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises [1990] OJ L225/10.

[82] For a detailed analysis see, eg, Ghislain TJ Joseph, 'Transfer Pricing: The EC Arbitration Convention as a Dispute Resolution Mechanism' (2002) 28:2 International Tax Journal 37.

[83] Commission, SEC(90) 601 final, para 23-26.

[84] In fact, a draft directive on losses was initially proposed in 1984 (Commission, 'Proposal for a Council Directive on the Harmonization of the Laws of the Member States relating to Tax Arrangements for the Carry-

harmonisation of corporate tax bases (1988) was never tabled due to the lack of political support.

At the same time, the Commission began to explore non-binding instruments for the purpose of stimulating cooperation on fiscal matters. Three communications were adopted: addressing the problems of international tax evasion and avoidance (1984);[85] encouraging cooperation between undertakings of different Member States through fiscal measures (1985);[86] and liberalising tax arrangements for capital movements (1989).[87] Acting upon the proposal from the Commission, the Council adopted an action plan for small to medium-sized enterprises (SMEs) in 1986.[88]

Another important development that took place at this stage was the first direct tax judgment delivered by the Court. The gateway for negative harmonisation was opened by the Commission. In 1984 France failed to amend its legislation in response to a reasoned opinion sent by the Commission in the framework of the infringement procedure, which resulted in the case being referred to Luxembourg (Case 270/83 *Avoir Fiscal*).[89] This first example did not result in a rapidly growing number of Commission referrals.[90] Enforcement actions in this

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over of Losses of Undertakings' COM(84) 404 final [1984] OJ C253/5), as amended by Commission, 'Amendments to the Proposal for a Council Directive on the Harmonization of the Laws of the Member States relating to Tax Arrangements for the Carry-over of Losses of Undertakings' COM(85) 319 final [1985] OJ C170/3 and subsequently withdrawn. The new directive had a wider coverage. See Commission, 'Proposal for a Council Directive concerning Arrangements for the Taking into Account by Enterprises of the Losses of their Permanent Establishments and Subsidiaries Situated in other Member States' COM(90) 595 final [1991] OJ C53/30, withdrawn in 2001. For the proposal on withholding taxes on interest and royalty payments see Commission, 'Proposal for a Council Directive on a Common System of Taxation Applicable to Interest and Royalty Payments Made between Parent Companies and Subsidiaries in Different Member States' COM(90) 571 final [1991] OJ C53/26, withdrawn in 1994.

[85] Commission, 'Community Action to Combat International Tax Evasion and Avoidance' (Communication) COM(84) 603 final.

[86] Commission, 'Fiscal Measures Aimed at Encouraging Cooperation between Undertakings of Different Member States' (Communication) COM(85) 360 final.

[87] Commission, 'Tax Measures to be Adopted by the Community in Connection with the Liberalization of Capital Movements' (Communication) COM(89) 60 final.

[88] Council Resolution of 3 November 1986 concerning the action programme for small and medium-sized enterprises (SMEs) [1986] OJ C287/1.

[89] Commission, '1st Annual Report on Commission Monitoring of the Application of Community Law (1983)' (Report) COM(84) 181 final, para 60.

[90] Cf Laurence W Gormley, 'The Internal Market: History and Evolution' in Nic Shuibhne (ed), *Regulating the Internal Market* (Edward Elgar 2006) 14, 17.

field remained exceptionally rare: all but the single infringement case mentioned in the first Commission's report on the application of Community law concerned indirect taxes.[91] The reports published in the 1980s even used the heading 'Customs Union and Indirect Taxation' rather than a more general 'Taxation'.[92] Member States' courts also maintained a passive position: in the 1980s only one judgment was delivered in response to the request for a preliminary ruling (Case 81/87 *Daily Mail*, referred by the High Court of Justice in England).[93]

This stage can thus be regarded as transitional: the Commission achieved a certain degree of progress towards positive harmonisation as part of its strategy to reinforce the Internal Market. It also made the first steps in involving non-binding instruments and infringement proceedings as a means of addressing fiscal obstacles. Although none of these tools became a prevailing and well-established practice at this stage, they laid the groundwork for future developments.

2.3. The Third Phase (the 1990s): The Increasing Role of Article 267 TFEU in the Field of Direct Taxation

When the priority measures were adopted in 1990, the Commission asked the Ruding Committee to explore the possibilities for further tax integration. This committee of experts

[91] The first direct tax infringement case was reported under the category 'Bank, Insurance, etc' rather than 'Taxation', which was used for indirect tax cases. In paras 73-74, the report stated that 'on taxation generally, the Commission decided to transmit reasoned opinions in 17 cases in which Member States have failed to meet their obligations. Of these cases, ten relate to the incorrect application of the sixth VAT Directive and seven to infringements of Article 95 of the EEC Treaty'.

[92] See Commission, '2nd Annual Report on Commission Monitoring of the Application of Community Law (1984)' (Report) COM(85) 149 final; Commission, '3rd Annual Report on Commission Monitoring of the Application of Community Law (1985)' (Report) COM(86) 204 final; Commission, '4th Annual Report on Commission Monitoring of the Application of Community Law (1986)' (Report) COM(87) 250 final; Commission, '5th Annual Report on Commission Monitoring of the Application of Community Law (1987)' (Report) COM(88) 425 final; Commission, '6th Annual Report on Commission Monitoring of the Application of Community Law (1988)' (Report) COM(89) 411 final; Commission, '7th Annual Report on Commission Monitoring of the Application of Community Law (1989)' (Report) COM(90) 288 final.

[93] Case 81/87 *Daily Mail* [1988] ECR 5483.

was asked to examine if the existing differences in corporate income taxation, particularly in relation to corporation tax rates, cause distortions of competition and investment decisions, and whether any special measures are required at the EU level to eliminate these distortions.[94] If a need for action were found, the experts were to suggest measures that should be taken (e.g. addressing the differences in tax bases or rates) and to specify how far these measures should go (e.g. harmonisation, approximation or the establishment of a uniform framework).[95]

The Ruding Report (1992) was drafted in line with the shift towards minimum harmonisation that could be observed in the EU.[96] It concluded that tax measures should be limited to those addressing the major market distortions, allowing Member States to maintain flexibility in exercising their taxing competences. The Ruding Committee recommended focusing on three objectives: (i) to remove discriminatory practices that hamper cross-border investment and shareholding; (ii) to introduce measures promoting the transparency of tax incentives; and (iii) to adopt the minimum level of corporate tax rates and harmonise the income tax bases in order to eliminate harmful tax competition.[97] The Commission accepted only some of these recommendations, refusing the proposals that had no realistic prospects of gaining political support, such as the harmonisation (even to a minimum extent) of corporate tax rates.[98] The Council's response to the Ruding Report emphasised the importance of the

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[94] Commission, *Conclusions and Recommendations of the Committee of Independent Experts on Company Taxation* (Office for Official Publications of the European Communities 1992) (Ruding Report).

[95] ibid.

[96] For more about this tendency see, eg, Paul Craig, 'The Evolution of the Single Market' in Catherine Barnard and Joanne Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Hart Publishing 2002) 1, 25; Michael Dougan, 'Minimum Harmonization and the Internal Market' (2000) 37 Common Market Law Review 853 (and other sources cited); Stephen Weatherill, 'Maximum versus Minimum Harmonisation: Choosing between Unity and Diversity in the Search for the Soul of the Internal Market' in Niamh Nic Shuibhne and Laurence W Gormley (eds), *From Single Market to Economic Union* (OUP 2012) 175. In the tax context see, eg, Charles E McLure, 'Coordinating Business Taxation in the Single European Market: The Ruding Committee Report' (1992) 1 EC Tax Review 13.

[97] The Ruding Report (1962), part III.

[98] Commission, 'Subsequent to the Conclusions of the Ruding Committee Indicating Guidelines on Company Taxation Linked to the further Development of the Internal Market' (Communication) SEC(92) 1118 final. See also Commission, 'Proposal for a Council Directive amending Directive 90/434/EEC of 23 July 1990 on the Common System of Taxation Applicable to Mergers, Divisions, Transfers of Assets and Exchanges of Shares concerning Companies of Different Member States' [1993] OJ C225/3; Commission, 'Proposal for a Council Directive amending Directive 90/435/EEC of 23 July 1990 on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States' [1993] OJ C225/5.

principle of subsidiarity and the fiscal sovereignty of Member States,[99] and the Parliament further echoed these concerns.

In March 1996 the Commission prepared a review of the remaining fiscal obstacles for the Informal Meeting of the Council of Ministers for Economics and Finance (ECOFIN), where it acknowledged that the Single Market required some additional steps to be taken.[100] The review emphasised the shortcomings of cross-border economic liberalisation and national autonomy over fiscal matters. One of the key objectives of the White Paper on the Internal Market (1985) was the stimulation of competition: 'ensuring that the market is flexible so that resources, both of people and materials, and of capital and investment, flow into the areas of greatest economic advantage.'[101] In 1996 the Commission warned that tax competition between Member States had intensified as a result of the liberalisation of capital movements and the lack of accompanying tax measures.[102]

To find an acceptable solution to this problem, the Council created a high-level tax group under the coordination of Mario Monti.[103] The group was advised not to 'seek harmonisation of taxation systems for harmonisation's sake' and to take due account of the principles of subsidiarity and proportionality.[104] In response, the Monti Report (1996) proposed 'a new European fiscal strategy', which was based upon the combination of binding and non-binding measures. The Monti Package consisted of legislative proposals on the tax treatment of interest, royalties and savings in cross-border situations, as well as a non-binding

[99] ECOFIN Council Meeting Conclusions of 23 November 1992 (1621st Council Meeting).

[100] Commission, 'Taxation in the European Union' (Discussion Paper for the Informal Meeting of ECOFIN Ministers) SEC(96) 487 final.

[101] Commission, 'White Paper on Completing the Internal Market' (Communication) COM(85) 310 final, para 8.

[102] Confirmation can be found in a number of economic studies such as Michael Devereux and others, 'Do Countries Compete over Corporate Tax Rates?' (2008) 92 Journal of Public Economics 1210; Hannes Winner, 'Has Tax Competition Emerged in OECD Countries? Evidence from Panel Data' (2005) 12 International Tax and Public Finance 667. On the positive aspects of regulatory competition see Jeanne-Mey Sun and Jacques Pelkmans, 'Regulatory Competition in the Single Market' (1995) 33 Journal of Common Market Studies 67, 82-83.

[103] ECOFIN Council Meeting Conclusions of 13 April 1996 (informal meeting).

[104] Commission, 'Taxation in the European Union: Report on the Development of Tax Systems' (Report) COM(96) 546 final, para 6.2.

instrument, the Code of Conduct for Business Taxation, which addressed the problem of harmful tax competition.[105] This regulatory approach should not be considered in isolation from developments in other policy areas: the evolution of the Single Market was developing towards an effective combination of binding and non-binding measures contributing to the same policy goal.[106] In 1996 the Commission published a general report on the impact and effectiveness of the Single Market, which was followed by an inventory of steps required by 1 January 1999.[107] The Commission's action plan (1997) mentioned the Monti Package among the priority measures.[108] The debate during the Internal Market Councils (March and May 1997) demonstrated that the tax package was considered to be 'too ambitious' and, as Mortelmans noted: '[i]t could already be inferred from the cautious reaction of the Internal Market Council to the Commission's proposals on taxation that the European Council would not show much initiative on this point.'[109] Indeed, although the Amsterdam European Council supported the action plan,[110] the direct tax initiatives, with the exception of the Code of Conduct for Business Taxation that was adopted by ECOFIN in 1997, were delayed.[111]

With very limited success in positive harmonisation, the third period was characterised by the increasing role of the Court.[112] The vast majority of cases were referred to Luxembourg

[105] Commission, 'Towards Tax Co-ordination in the European Union – A Package to Tackle Harmful Tax Competition' (Communication) COM(97) 495 final.

[106] See, eg, Paul Craig, 'The Evolution of the Single Market' in Catherine Barnard and Joanne Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Hart Publishing 2002) 1, 31.

[107] Commission, 'Impact and Effectiveness of the Single Market' (Communication) COM(96) 520 final; Commission, 'The 1996 Single Market Review' (Staff Working Paper) SEC(96) 2378.

[108] Commission, 'Action Plan for the Single Market (1997–1999)' (Communication) CSE(97)1 final.

[109] Mortelmans then concluded that the progress in relation to the four priority targets set by the Action Plan was different: some proposals were adopted without delay, i.e. mainly target 1 (effective rules) and 3 (sectoral distortions to market integration), while others were much less successful, i.e. target 2 (tax barriers and anticompetitive behaviour harmonisation) and target 4 (liberalisation of service markets). See Kamiel Mortelmans, 'The Common Market, the Internal Market and the Single Market, What's in a Market?' (1998) 35:1 Common Market Law Review 101, 114 and 135.

[110] European Council Conclusions of 16–17 June 1997, point 8.

[111] ECOFIN Council Meeting Conclusions of 1 December 1997 concerning taxation policy (Annex 1: Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997 on a code of conduct for business taxation) [1998] OJ C2/1. The Interest and Royalty Payments Directive and the Savings Taxation Directive were only adopted in 2003.

[112] Notably, Miguel P Maduro, *We the Court: The European Court of Justice and the European Economic Constitution: A Critical Reading of Article 30 of the EC Treaty* (Hart Publishing 1998).

by national courts, making Article 267 TFEU a dominant tool of tax integration. The Commission was inert in using its enforcement powers: by 2001 only three judgments were delivered under the infringement procedure framework.[113] The number of investigated cases was low: in 1999, for instance, the Commission issued only two reasoned opinions on direct taxation.[114]

This stage demonstrated that the effectiveness of regulation in the EU was no longer associated with the uniformity of legislative harmonisation, but was considered to require a more complex combination of binding and non-binding instruments. Considering the limited success beyond the non-binding domain, the Commission passed the leading role in this field to the Court.

2.4. The Fourth Phase (the 2000s): Strengthening the Alternative Regulatory Tools – A More Proactive Enforcement Strategy and Non-Binding Coordination

The regulatory aspect became one of the central issues discussed in the Communication 'Tax Policy in the European Union – Priorities for the Years Ahead' (2001).[115] The Commission stated that the ambitious Lisbon Agenda required tax policy to be considered with 'a new perspective', which would entail more effective tools for policy delivery.[116] Rejecting the need for broad tax harmonisation measures, the Commission concluded that the mobility of tax bases needed 'a certain degree of co-ordination' to eliminate the remaining obstacles to

[113] Based on DG TAXUD, 'CJEU Cases in the Area of, or Particular Interest for, Direct Taxation' (updated to 22 October 2012) <http://ec.europa.eu/taxation_customs/resources/documents/common/infringements/case_law/court_cases_direct_taxation_en.pdf> accessed 5 November 2012.

[114] Commission, '17th Annual Report on Monitoring the Application of Community Law (1999)' [2001] OJ C30/1, 24-25.

[115] Commission, COM(2001) 260 final.

[116] ibid, section 2.1. The substantive policy priorities included tackling tax obstacles for cross-border economic activities, combating harmful tax competition and promoting closer cooperation between tax administrations.

the Internal Market, particularly double taxation and unintentional non-taxation.[117] Four potential tools were discussed: legislative acts, enforcement actions, 'soft legislation' and enhanced cooperation.[118] In relation to the legislative process, the Commission expressed the view that a qualified majority voting system should be introduced for certain tax matters, in particular those creating severe distortions to the freedom of movement. But since the prospect of this procedural change was questionable, the Communication focused on strengthening the Commission's role as guardian of the Treaties, broadening the range of policy instruments and making the use of variable geometry under Article 20 TEU.[119] The main emphasis was put on better compliance and coordination.[120]

The enhanced role of infringement proceedings was associated with making the Commission's actions more targeted, in particular through the proactive initiation of its own cases, which were exceptionally rare compared with the infringement files opened in response to complaints from citizens and businesses. The need for a more rigorous approach was explained as follows. First, the Commission noted that the increased number of requests for preliminary rulings indicated that the level of non-compliance was high. The market-led integration, where the development of case law was left in the expectation that the matter of EU law would be raised by litigants, was criticised as the wrong way to ensure stable progress towards the agreed Community objectives. Second, the Commission was facing an 'asymmetrical' effect of the Court's case law.[121] Due to the differences in national tax systems, the application of judgments was often uncertain and many Member States were adjusting their laws to ensure better compliance with EU requirements 'in vastly differing

[117] EU Member States 'are free to choose the tax systems that they consider most appropriate and according to their preferences' (ibid, section 2.4).

[118] ibid, section 4.

[119] ibid.

[120] For an analysis see, eg, Alexander Fortuin, 'The Influence of European Law on Direct Taxation – Recent and Future Developments' (2007) 47 European Taxation 144.

[121] Communication, COM(2001) 260 final, section 4.2.

ways'.[122] As guardian of the Treaties, the Commission was foremost concerned with the proper implementation of case law, particularly in relation to rulings with wide horizontal importance.

The non-legislative approach (so-called 'soft legislation') was considered as another route for taking cooperation in the field of direct taxation to a new level. As discussed earlier, these instruments had been in limited use for the purpose of direct tax policies before 2001. The Commission stated that non-binding instruments (e.g. communications, recommendations, guidelines and interpretative notices) could explain the application of EU law in a specific context, contributing to better compliance. As a follow-up to the Court rulings, these instruments could offer new policy solutions if the existing tax provisions were found to infringe EU law, and could thus contribute to more coordinated responses from Member States. Soft law could also fulfil a preventive function by communicating potential legal conflicts between national tax provisions and EU law, and identifying ways of resolving them without costly litigation. This approach, however, was not considered to have a universal scope. The Commission mentioned that non-binding instruments could be appropriate in cases with firm legal foundations, such as treaty provisions and the Court's jurisprudence. In other cases, soft law could consume substantial resources without making an evident difference due to the lack of direct enforceability.

The regulatory agenda with regard to tax matters corresponded with the notes contained in the programme documents defining the strategy of the Single Market. As the process of integration advanced, the Commission's attention shifted from the elimination of barriers to making the Single Market operate more efficiently and enhancing the competitiveness of the European economy.[123] All three generations of the Single Market's programme documents, which covered the period from 1999 to 2009, devoted substantial attention to effective policy

[122] ibid.

[123] Commission, 'The Strategy for Europe's Internal Market' (Communication) COM(1999) 624 final.

delivery.[124] The new strategy continued the move from systematic legislative harmonisation to a fuller integration of non-binding instruments.[125] According to the Commission, this approach reflected 'the characteristics of a more mature Internal Market'.[126]

The White Paper on European Governance (2001), which set the direction for changes in EU policymaking, also reflected this regulatory tendency.[127] Its key targets included: (i) a wider and more coherent use of different policy tools, particularly non-legislative instruments, either to complement a legislative approach or to encourage cooperation and progress towards common targets in those policy areas 'where there is little scope for legislative solutions'; (ii) more effective enforcement strategies based on clear selection criteria, allowing a focus on priority cases; and (iii) a higher quality of drafting ensured by minimum consultation standards and the impact assessment of legislative and policy proposals.[128]

In 2006 the Communication 'A Citizens' Agenda – Delivering Results for Europe' called for 'a fundamental review' of the Single Market.[129] The key 'modernisation' message for 2006–2009 concerned the choice of regulatory instruments: the Commission's 'toolbox' should be more strategic (to engage the most suitable tool) and flexible (to accommodate differences between Member States and changes over time).[130] The Staff Working Document 'Instruments for a Modernised Single Market Policy', which accompanied the Communication 'A Single Market for 21st Century Europe' (2007), defined specific

[124] Communication, 'The Strategy for Europe's Internal Market' (Communication) COM(1999) 624 final; Commission, 'Internal Market Strategy – Priorities 2003–2006' (Communication) COM(2003) 238 final; Commission, 'A Single Market for 21st Century Europe' (Communication) COM(2007) 724 final.

[125] For more see Nick Bernard, 'Flexibility in the European Single Market' in Catherine Barnard and Joanne Scott (eds), *The Law of the Single Market: Unpacking the Premises* (Hart Publishing 2002) 101; Paul Craig, 'The Evolution of the Single Market' in Catherine Barnard and Joanne Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Hart Publishing 2002) 1, 31.

[126] Commission, 'The Strategy for Europe's Internal Market' (Communication) COM(1999) 624 final.

[127] Commission, 'White Paper on European Governance' (Communication) COM(2001) 428 final (hereafter 'Commission, COM(2001) 428 final').

[128] ibid, section 3.2.

[129] Commission, 'A Citizens' Agenda – Delivering Results for Europe' (Communication) COM(2006) 211 final.

[130] Commission, 'A Single Market for 21st Century Europe' (Communication) COM(2007) 724 final, section 1.

recommendations for the better use of non-binding tools and enforcement powers.[131] In 2009 the Commission published a set of measures that could further improve the functioning of the Single Market.[132] It emphasised the importance of strengthening enforcement policies and alternative problem-solving tools (e.g. SOLVIT and EU Pilot), as well as communication policies, particularly through interpretative communications. This brief overview illustrates the post-1999 shift from 'what' (recognising the direction for the requisite substantive changes) to 'how' (providing measures to ensure that existing laws are correctly transposed, applied, enforced and monitored).

In the view of these priorities, it does not come as a surprise that the scope of legislative changes in the field of direct taxation was modest. The Strategy for Europe's Internal Market for 1999–2003 stressed the importance of the legislative component of the Monti Package.[133] The annual reviews published in 2000–2002 confirmed that the 'tax package' was vital, but the deadline was postponed.[134] Both directives were adopted only in 2003.[135] The Internal Market Strategy for 2003–2006 included two sets of priority tax measures.[136] The short-term goals included the revision of the Parent–Subsidiary and Merger Directives, which were agreed in 2003 and 2005 respectively. As a long-term strategy, the Commission focused on

[131] Commission, 'Instruments for a Modernised Single Market Policy' (Communication) SEC(2007) 1518 final accompanying ibid.

[132] Commission Recommendation of 29 June 2009 on measures to improve the functioning of the single market [2009] OJ L176/17.

[133] Commission, 'The Strategy for Europe's Internal Market' (Communication) COM(1999) 624 final; see also Commission, 'Company Taxation in the Internal Market' (Staff Working Paper) SEC(2001) 1681 final.

[134] Commission, '2000 Review of the Internal Market Strategy' (Communication) COM(2000) 257 final; Commission, '2001 Review of the Internal Market Strategy – Working Together to Maintain Momentum' (Communication) COM(2001) 198 final; Commission, '2002 Review of the Internal Market Strategy – Delivering the Promise' (Communication) COM(2002) 171 final.

[135] Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments [2003] OJ L157/38 (Saving Directive); Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49 (Interest and Royalty Directive).

[136] Commission, 'Internal Market Strategy – Priorities 2003–2006' (Communication) COM(2003) 238 final, followed by two subsequent implementation reports: Commission, 'Report on the Implementation of the Internal Market Strategy (2003–2006)' (Communication) COM(2004) 22 final and 'Second Implementation Report of the Internal Market Strategy 2003–2006' (Communication) COM(2005) 11 final.

the CCCTB and the 'Home State Taxation' pilot scheme for SMEs.[137] The Single Market Strategy for 2006–2009 retained these long-term objectives: the Commission confirmed its intention to tackle the fragmentation of the Single Market through the CCCTB proposal and to further examine how the cross-border operation of SMEs is affected by tax policies.[138]

Thus, to respond to the increasing number of requests for preliminary rulings from domestic courts to the Court, the Commission declared that it should intervene more effectively in the field of direct taxation. The choice of a proactive enforcement strategy and non-binding coordination reflected the general regulatory tendencies in the Single Market strategy for 1999–2009.

2.5. The Fifth Phase (beyond 2009): Towards a New Differentiated Model of Tax Integration?

In 2009 the new Barosso Commission relaunched the Single Market as a strategic objective that had to be pursued 'with renewed political determination'.[139] Mario Monti was asked to prepare a report that would answer 'whether, and how, the single market may be turned from a perception of being "yesterday's business" into a key political priority, to meet the growing challenges of European integration.'[140] The Monti Report (2010) did not propose any revolutionary changes in relation to tax policies. It argued for stricter enforcement of the Single Market requirements and further progress with tax coordination measures to stimulate market integration. Tax coordination was praised as being able to 'safeguard national tax

[137] Commission, 'Towards an Internal Market without Tax Obstacles – A Strategy for Providing Companies with a Consolidated Corporate Tax Base for their EU-wide Activities' (Communication) COM(2001) 582 final.

[138] Commission, 'The Single Market: Review of Achievements' (Staff Working Document) SEC(2007) 1521 final accompanying 'A Single Market for 21st Century Europe' (Communication) COM(2007) 724 final.

[139] José Manuel Barosso, 'Political Guidelines for the Next Commission' (3 September 2009).

[140] Mario Monti, 'A New Strategy for the Single Market' (9 May 2010) (Monti Report), section 1.1.

sovereignty as market integration proceeds'.[141] The idea of tax harmonisation was rejected again.[142]

Following the Monti Report, the Commission published the Single Market Act (2011) to relaunch the Single Market by its 20th anniversary and to contribute to the objectives of the Europe 2020 Strategy.[143] The Commission's focus shifted back from the instruments delivering effective policies to the substantive policy targets. The Single Market Act defined 12 priority projects for the coming 18 months. In the field of direct taxation, it highlighted the legislative proposal for a CCCTB and non-legislative measures addressing cross-border taxation problems for citizens.[144] The Single Market Act II, presented in October 2012, did not include any new substantive items on direct taxation.[145]

The Commission's proposal for the CCCTB Directive was published in March 2011. However, its adoption under Article 115 TFEU, which requires a unanimity voting in the Council, remains doubtful.[146] In April 2012 the CCCTB proposal was approved with some amendments by the Parliament following the consultation procedure. The Parliament explicitly stated that the alternative procedural arrangement with the limited participation of Member States should be initiated 'without delay' once it is confirmed by the Council that the legislative proposal lacks the political support of all governments.[147] The first application of the enhanced cooperation in already on its way in relation to the tax initiative proposed under Article 113 TFEU. In October 2012, when 10 Member States had officially expressed their willingness to establish closer cooperation, the Council gave a green light to Article 20 TEU

[141] ibid, see 'Executive Summary'.

[142] ibid.

[143] Commission, 'Europe 2020: A Strategy for Smart, Sustainable and Inclusive Growth' (Communication) COM(2010) 2020 final.

[144] Commission, 'Single Market Act: Twelve Levers to Boost Growth and Strengthen Confidence "Working together to Create New Growth"' (Communication) COM(2011) 206 final, section 2.9.

[145] Commission, 'Single Market Act II: Together for New Growth' (Communication) COM(2012) 573 final.

[146] See, eg, Christiana HJI Panayi, 'The Common Consolidated Corporate Tax Base and the UK Tax System' [2011] 9 The Institute for Fiscal Studies TLRC Discussion Paper, point 2.1.14.

[147] European Parliament Legislative Resolution 2011/0058(CNS) of 19 April 2012 on the proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB).

as ‘a last resort’ option for introducing a financial transactions tax (FTT).[148] The resolution of the Parliament was adopted in December 2012.[149] The Commission is preparing a substantive proposal, which should be adopted by a qualified majority in the Council. So far, Article 20 TEU has been relied upon only twice (in relation to bi-national divorce and EU patents), which makes the field of direct taxation one of the potential frontrunners in the application of this procedure.

In the non-binding tax coordination domain, several communications have been issued to address the cross-border taxation problems for citizens.[150] Important developments in this direction were introduced in response to the financial crisis in the eurozone: Member States agreed upon a closer coordination of their budgetary and economic policies through a new model of governance, ‘the European Semester’ (2010).[151] Assessing the first annual cycle, the European Council concluded that it should integrate a ‘pragmatic coordination of tax policies’, particularly ‘to ensure the exchange of best practices, avoidance of harmful practices, and proposals to fight fraud and tax evasion’.[152] In November 2011 the Commission published the Annual Growth Survey (AGS), which included the Annex on Growth-Friendly Tax Policies in Member States and Better Tax Coordination in the EU.[153] This step established an *ex ante* coordination of tax policies by setting guidance for Member States’ tax

[148] See Commission, IP/12/1138; confirmed in Council Decision 2013/52/EU of 22 January 2013 authorising enhanced cooperation in the area of financial transaction tax [2013] OJ L22/11.

[149] European Parliament Legislative Resolution 2012/0298(APP) of 12 December 2012 on the proposal for a Council Decision authorising enhanced cooperation in the area of the creation of financial transaction tax. The participating Member States include Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain.

[150] Commission, ‘Removing Cross-Border Tax Obstacles for EU Citizens’ (Communication) COM(2010) 769 final; Commission, ‘Double Taxation in the Single Market’ (Communication) COM(2011) 712 final; Commission, ‘Tackling Cross-Border Inheritance Tax Obstacles within the EU’ (Communication) COM(2011) 864 final; Commission Recommendation 2011/856/EU of 15 December 2011 regarding relief for double taxation of inheritances [2011] OJ L336/81; Commission, ‘Non-Discriminatory Inheritance Tax Systems: Principles Drawn from EU Case-Law’ (Staff Working Paper) SEC(2011) 1488 final.

[151] Commission, ‘Enhancing Economic Policy Coordination for Stability, Growth and Jobs – Tools for Stronger EU Economic Governance’ (Communication) COM(2010) 367/2.

[152] European Council Conclusions of 23–24 June 2011, point 6.

[153] Commission, ‘Growth Friendly Tax Policies in Member States and Better Tax Coordination’ (Annex IV to the Annual Growth Survey 2012) COM(2011) 815 final.

reforms.[154] The existing coordination model under the European Semester distinguishes between those countries that participate in the Euro Plus Pact (eurozone countries plus Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania) and those countries that have chosen not to sign up (the Czech Republic, Hungary, Sweden and the United Kingdom).[155]

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, concluded on 2 March 2012, reflects the direction of these developments.[156] It sets the strengthening of the coordination of economic policies as one of its key objectives (Article 1 TSCG). Although it has no explicit references to tax policies, the Treaty declares a readiness to 'make active use (…) of enhanced cooperation' (Article 10 TSCG) and to 'ensure that all major economic policy reforms that they plan to undertake will be discussed ex-ante and, where appropriate, coordinated among themselves' (Article 11 TSCG). The Treaty, which is currently waiting for ratification, differentiates between 17 eurozone countries and eight contracting parties 'other than those whose currency is the euro'. Two Member States did not sign up to the Treaty: the United Kingdom and the Czech Republic.

To sum up, the progress towards the use of an enhanced cooperation procedure in the area of tax and the differentiation between Member States at the level of tax coordination measures, which emerged at this stage, demonstrates a decisive shift to a differentiated model of European tax integration.[157] This development does not come across as surprising: EU law scholars found 'a positive correlation between those policy areas that require unanimity and their level of pressure for differentiated integration.'[158] This tendency closely resembles the processes taking place in other policy fields: the last decade has clearly been dominated by a

[154] Communication, 'Annual Growth Survey 2013' (Communication) COM(2012) 750 final, section 1. For an outline of key tax-related issues also refer to Commission, MEMO/12/915.

[155] The differences are not discussed in this study, but, for instance, eurozone countries annually present stability programmes, while Member States that do not belong to the eurozone present convergence programmes.

[156] Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (2012). To be effective, the Treaty has to be ratified.

[157] More generally on the shift from uniformity to flexibility see Gráinne de Búrca and Joanne Scott (eds), *Constitutional Change in the EU: From Uniformity to Flexibility?* (Hart Publishing 2000).

[158] Jan-Emmanuel de Neve, 'The European Onion? How Differentiated Integration is Reshaping the EU' (2007) 29 Journal of European Integration 503, 508.

tendency towards the use of non-binding instruments and minimum harmonisation, based on the high appraisal of subsidiarity and flexibility concerns.[159] Yet, the limited scope of legislative harmonisation in this field, combined with the proactive use of flexible policy tools, makes direct taxes a critical example of 'unity in diversity'.

2.6. Interim Conclusion

This section has demonstrated how the Commission's regulatory approaches have evolved. The process of direct tax harmonisation has gone through five stages. The first stage (from the 1960s to the mid-1980s) can be characterised by the move from the maximum harmonisation model to a more limited focus on the priority measures. During the second stage (from the mid-1980s to 1992), the Commission took the steps required for the reinforcement of the Internal Market, which resulted in a breakthrough in legislative harmonisation. The third stage (the 1990s) brought significant development in the role played by the Court. Towards the end of the decade, Article 267 TFEU became the dominant form of harmonisation in the field of direct taxation. During the fourth stage (the 2000s), the Commission actively sought alternative tools to stimulate European tax integration, choosing to rely on infringement proceedings and non-binding coordination. Finally, the crisis in the eurozone has forced closer cooperation between the 'core' countries, completing the shift towards the differential model of direct tax integration (post-2009).

Two conclusions are to be made. First, the history of EU direct tax integration demonstrates a departure from the idea of homogeneous regulation towards a multidimensional flexibility of integration process. This change could be considered as a U-turn in the vision: the initial proposals of tax harmonisation, which were presented in the

[159] For further analysis see, eg, Dominik Hanf, 'Legal Concept and Meaning of the Internal Market' in Jacques Pelkmans and others (eds), *The EU Internal Market in Comparative Perspective: Economic, Political and Legal Analyses* (PIE Peter Lang 2008) 77.

Neumark Report (1962), only briefly acknowledged the possibility of differentiated measures.[160] Second, from the late 1990s, the field of direct taxation has been dominated by negative harmonisation initiated under Article 267 TFEU. In response, the Commission has demonstrated its intention to play a more active role through the involvement of alternative regulatory tools.

Setting the general context of the European harmonisation process in the field of direct taxation, Part II has answered the question as to *how* the attention of the Commission moved towards alternative regulatory tools. Before the infringement procedure and non-binding instruments are assessed in greater detail, this study discusses some specific problems created by the dominance of Article 267 TFEU in the process of direct tax integration, which the Commission used to explain *why* these alternative regulatory instruments might be needed for a more balanced tax integration.

3. The Drawbacks of Article 267 TFEU as a Primary Route to the Establishment and Smooth Functioning of the Internal Market

Negative harmonisation allows the elimination of barriers that hinder the freedom of cross-border movement and interfere with the principle of non-discrimination. As Weatherill puts it, '[t]he more that national barriers are, first, vulnerable to attack and, second, ruled unjustified under the law of free movement, the greater the scope for deregulation and inter-jurisdictional competition under the framework of "negative law", and the less extensive the need for harmonisation.'[161] However, the ability of the judiciary to fill in the legislative gap remains

[160] '[T]he recommended measures of harmonisation must, even over the long term, leave the Member State (…) sufficient room for manoeuvre to take, if necessary, differentiated measures to influence their economies in the framework of the Community policy'. See Neumark Report (1962) 102.

[161] Stephen Weatherill, 'Supply of and Demand for Internal Market Regulation: Strategies, Preferences and Integration' in Niamh Nic Shuibhne (ed), *Regulating the Internal Market* (Edward Elgar Publishing 2006) 29, 30.

limited.[162] It is widely accepted that 'the courts cannot by themselves achieve full integration'.[163] To achieve 'a true common market', case law should be supplemented by positive harmonisation measures.[164] Besides, the Court depends on external actors to lodge the case and to ensure the enforcement of its judgments.

This section considers these theoretical arguments in the context of direct tax harmonisation. It covers some selected procedural and substantive problems, which the Commission used as an argument for explaining the need for the proactive involvement of the infringement procedure and non-binding instruments. Although Article 267 TFEU and 258 TFEU share similar problems as forms of negative harmonisation, they require a more nuanced analysis at the level that differentiates their roles in the legal system. A theoretical discussion is supported by the case law of the Court on the cross-border transfer of losses and exit taxation. These two examples will be examined in detail in Parts III and IV in the course of the evaluation of the Commission's enforcement actions and non-binding measures that were called to balance the implications of Article 267 TFEU.

3.1. Procedural Limitations

3.1.1. The Market-Led Harmonisation Path under Article 267 TFEU

Since the EU judicial architecture has a decentralised nature and the Court cannot open cases on its own initiative, the flow of case law under Article 267 TFEU is shaped by litigation at

[162] Adam Zalasiński, 'Contribution of Infringement Procedures to European Tax Integration' in Dennis Weber (ed), *Traditional and Alternative Routes to European Tax Integration* (IBFD 2010) 117, 126-127; see also Dominik Hanf, 'Legal Concept and Meaning of the Internal Market' in Jacques Pelkmans and others (eds), *The EU Internal Market in Comparative Perspective: Economic, Political and Legal Analyses* (PIE Peter Lang 2008) 77.

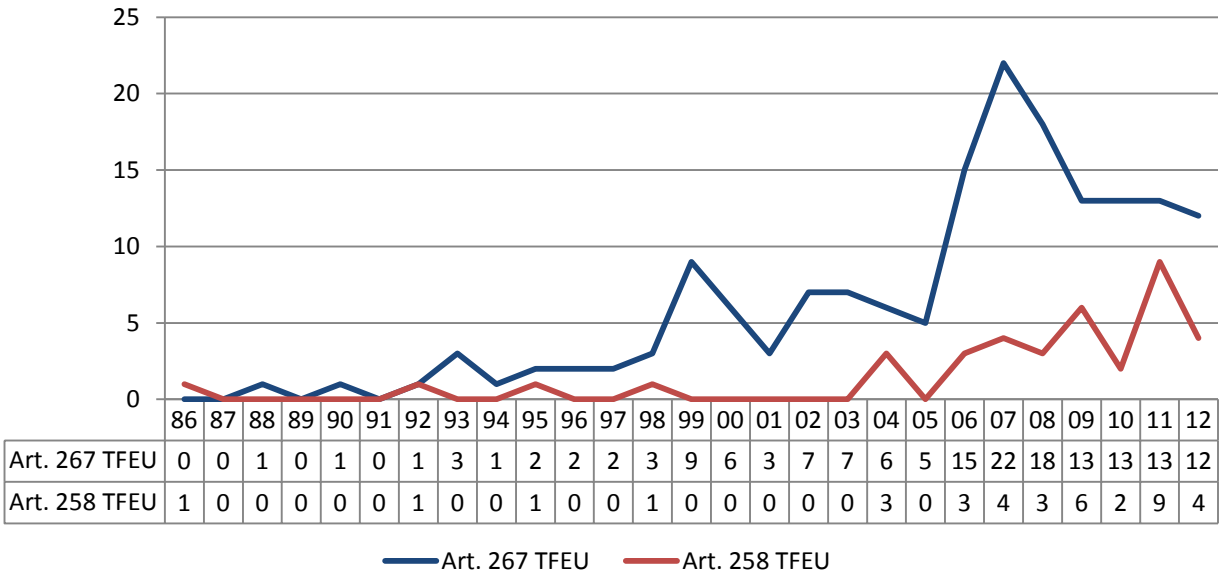
[163] Alex Easson, 'Legal Approaches to European Integration: The Role of Court and Legislator in the Completion of the European Common Market' (1989) 12 Journal of European Integration 101, 114 and the sources cited.

[164] Paul Craig, 'The Evolution of the Single Market' in Catherine Barnard and Joanne Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Hart Publishing 2002) 1, 3 (citations omitted).

the national level, particularly by Member States' courts. The state of cooperation between the Court and national-level courts not only reflects the authority of EU law, but also defines its future development. The cultivation of judicial dialogue is thus of extreme importance.

The Court has been persuasively establishing its jurisdiction in the field of direct taxation since the mid-1980s. As mentioned in Part I Section 1, the first direct tax case was referred by the Commission. The national courts of Member States were slow in accepting the authority of EU law: until the late 1990s, the Court was annually delivering no more than three direct tax judgments under Article 267 TFEU. Diagram 1 shows that this figure had an increasing pattern, reaching a peak of 26 judgments decided by the Court in 2007. Since then, the annual number of preliminary rulings has been continually dropping. Considering the enlargement of the EU, these falling figures are even more convincing. Since the vast majority of pending cases are recent, this trend cannot be explained by the slowdown in the procedure: apparently, the national courts have referred fewer cases.

Diagram 1. The Dynamics of Direct Tax Judgments Delivered by the Court (1986–2012)[165]



	86	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06	07	08	09	10	11	12
Art. 267 TFEU	0	0	1	0	1	0	1	3	1	2	2	2	3	9	6	3	7	7	6	5	15	22	18	13	13	13	12
Art. 258 TFEU	1	0	0	0	0	0	1	0	0	1	0	0	1	0	0	0	0	0	3	0	3	4	3	6	2	9	4

[165] Based on DG TAXUD, 'CJEU Cases in the Area of, or Particular Interest for, Direct Taxation' (updated to 22 October 2012) <http://ec.europa.eu/taxation_customs/resources/documents/common/infringements/case_law/court_cases_direct_taxation_en.pdf> accessed 5 November 2012.

The requests for preliminary rulings are asymmetrically spread between Member States: while some national courts in the EU cooperate more willingly, others resist endangering domestic tax laws. Depending on the dynamics of judicial cooperation, all countries can be classified into four categories (see Table 1). The first category refers to the 'active multilevel players': those Member States that have submitted more than 10 requests for preliminary rulings in direct tax cases since 1986. Five countries satisfy this criterion: Germany (43), Belgium (29), the Netherlands (25), France (14) and the United Kingdom (12). In total, more than half of the direct tax cases have been referred by these Member States. The second category includes 'occasional multilevel players' with over five referrals: Luxembourg (9), Austria (7), Sweden (7), Finland (6) and Portugal (5). The third category refers to the old Member States that are reluctant to get involved in a judicial dialogue in the field of direct taxes. These are predominantly southern European countries, such as Italy (3), Greece (2) and Spain (1), but also include Denmark (3) and Ireland (0). The fourth and final category groups the 'newcomers', referring to the new Member States that cannot be compared to the EU-15. In most cases, these countries have made no or very few referrals. Poland and Hungary appear to be the most active newcomers, with three references made by each country since the enlargement.

Table 1. CJEU Cases in the Area of Direct Taxation by Country *(as of 22 October 2012)*[166]

Category	Member State	Article 267 TFEU		Total	Articles 258 and 260 TFEU		Total
		Completed	Pending		Completed	Pending	
Active	Germany	43	4	47	4	1	5

[166] Based on DG TAXUD, 'CJEU Cases in the Area of, or Particular Interest for, Direct Taxation' (updated to 22 October 2012) <http://ec.europa.eu/taxation_customs/resources/documents/common/infringements/case_law/court_cases_direct_taxation_en.pdf> accessed 5 November 2012.

multilevel players	Belgium	24	4	28	7	3	10
	Netherlands	25	2	27	1	1	2
	France	12	2	14	2	1	3
	United Kingdom	12	3	15	0	0	0
Occasional players	Luxembourg	9	0	9	1	0	1
	Austria	7	0	7	2	2	4
	Sweden	7	0	7	1	0	1
	Finland	6	3	9	0	1	1
	Portugal	5	1	6	6	0	6
Passive players, EU-15	Denmark	3	0	3	1	1	2
	Italy	3	2	5	2	0	2
	Greece	2	0	2	3	0	3
	Spain	1	0	1	6	3	9
	Ireland	0	0	0	0	0	0
Newcomers	Poland	2	1	3	0	0	0
	Hungary	1	2	3	1	0	1
	Bulgaria	0	0	0	0	0	0
	Cyprus	0	0	0	0	0	0
	Czech Republic	0	0	0	0	0	0
	Estonia	0	0	0	1	0	1
	Latvia	0	0	0	0	0	0
	Lithuania	0	0	0	0	0	0
	Malta	0	0	0	0	0	0
	Romania	0	0	0	0	0	0
	Slovakia	0	0	0	0	0	0
	Slovenia	1	0	1	0	0	0

The willingness of national courts to seek guidance from the Court depends on various factors. From a purely procedural perspective, differences in access to justice under national procedural rules,[167] as well as the application of the *acte clair* doctrine,[168] may explain the variations in the number of referrals from Member States. The range of socio-legal factors could be much wider. For instance, Pistone (2010) suggests four explanations for the passivity of Italian tax courts: (i) the level of legal culture in the country is low; (ii) the uncertainty of EU-related legal arguments forces claimants to refrain from raising points of EU law; (iii) more traditional legal routes through national-based reasoning appear to be preferable; and (iv) any potential prolongation in litigation is viewed as undesirable.[169] Indeed, the request for a preliminary ruling delays the case for approximately 20 months,[170] brings additional expenses and may sometimes cause further ambiguity rather than resolve the conflict between legal systems. It is therefore not surprising that in most cases a preliminary ruling from the Court will only be requested if it is 'inescapable', although some national courts are more confident with this exercise than others.

Clearly, the interpretation provided by the Court applies equally across the EU. The lack of preliminary references from a particular country therefore should not undermine the impact of case law at the domestic level. The inertness on the European stage could be compensated

[167] Michael Lang and others (eds), *Procedural Rules in Tax Law in the Context of European Union and Domestic Law* (Wolters Kluwer Law & Business 2010).

[168] On the ambiguity of the *acte clair* doctrine in general see Niels Fenger and Morten P Broberg, 'Finding Light in the Darkness: On the Actual Application of the *Acte Clair* Doctrine' (2011) 30 Yearbook of European Law 180. In the direct tax context, Dourado argues that due to a low predictability of the CJEU decisions, 'unless a case on direct tax issues is identical to a previous one (*acte éclairé* in the sense of *Da Costa*), a national tax court should always refer a case, contrary to what the ECJ recommended in *CILFIT*.' See Ana Paula Dourado, 'Is it *Acte Clair*? General Report on the Role played by *CILFIT* in Direct Taxation' in Ana Paula Dourado and Ricardo da Palma Borges (eds), *The Acte Clair in EC Direct Tax Law* (IBFD 2008) 13, 14 (citations omitted).

[169] Pasquale Pistone, 'The Impact of ECJ Case Law on National Taxation' (2010) 64 Bulletin for International Taxation 412, 423.

[170] Court of Justice, 'Annual Report of the Court of Justice 2011: D – Statistics Concerning the Judicial Activity of the Court of Justice', table 12.

by the active incorporation of the Court's jurisprudence through the *Marleasing* principle and legislative changes.[171] These variations, however, are worrying for at least two reasons.

First, the differences in the number of references do not reflect the state of compliance of national direct tax provisions with EU law. For instance, does Italy, which made only a few references, have a higher degree of compliance than Germany, which is at the top of the table? The lack of coherence between the number of preliminary ruling references and infringement proceedings initiated by the Commission against Member States, shows that this is not likely to be the case. For instance, German courts have referred 47 cases for preliminary rulings since 1986, but only five infringement cases have reached the Court under the Article 258 TFEU procedure. In contrast, the Court received one case under Article 267 TFEU from Spain and nine cases were referred by the Commission. The number of alleged infringements of EU law detected by the Commission in its reasoned opinions provides an even better comparison, because only a minor share of infringement cases reach the Court. While Italian, Greek and Spanish courts rarely initiate a judicial dialogue with Luxembourg, these Member States occupy leading positions in the list of alleged infringements.[172] Clearly, the level of non-compliance in a Member State cannot be estimated based on infringement procedures that are selective in nature.[173] However, the lack of references for preliminary rulings from countries with a large number of infringement cases, confirms that the mere reliance on Article 267 TFEU might be insufficient to ensure compliance with EU law.

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[171] Articles 258 and 260 TFEU may also play an important corrective role in this context. When the German Federal Finance Court decided that by excluding the possibility of deducting school fees for attending a school situated in another Member State, the German Law on Income Tax did not breach EU law (*Bundesfinanzhof* of 14 December 2005, XI R 66/03, DStRE 2005, 633), the Commission pursued the infringement case and proved the opposite in the Court of Justice (Case C-318/05 *Commission v Germany* [2007] ECR I-6957). For further details see Niels Fenger and Morten P Broberg, 'Finding Light in the Darkness: On the Actual Application of the *acte clair* Doctrine' (2011) 30 Yearbook of European Law 180, 198-199.

[172] For instance, by the end of 2008 the Commission had under investigation more than 500 cases against these Member States at the stage of reasoned opinion and beyond (Spain: 150 cases, Italy: 143, Greece: 124 and Portugal: 194).

[173] Miriam Hartlapp and Greda Falkner, 'Problems of Operationalization and Data in EU Compliance Research' (2009) 10 European Union Politics 281.

Second, Article 267 TFEU leaves the construction of the Internal Market to the litigants, allowing the agenda of the integration process to take an accidental pattern defined by market forces. The choice of which national tax provisions to challenge depends on the cost and benefit calculations of taxpayers. As Wattel concludes, '[t]he case law of the ECJ in tax matters tends to play into the hands of taxpayers (or maybe non-payers) who are interested in the internal market mainly insofar as it will help them make someone else pay for public expenditure from which they benefit.'[174] At the theoretical level, the Court's definition of restriction and disparity, its willingness to accept the grounds of justification submitted by Member States and the rigorousness of proportionality analysis determine the scope of the freedoms created by the Internal Market. However, a proactive and more prudent approach by the Court at various stages of integration has another side to it: it may influence the pattern of integration, as market players react by adjusting their tax litigation strategy accordingly.

Kofler and Mason (2008) have demonstrated the following:

> Until 2005, the ECJ's direct tax discrimination cases were amazingly consistent in their outcome: the ECJ almost always invalidated the challenged Member State tax provision as contrary to EC law. But recently, Member States have experienced major victories before the Court of Justice in direct tax cases. (…) Recent decisions (…) suggest that the Court is only willing to go so far to achieve judicial tax integration. Are we experiencing a European 'switch in time?'[175]

The 2005 shift has also been acknowledged by Cordewener, Kofler and van Thiel:

> [T]he Court's position on justifications for discriminatory tax measures has evolved in line with the broad cyclical pattern which developed in its income tax case law over the last 20 years. After an initial hesitant phase, the Court arrived at a long intermediate period, lasting from the early 1990s until 2005, in which it has routinely applied Internal Market principles in the income tax area. Since 2005, however, the Court seems to have returned to a more prudent phase, rearranging the relationship between fundamental private sector rights and the ways in which the Member States exercise their taxing powers, and becoming more cautious again in all the main questions that arise in each income tax case: whether Community law is applicable, whether the contested tax measure

[174] Peter J Wattel, 'Red Herrings in Direct Tax Cases before the ECJ' (2004) 31 Legal Issues of Economic Integration 81, 82.

[175] Georg W Kofler and Ruth Mason, 'Double Taxation: A European "Switch in Time?"' (2008) 14 Columbia Journal of European Law 63, 96-97 (citation omitted, but the authors refer to a similar observation made by Michael Lang, 'Direct Taxation: Is the ECJ Heading in a New Direction' (2006) 46 European Taxation 421).

> constitutes discrimination, and whether the continued application of that measure can nevertheless be justified by overriding public interest grounds.[176]

Diagram 1 suggests a correlation between the Court's approach and the number of litigants seeking protection in Luxembourg. In the period between the 1990s and 2005, when the Court was demonstrating an exceptionally pro-integration approach, the number of cases had been growing. The dropping numbers of referred cases after 2007 may be interpreted as a market reaction to the more prudent approach adopted by the Court. Taxpayers, however, can hardly be criticised: it is the inertia of EU legislators that leads them towards the Court to claim the benefits that are to be gained from the Internal Market.[177] It is questionable to what extent the burden of direct tax integration should be put on private litigants through Article 267 TFEU. The taxpayer cannot be expected to scrutinise the national tax laws, to fund the transformation of provisions that breach the obligations of Member States, or to promote the establishment of rights under EU law, as this would undermine the Commission's function as guardian of the Treaties.

In relation to both the arguments submitted here, the infringement procedure could potentially bring more balance. Direct communication between the Commission and Member States' governments under Articles 258 and 260 TFEU may fill the gaps left by Article 267 TFEU. It may also help to set the Court's agenda in a more strategic way than the ad hoc targets chosen by taxpayers. Non-binding measures can be used to give advance warning to

[176] Alex Cordewener and others, 'The Clash between European Freedoms and National Direct Tax Law: Public Interest Defences Available to the Member States' (2009) 46 Common Market Law Review 1951, 1996–1997 (citations omitted).

[177] Parallels can be drawn with the US experience: analysing the legal history of the US of the nineteenth and twentieth centuries, Hurst notices that '[l]egislative default concerning substantive public policy was largely responsible for overcrowded court dockets (…). Fault issues were inherently costly of litigating time, but legislative inertia – in areas of personal injury, consumers' rights, and nuisance law particularly – allowed these costly issues to dominate resolution-of-conflict situations (…). If constitutions or statutes failed to provide standards or rules, obedience to the constitutional ideal called on judges to fashion the generalizations themselves'. James W Hurst, *Law and Social Order in the United States* (Cornell University Press 1977) 135-136. This argument is often raised by EU tax scholars (see, eg, Frans Vanistendael, 'Does the ECJ Have the Power of Interpretation to Build a Tax System Compatible with the Fundamental Freedoms?' (2008) 17 EC Tax Review 52), but is rarely accepted as a sufficient argument for the Court's far-reaching intervention in national fiscal sovereignty.

Member States of potential infringements and to avoid extensive spending on enforcement actions.

3.1.2. Horizontal and Vertical Applications of CJEU Judgments

The influence of EU law on national substantive and procedural tax provisions has been increasing as a result of the growing body of jurisprudence generated by the Court.[178] Despite this strengthening pressure, comparative studies find asymmetrical reactions by Member States to case law, and the lack of a uniform application of EU law.[179] One of the major collective contributions that discussed the impact of case law on Member States' direct systems was published in 2006.[180] Summarising the national reports, Brokelind concluded that 'there is no homogeneity of Community law in direct taxation, as the ECJ rulings are applied quite differently from Member State to Member State.'[181] More recently, Kemmerling arrived at a similar conclusion: 'Europeanization does have a visible impact on national tax policies, even if the ultimate outcome is not always a strong, symmetric convergence of national tax policies.'[182] The Parliament's study goes even further and questions even the expectation of the convergence of national tax systems as such:

> [T]he phrases "negative harmonization" or "negative integration" can be misleading, because harmonization implies that the "harmonizators" consciously decide to adopt and implement common rules in order to attain a common objective whilst there is no real integration between the national tax systems as a result of the EC judgements, since these systems continue to co-exist without looking alike.[183]

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[178] See, eg, Arjo van Eijsden and Janco van Dam, 'The Impact of European Law on Domestic Procedural Tax Law: Wrongfully Underestimated?' (2010) 19 EC Tax Review 199.

[179] See, eg, Cécile Brokelind (ed), *Towards a Homogeneous EC Direct Tax Law: An Assessment of the Member States' Responses to the ECJ's Case Law* (IBFD 2007).

[180] ibid.

[181] Cécile Brokelind, 'Setting out the Contours of Future Research' in ibid 401, 403.

[182] Achim Kemmerling, 'Does Europeanization Lead to Policy Convergence? The Role of the Single Market in Shaping National Tax Policies' (2010) 17 Journal of European Public Policy 1058, 1059.

[183] Jacques Malherbe and others, *The Impact of the Rulings of the European Court of Justice in the Area of Direct Taxation* (European Parliament 2011), point 243.

But what does this 'lack of homogeneity' mean and why should it be considered with caution? Following the judgment delivered by the Court, one of these three consequences takes place:

(i) Ideally, each Member State adjusts its national tax provisions in accordance with the principles established by the Court, making them fully compliant with the requirements of EU law.

(ii) Due to the complexity of national legal systems, the situation is not always easily classified as 'compliance' or 'non-compliance': a Member State's response (or lack of it) could be seen as belonging to the 'grey zone'.[184]

(iii) A Member State may fail to react to emerging case law.

With regard to (i), since each country responds unilaterally, the regulatory solutions may vary. From a purely legal perspective, as long as these – even asymmetrical – responses are EU-compliant, it should be considered a satisfying result. This, however, would not always be the case: the following three examples aim to illustrate the potential shortcomings.

First, the judgment of the Court may fail to deliver the desirable freedom of movement, since a Member State may choose to eliminate the discriminatory treatment against foreign taxpayers or transactions by abolishing a favourable tax regime for both types of situations, domestic and cross-border. For instance, before the accession to the EU, Slovenia introduced a tax reform to adjust its fiscal environment to the membership. The 2004 Corporate Income Tax Act changed the qualifying requirements for a group tax regime. Although the definition

[184] Michael Blauberger, 'With Luxembourg in Mind… The Remaking of National Policies in the Face of ECJ Jurisprudence' (2012) 19 Journal of European Public Policy 109, 111. See also the sources cited, particularly Lisa Conant, *Justice Contained: Law and Politics in the European Union* (Cornell University Press 2002).

of companies that could form a group was extended to those companies that have the place of effective management in Slovenia, it was still limited to resident companies, which raised concerns about its compliance with EU law.[185] The *Marks & Spencer* ruling (M&S), which was delivered by the Court in 2005, was seen as confirmation of the aforementioned conflict. The new Income Tax Act, which entered into force in 2006, abolished the group tax regime that was allegedly in breach of EU law. The government explained that the extension of group taxation to non-resident companies might increase 'uncertainty regarding tax revenues'.[186] In some cases, Member States demonstrate their unwillingness to introduce a preferential tax treatment in the first place – even if it would be considered to stimulate business activity in a domestic context – in order to avoid the danger of any consequences related to the need to expand it into cross-border situations with a retrospective effect.[187]

Second, in some cases the implications may be even more controversial. A Member State could introduce more restrictive conditions to cross-border movement than those that were applied before the judgment of the Court. For instance, in reaction to recent developments in EU/European Economic Area (EEA) law, in particular Case C-371/10 *National Grid Indus*, which was confirmed in relation to EEA states in the advisory opinion of the Court of Justice of the European Free Trade Association States (hereafter 'the EFTA Court') requested by the district court of Oslo (Case E-15/11), Norway amended its exit tax regime.[188] Before the amendment, the deferral of exit tax liability until the moment of realisation was only allowed in relation to tangible assets, financial assets and liabilities. For intangible assets and inventories the exit tax was due on the day of exit. In 2012 the possibility of deferral was extended to all types of assets that are moved to other EU/EEA

[185] Lucie Vorlícková and Gregor Zorman, 'New Group Taxation Regime' (2005) 45:1 European Taxation 33, 33.

[186] Gregor Zorman, 'The Slovenian Tax Reform 2006' (2007) 47:4 European Taxation 204, 206.

[187] See the conclusion by Wolfgang Schön, 'Taxing Multinationals in Europe' (2012) 11 Working Paper of the Max Planck Institute for Tax Law and Public Finance 28.

[188] Case C-371/10 *National Grid Indus* [2011] ECR I-0000; Case E-15/11 of 3 October 2012 *Arcade Drilling AS v Staten v/Skatt Vest* (not yet published). See Eivind Furuseth, 'Revised Budget for 2012 Presented' IBFD News (16 May 2012) and 'Revised Budget for 2012 Adopted by Parliament' IBFD News (27 June 2012); Eivind Furuseth, 'Norway – Corporate Taxation: 6.2. Non-Resident Companies' (2012) IBFD Surveys.

states. However, the conditions of deferral were modified according to case law, which made them much less favourable for the taxpayers. The new exit tax regime introduced interest payments for deferral. Interest charges are accumulated for all years and paid upon the realisation of the asset. The deferral is subject to a bank guarantee notwithstanding the existing treaty relationship, whereas previously it was only required for those countries that had not entered into an exchange of information and administrative cooperation agreements with Norway. The subsequent decrease in the value of the asset does not reduce the tax liability, which was possible under the previous regime for tangible assets, financial assets and liabilities. No tax credit is provided for the tax on the capital gain levied in another country. The tax liability has no time limit and could be brought forward for an indefinite number of years (under the previous regime it was limited to five years), and it remains fixed even if the asset is subsequently returned to Norway.

Third, the removal of discriminatory tax provisions at the national level does not always contribute to the establishment of a more level playing field on an EU-wide scale. It could even move the EU further away from reaching the objectives of the Internal Market. This effect was demonstrated by de la Feria and Fuest (2011) through economic modelling.[189] Discussing Member States' reactions to *Marks & Spencer*,[190] where Member States had a choice between extending their group regime to cross-border situations or abolishing it, the authors demonstrated that various responses could increase the differences between Member States in the cost of capital and the levels of production.[191] Their interpretation of these results was that the Court contradicts its constitutional mandate and thus should restrain itself in situations that may impede progress towards a more level playing field and increased tax neutrality. This interpretation, however, conflicts with the core objective of the Court – to

[189] Rita de la Feria and Clemens Fuest, 'Closer to an Internal Market? The Economic Effects of EU Tax Jurisprudence' (2011) 12 CBT Working Papers.

[190] Case C-446/03 *Marks & Spencer* [2005] ECR I-10837.

[191] Rita de la Feria and Clemens Fuest, 'Closer to an Internal Market? The Economic Effects of EU Tax Jurisprudence' (2011) 12 CBT Working Papers.

protect rights under EU law. Since the origin of the problem is in the nature of *domestic* responses, this case study could be considered to be one that carries a stronger argument for the coordination of Member States' responses: the model demonstrates that a coherent choice of options could eliminate the negative effect.

With regard to (ii), case law may leave some uncertainty, allowing national authorities to 'explore how to preserve autonomous domestic regulation in EU-compatible ways'[192] and mitigate a potential loss of revenue. The qualifying conditions that are often introduced to reflect the particularities of national tax law cause the lack of a uniform application of case law across the EU. Furthermore, these 'add-ins' may substantially soften the interventionist potential of case law. Tridimas rightly emphasised that 'in the event that the ECJ is perceived to exceed its powers, the response of the political authorities is most likely to be subtle, indirect, prospective, and seek a change in judicial attitudes in the long-term.'[193] Not surprisingly, while some EU tax scholars argue that the 'ECJ should not unbundle integrated tax systems!' in reference to its far-reaching interpretations of the EU Treaties,[194] others, conducting empirical examinations of Member States' reactions, conclude that 'the *actual* impact of the ECJ's case law is not as extensive as it should be'.[195] The ambiguity of the 'grey zone' is hard to eliminate through Article 267 TFEU: it may remain unchallenged by the taxpayer due to a high risk of failure. The uncertainty of the legal situation may also put taxpayers at risk of missing the time limits for making claims under domestic legislation.

With regard to (iii), analysing the judicialisation process, Stone Sweet rightly notes that '[t]he important non-judicial policy actors must learn to accept the authority of the Court – a complex socialization *process* of dialogue and accommodation – and adapt their decision-

[192] Michael Blauberger, 'With Luxembourg in Mind… The Remaking of National Policies in the Face of ECJ Jurisprudence' (2012) 19 Journal of European Public Policy 109, 111.

[193] Takis Tridimas, 'Knocking on Heaven's Door: Fragmentation, Efficiency and Defiance in the Preliminary Reference Procedure' (2003) 40 Common Market Law Review 9, 37.

[194] Eric CCM Kemmeren, 'ECJ should not Unbundle Integrated Tax Systems!' (2008) 17 EC Tax Review 4.

[195] Cécile Brokelind, 'Setting Out the Contours of Future Research' in Cécile Brokelind (ed), *Towards a Homogeneous EC Direct Tax Law: An Assessment of the Member States' Responses to the ECJ's Case Law* (IBFD 2007) 401, 401 (emphasis added).

making, at least in part, to the Court's case law.'[196] When national authorities are slow to respond to case law, the infringement procedure plays an important role in ensuring their compliance with EU law. Considering the nature of direct tax cases, the lack of reaction from some Member States may be considered to be distorting the conditions for tax competition: for instance, where one government is prohibited from levying an immediate exit tax, thus liberating the exit conditions for companies, another country may continue to exercise this right. Although Member States can bring claims against each other, it remains exceptional that they do so.[197]

Hence, negative harmonisation has a differential impact,[198] and case law does not generate the emergence of a homogeneous tax law per se. As Mason noted, the decisions of the Court are based on the factual and legal circumstances of a specific country, which makes them 'poorly equipped to fashion EU-wide solutions to tax problems.'[199] Progress towards the Internal Market without a coordination of national responses is thus questionable.

3.2. Substantive Limitations

3.2.1. EU Tax Policy Made through Case Law

The far-reaching and pro-integration approach of the Court in direct tax cases is strongly criticised in the academic literature as violating the fiscal sovereignty of Member States.[200] In

[196] Alec Stone Sweet, 'The European Court of Justice and the Judicialization of EU Governance' (2010) 5:2 Living Reviews in EU Governance <http://europeangovernance.livingreviews.org> accessed 28 December 2012, 20.

[197] So far, it has been used in four cases: Case 141/78 *France v United Kingdom* [1979] ECR 2923; Case C-388/95 *Belgium v Spain* [2000] ECR I-3123; Case C-145/04 *Spain v United Kingdom* [2006] ECR I-7917; Case C-364/10 *Hungary v Slovakia* [2012] ECR I-0000.

[198] See Adrienne Héritier, 'Differential Europe: The European Union Impact on National Policymaking' in Adrienne Héritier and others, *Differential Europe: The European Union Impact on National Policymaking* (Rowman & Littlefield 2001) 1.

[199] Ruth Mason, 'Flunking the ECJ's Tax Discrimination Test' (2007) 46 Columbia Journal of Transnational Law 72, 117.

[200] See (n 8).

some cases, the Court comes very close to the borderline of its competence by taking 'quintessentially legislative' decisions.[201] In 2007 the former EU Commissioner for Taxation and Customs Union, László Kovács, admitted that 'EU tax policy is increasingly being made as a result of Court decisions rather than as a result of coordinated policy actions of Member States'.[202] This can be seen as contradicting the spirit of the Member States' veto power on any imposed direct tax solutions enshrined in the Treaties.[203] However, the interventionist nature of the Court's jurisprudence can hardly be found surprising. As Barav rightly pointed out, '[j]udges have everywhere changed, improved and created the law, even though this has usually been presented as the outcome of a faithful, albeit constructive, interpretation of the law.'[204] Furthermore, criticism against the Court can be turned against the legislators. The argument made by Easson precisely describes the nature of the Court's intervention in the field of direct taxation:

> As a result of this limited range of option, solutions prescribed by the Court are not always entirely satisfactory. Sometimes, indeed, they may be the direct cause of legal uncertainty which, in turn, can only be remedied by legislative action. But if such uncertainty is to be deplored, it is not so much because the Court has usurped the proper function of the legislator, but rather because the legislator has failed to act where action has been necessary and required by the Treaty. If the Court has become too deeply involved in making choices between competing policies, it is primarily because the Council has been unable or unwilling to make those choices. In the great majority of cases in which the Court has assumed the role of legislator, the alternatives have not been action by the Court or action by the Council, but rather action by the Court, sometimes in circumstances where such action is contrary to the intentions of the authors of the Treaty, or where the Court lacks the means to secure an entirely satisfactory result, and the non-observance of the Treaty itself, bringing into disrepute the entire fabric of Community law. The Court would thus have been in dereliction of its duty to ensure that in the interpretation and application of the Treaty the law is observed. In such circumstances, usurpation is to be preferred to disintegration.[205]

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[201] Michael J Graetz and Alvin C Warren, 'Income Tax Discrimination and the Political and Economic Integration of Europe' (2006) 115 Yale Law Journal 1186, 1207; see also Michael J Graetz and Alvin C Warren, 'Dividend Taxation in Europe: When the ECJ Makes Tax Policy' (2007) 44 Common Market Law Review 1577.

[202] Suzanne Kingston, 'A Light in the Darkness: Recent Developments in the ECJ's Direct Tax Jurisprudence' (2007) 44 Common Market Law Review 1321, footnote 5.

[203] See, eg, Michael J Graetz and Alvin C Warren, 'Income Tax Discrimination and the Political and Economic Integration of Europe' (2006) 115 Yale Law Journal 1186, 1254.

[204] Ami Barav, 'Omnipotent Courts' in Deirdre Curtin and Ton Heukels (eds), *Institutional Dynamic of European Integration: Essays in Honour of Henry G Schermers* (Kluwer Academic Publishers 1994) 265, 265.

[205] Alex Easson, 'Legal Approaches to European Integration: The Role of Court and Legislator in the Completion of the European Common Market' (1989) 12 Journal of European Integration 101, 119 (citations omitted).

Although the court approach can be seen as explainable, the negative consequences should be acknowledged. The Court is equipped with a limited number of tools (basically, the definition of obstacle and discrimination), so it cannot accommodate many important policy considerations (e.g. fairness, administrability and economic efficiency) that are seen as essential for complex policy decisions.[206] Taking critical decisions in the field of direct taxation, the Court cannot balance their externalities. Haufler and Mardan (2012) demonstrated that a partial or full cross-border loss offset in the EU in response to the *Marks & Spencer* case could further enhance the conditions of tax competition between Member States. Along with the elimination of fiscal distortions for the investment decisions of multinational enterprises, it may cause a further decrease of tax rates and revenues.[207] The Court, however, lacks the competence to introduce a supplementing measure that could address problems such as the increased tax competition as a result of the elimination of hindrances to the freedom of movement.

The list of critical comments against the Court could be much longer. Under the jurisprudential argument, the CJEU case law is described as increasing the complexity of national tax systems and deepening legal uncertainty.[208] Analysing the 'trends, tensions and contradictions' in tax cases, scholars either demonstrate the failure of the Court to deliver a well-grounded and consistent result, or disagree upon the logical explanations of

[206] The problems related to the tax policy choices made by the Court of Justice are discussed by Michael J Graetz and Alvin C Warren, 'Income Tax Discrimination and the Political and Economic Integration of Europe' (2006) 115 Yale Law Journal 1186; Michael J Graetz and Alvin C Warren, 'Dividend Taxation in Europe: When the ECJ Makes Tax Policy' (2007) 44 Common Market Law Review 1577. The discussion about the lawmaking role of the Court of Justice also has long roots in EU law scholarship; see, eg, Hjalte Rasmussen, *On Law and Policy in the European Court of Justice: A Comparative Study in Judicial Policymaking* (Martinus Nijhoff Publishers 1986); Karen J Alter, *The European Court's Political Power: Selected Essays* (OUP 2009).

[207] Andreas Haufler and Mohammed Mardan, 'Tax Competition and Risk-Taking under Cross-Border Loss Offset' (presented at the CBT Seminar, 9 May 2012) <http://www.eea-esem.com/files/papers/eea-esem/2012/2158/Loss-Jan12.pdf> accessed 28 December 2012.

[208] Luc Hinnekens, 'Forum: European Court Goes for Robust Tax Principles for Treaty Freedoms. What about Reasonable Exceptions and Balances?' (2004) 13 EC Tax Review 65; Peter J Wattel, 'Red Herrings in Direct Tax Cases before the ECJ' (2004) 31 Legal Issues of Economic Integration 81; Ruth Mason, 'Flunking the ECJ's Tax Discrimination Test' (2007) 46 Columbia Journal of Transnational Law 72.

divergences.[209] From an institutional perspective, the Court is criticised for lacking specialist expertise, which results in errors occurring in the legal interpretation of international tax law concepts.[210]

The most radical solution for the current problems would be to restrict the competence of the Court in relation to matters of direct taxation, which would require a revision of the Treaties.[211] The Treaties may also restrict the application of Articles 258 and 260 TFEU in relation to the matters of direct taxation, limiting the ability of the Commission to bring the case before the Court.[212] However, these steps could endanger the integrity of the EU legal order, undermine the Internal Market and infringe the principle of the effective protection of rights under EU law. Therefore, it can hardly be considered as a rational, realistic or even a desirable prospect. A much more feasible solution would need to combine two elements.

First, at the substantive level, the Court may adopt a more prudent approach by clarifying and strictly observing the dividing lines between restrictions that are prohibited by the freedom of movement and disparities that cannot be considered to infringe the Treaties.[213] A wide interpretation of the latter and broadening the scope of permissible justifications for the former can re-establish the balance between the EU and national fiscal interests. More questionable is the possibility of introducing additional tests, such as 'the internal consistency test' used by the Supreme Court of the United States in tax cases.[214]

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[209] Michael Lang, 'Recent Case Law of the ECJ in Direct Taxation: Trends, Tensions, and Contradictions' (2009) 18 EC Tax Review 98; Mattias Dahlberg, 'The European Court of Justice and Direct Taxation: A Recent Change of Direction?' in Krister Andersson and others (eds), *National Tax Policy in Europe: To Be Or Not to Be?* (Springer 2007) 165.

[210] See, eg, Peter J Wattel, 'Red Herrings in Direct Tax Cases before the ECJ' (2004) 31 Legal Issues of Economic Integration 81, 82.

[211] Michael J Graetz and Alvin C Warren, 'Income Tax Discrimination and the Political and Economic Integration of Europe' (2006) 115 Yale Law Journal 1186, 1233. See also the example of some steps towards this solution in Claudio M Radaelli and Ulrike S Kraemer, 'Governance Arenas in EU Direct Taxation' (2008) 46 Journal of Common Market Studies 315, 331-332.

[212] ibid.

[213] Suzanne Kingston, 'A Light in the Darkness: Recent Developments in the ECJ's Direct Tax Jurisprudence' (2007) 44 Common Market Law Review 1321, 1358-1359.

[214] Ruth Mason, 'Made in America for European Tax: The Internal Consistency Test' (2008) 49 Boston College Law Review 1277.

Second, at the procedural level, a greater respect can be given to the division of competences between the CJEU and Member States' courts under Article 267 TFEU, with a sufficient degree of discretion left to the latter in the application of the Court's interpretation of EU law to domestic tax provisions, particularly in the assessment of proportionality.[215] The limitation of retrospective effect could help Member States to manage the budgetary implications of case law. Since it may remove a financial incentive for the voluntary screening of direct tax provisions by national authorities, this possibility can be linked to a number of qualifying conditions, such as the uncertainty surrounding the application of EU law in a specific case.[216]

3.2.2. Disparities and Double Taxation in the Jurisprudence of the Court

As discussed earlier, the Court contributes to the establishment of a level playing field taken in its narrow interpretation: as the elimination of restrictions created by the unilateral measure of a Member State that cannot be justified (or is considered to be disproportionate).[217] The advantages and disadvantages arising for the taxpayer from the differences in national laws of two or more countries are usually classified as disparities, which lie beyond the reach of the Court.[218] At the conceptual level, these differences are seen as the simultaneous exercise of sovereign taxing powers by Member States. In non-tax cases, regulatory differences between

[215] Pasquale Pistone, 'Ups and Downs in the Case Law of the European Court of Justice and the Swinging Pendulum of Direct Taxation' (2008) 36 Intertax 146, 148. There will always be some room for disagreement on the interpretative path taken by the Court of Justice, with scholars arguing the need for more abstract or concrete rulings; see on this matter Gareth Davies, 'Abstractness and Concreteness in the Preliminary Reference Procedure: Implications for the Division of Powers and Effective Market Regulation' in Niamh Nic Shuibhne (ed), Regulating the Internal Market (Edward Elgar 2006) 210.

[216] Michael J Graetz and Alvin C Warren, 'Income Tax Discrimination and the Political and Economic Integration of Europe' (2006) 115 Yale Law Journal 1186, 1223-1224 and 1235.

[217] See the discussion on the 'snooker table' argument by Wolfgang Schön, 'Losing Out at the Snooker Table. Cross-Border Loss Compensation for PEs and the Fundamental Freedoms' in Luc Hinnekens and Philippe Hinnekens (eds), *A Vision of Taxes within and outside European Borders: Festschrift in Honor of Prof. dr. Frans Vanistendael* (Kluwer Law International 2008) 813.

[218] For a detailed examination see, eg, Sjoerd Douma, 'The Three Ds of Direct Tax Jurisdiction: Disparity, Discrimination and Double Taxation' (2006) 46 European Taxation 522.

Member States are resolved through the principle of mutual recognition, but its application in the context of direct taxation is far from clear.

The Court cannot balance the exercise of tax rights by Member States, so it refuses to eliminate double taxation arising in this context: from the perspective of each country, this tax treatment may appear non-discriminatory. According to settled case law, juridical double taxation is not prohibited by the Treaties per se, even if it distorts the Internal Market.[219] Article 293 of the EC Treaty, requiring Member States to enter into negotiations for the abolition of double taxation in the EU, was interpreted by the Court as not having direct effect, and was subsequently repealed by the Treaty of Lisbon.[220]

The problem of double taxation could be seen to be one of the key limitations for the establishment of the Internal Market through negative harmonisation.[221] For instance, in the *National Grid Indus* judgment, the Court decided that the emigration state was not required to take into account the change in the value of assets that were moved to another state.[222] Furthermore, it is not required to acknowledge any taxes levied by the host state. Under the interpretation provided, the potential problem of double taxation was left for Member States to resolve. The most reasonable solution would be a step-up or a system where the taxes levied are shared between two states.[223] Since in the majority of situations such coordination

[219] See, eg, Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673 and Opinion of AG Geelhoed delivered on 23 February 2006; Case C-513/04 *Kerckhaert and Morres* [2006] ECR I-10967 and Opinion of AG Geelhoed delivered on 6 April 2006.

[220] Article 220 of the EC Treaty (pre-Amsterdam Treaty numbering), Article 293 of the EC Treaty (post-Amsterdam Treaty numbering), repealed by the Treaty of Lisbon. For an analysis see, eg, Herwig Hofmann, 'Double Tax Agreements: Between EU Law and Public International Law' in Alexander Rust (ed), *Double Taxation within the European Union* (Wolters Kluwer Law and Business 2011) 73; Ekkehart Reimer, 'The Abolition of Article 293 EC: Comments on Hofmann's Analysis' in Alexander Rust (ed), *Double Taxation within the European Union* (Wolters Kluwer Law and Business 2011) 85.

[221] See, eg, Joachim Englisch, 'The European Treaties' Implications for Direct Taxes' (2005) 33 Intertax 310; Alexander Rust (ed), *Double Taxation within the European Union* (Wolters Kluwer Law & Business 2011).

[222] Case C-371/10 *National Grid Indus* [2011] ECR I-0000.

[223] Réka Világi, 'Exit Taxes on Various Types of Corporate Reorganizations in Light of EU Law' (2012) 52 European Taxation 346, 354.

does not exist, the Court addressed the smaller problem of taxes being levied in advance, leaving the more substantial issue of the double burden unresolved.[224]

There is no ultimate agreement as to whether double taxation should remain beyond the reach of the Court. Some scholars, such as Vanistendael, argue that if viewed from the Internal Market perspective, double taxation constitutes an obstacle that hinders the freedom of movement in the Internal Market.[225] Kofler and Mason conclude that the obligation of Member States to eliminate juridical double taxation 'could reasonably be inferred from the goals of the fundamental freedoms and the European Court of Justice's "double burden" jurisprudence'.[226] But these scholars then refer to the United States' (US) experience opposing the *need* to eliminate double taxation of a non-discriminatory nature: differences between tax systems of different states may also result in an additional tax burden, but the Commerce Clause demonstrates similar limitations.[227] Others go even further, such as Weber, who emphasises that an attempt to eliminate the disparities could 'jeopardize' Member States' fiscal sovereignty and put their freedom to collect taxes 'at immediate risk'.[228] The Court can hardly tackle double taxation without taking an ultimate decision on which state has the right to raise the tax revenue. This argument appears convincing: requiring national authorities to take into account a tax regime applied by another country would further restrict the fiscal autonomy of Member States.

Weber thus rightly proposes that '[i]f the Member States want to remove advantages (tax vacuums) or disadvantages arising from disparities, they will have to do so (…) through coordination, harmonization or unification of national legislation by means of national,

[224] ibid.

[225] Frans Vanistendael, 'Does the ECJ Have the Power of Interpretation to Build a Tax System Compatible with the Fundamental Freedoms?' (2008) 17 EC Tax Review 52.

[226] Georg W Kofler and Ruth Mason, 'Double Taxation: A European "Switch in Time?"' (2008) 14 Columbia Journal of European Law 63, 63.

[227] ibid 98.

[228] Dennis Weber, 'In Search of a (New) Equilibrium between Tax Sovereignty and the Freedom of Movement within the EC' (2009) 34 Intertax 585, 588 and 593.

international or Community law.'[229] A similar conclusion is made by Vanistendael: '[t]he only way to resolve these remaining questions is either by legislative action at EU level or by ECJ case law on the condition that the national policy choices of the Member States on these items become much more coordinated than they are today'.[230]

3.3. Interim Conclusion

The Court is often regarded as 'the most effective supranational judicial body in the history of the world'.[231] However, the legal nature of judicial competence does not enable it to substitute the lack of a positive legislator. This section has discussed some of the key problems created by the dominance of Article 267 TFEU in the process of direct tax integration, which force EU tax scholars to conclude that 'the results [of negative harmonisation] are not the desirable ones either from the perspective of the effectiveness of ECJ case law or the protection of the taxpayers covered by EC law'.[232]

This section has raised four issues. First, it questioned an accidental pattern of integration under Article 267 TFEU, where the agenda of the integration process is determined by private litigants. Second, the application of case law at the domestic level has been found to be problematic. Several studies cited earlier conclude that progress towards a homogeneous direct tax law in the EU as a result of negative harmonisation remains slow. However, the lack of 'homogeneity' demonstrates only the surface of the problem. By discussing the potential forms of these differences in greater detail, this section has illustrated that the Court eliminates the obstacles in a narrow legal meaning, which does not necessarily

[229] ibid 588.

[230] Frans Vanistendael, 'Does the ECJ Have the Power of Interpretation to Build a Tax System Compatible with the Fundamental Freedoms?' (2008) 17 EC Tax Review 52, 66.

[231] Alec Stone Sweet, 'European Integration and the Legal System' in Tanja A Börzel and Rachel A Cichowski (eds), *The State of the European Union: Law, Politics, and Society* (vol 6, OUP 2003) 18, 18.

[232] Ana Paula Dourado, 'Is it *Acte Clair*? General Report on the Role played by *CILFIT* in Direct Taxation' in Ana Paula Dourado and Ricardo da Palma Borges (eds), *The Acte Clair in EC Direct Tax Law* (IBFD 2008) 13, 16 (citations omitted).

contribute to the freedom of movement and the establishment of a level playing field. Third, the lack of supplementing policy input enhances the drawbacks of negative harmonisation. Finally, judicial power is limited to a non-discriminatory legal formula, and thus the problems created by the parallel exercise of Member States' taxing rights remain unresolved, despite their negative implications for the Internal Market. These considerations demonstrate that the nature of the integration process in the field of direct taxation makes it challenging to ensure coherent and balanced changes across the EU.

4. Conclusion to Part II

The academic debate on the future direction of European direct tax integration has developed in two major areas, namely (i) limiting the intervention of the Court, and (ii) introducing closer legislative cooperation between Member States. This dual approach disregards alternative regulatory tools, which could be seen as a third solution, able to balance the equilibrium of EU and national fiscal interests. According to the Commission, proactive enforcement, non-binding coordination and an enhanced coordination procedure may offer an adequate response to the dilemmas of direct tax integration. Despite the fact that this route has been mentioned as a priority in the Commission's programme documents since 2001 and, furthermore, has been actively pursued since then, the study of the potential role and actual application of these regulatory instruments has received very limited attention from EU tax scholars.

Parts III and IV attempt to meet this need for academic input. These sections will analyse the application of the infringement procedure and non-binding measures by the Commission, and will discuss to what extent these tools could contribute to a more balanced tax integration in the EU. The following questions are analysed in detail: (i) the legal nature of infringement proceedings and non-binding instruments; (ii) the history of their application

in the field of direct taxation; (iii) the key procedural problems and possibilities for increasing the legitimacy and effectiveness of these instruments.

PART III. The Infringement Procedure and its Role in the Elimination of Fiscal Barriers in the EU

1. Outline

The role of the Commission as the guardian of the Treaties has been subject to notable changes in the past decade. Procedurally, its enforcement powers under Articles 258 and 260 TFEU have been strengthened through the Treaty of Lisbon and the case law of the Court. The Commission's working methods have developed, allowing a more effective handling of cases and setting higher transparency standards. Alternative problem-solving mechanisms (SOLVIT and EU Pilot) supplemented the process of formal investigation, providing a better response to the enquiries and complaints of citizens and businesses. These improvements, however, have not eliminated all problems. By discussing the exercise of the Commission's enforcement powers under Articles 258 and 260 TFEU, Part III addresses two questions. First, it examines the role of the infringement procedure in the process of direct tax harmonisation. Second, it illustrates the scope of the remaining procedural challenges.

Following the Commission's declaration of its proactive use of the infringement procedure in the field of direct taxation,[233] the number of infringement cases rapidly grew from 18 cases initiated in 2001, to 145 cases initiated in 2008.[234] These figures differed from a

[233] Commission, COM(2001) 260 final, sections 4.2 and 5. See also Commission, 'White Paper on Reforming the Commission' (Communication) COM(2000) 2000 final, where the Commission emphasised the necessity to strengthen its enforcement actions.

[234] Based on the data provided by the Commission in correspondence and reported in the Commission annual reports on monitoring the application of EU law and the DG TAXUD reports on activities of the European Union in the tax field in 2006–2011. More detailed analysis of the data can be found in Part III Section 2.2.

general tendency across other policy fields, which showed a moderate fluctuation without any significant increase. A sharp drop seen since then has brought the direct tax records back to the 2001 level (with only 18 cases initiated in 2010), making the pattern of enforcement actions more consistent with the declining number of detected infringement cases across other policy fields.[235] Despite the recent drop, direct tax cases constitute the largest group of pending investigations (103), followed by indirect taxation (95) and water protection and management (63).[236] This figure was even more striking in its 2009 peak with 298 direct tax cases pending before the Commission.[237] Due to the confidentiality of the infringement procedure, the complexity of publicly reported information and the lack of a clear procedural framework, the analysis and interpretation of this data is challenging.

Part III is structured as follows. Section 2 starts by introducing the infringement procedure and explaining recent changes that have improved the management of infringement cases and made the process of investigation more effective. Next, Section 3 studies the communication between the Commission's services and Member States, identifying the key procedural problems that remain unresolved. Then, Section 4 integrates the legal and policy perspectives. It offers a theoretical argument supported by empirical observations, which allows the construction of a more objective picture. Using the empirical data, this section maps the tax policy areas targeted by infringement proceedings in 2005–2012, exploring the Commission's working methods and policy implications on an EU-wide scale. Finally, Section 5 summarises the conclusions drawn, proving the need to give more attention to the application of this tool and proposing a theoretical framework for potential developments.

[235] ibid.

[236] Commission, 'Internal Market Scoreboard' (September 2012, No 25) 20.

[237] Commission, 'Internal Market Scoreboard' (July 2009, No 19) 20. The decreasing number of infringement cases will be explained in Part III Section 2.2.

2. Articles 258 and 260 TFEU in the Field of Direct Taxation

Article 258 TFEU is frequently described as a 'great survivor', because its initial text has hardly been changed since the earliest stages of European integration.[238] In the same way as its predecessors,[239] it authorises the Commission to send a reasoned opinion to a Member State that has failed to fulfil an obligation under the Treaties after providing that State with the opportunity to submit its observations. If the Commission is not satisfied with the Member State's response, it may bring the case before the Court. However, a closer look beyond the wording of Article 258 TFEU demonstrates that the perception and application of this procedure has dramatically changed over time.

Back in the 1960s, the Court claimed that the infringement procedure was 'a last resort' (*ultima ratio*) that could be invoked by the Commission to overcome Member States' unwillingness to comply with their obligations under EU law.[240] The mechanism of centralised enforcement was labelled as original and novel,[241] and clearly derogated from the traditional approach 'recognized in classical international law to ensure that obligations of States are fulfilled',[242] but it was still very weak. Due to this weakness, which was predominantly associated with a lack of legal remedies, Advocate General (AG) Roemer argued that 'to invoke it excessively may in fact detract from its efficiency (...) it seems proper to rule out any automatic application, any compulsion to initiate it'.[243] More than 40

[238] Richard Rawlings, 'Engaged Elites Citizen Action and Institutional Attitudes in Commission Enforcement' (2000) 6 European Law Journal 4, 4.

[239] Ex Article 169 of the EC Treaty (pre-Amsterdam Treaty numbering), Article 226 of the EC Treaty (post-Amsterdam Treaty numbering).

[240] Case 20/59 *Italy v High Authority* [1960] ECR 663, 339; see also Andrew C Evans, 'The Enforcement Procedure of Article 169 EEC: Commission Discretion' (1979) 4 European Law Review 442, 448; Ami Barav, 'Failure of Member States to Fulfil Community Obligations' (1975) 12 Common Market Law Review 369, 370.

[241] Ami Barav, 'Failure of Member States to Fulfil Community Obligations' (1975) 12 Common Market Law Review 369, 370; Alan Dashwood and Robin White, 'Enforcement Actions under Articles 169 and 170 EEC' (1989) 14 European Law Review 388, 388.

[242] Case 20/59 *Italy v High Authority* [1960] ECR 663, 339.

[243] Case 7/71 *Commission v France* [1971] ECR 1003, Opinion of AG Roemer, 1026.

years later, Prete and Smulders argued that 'the corpus of judicial and legislative developments has made the infringement proceedings "come of age", as they have evolved into a common, fairly transparent and highly technical procedure.'[244] The following section summarises the recent transformations that have turned the infringement procedure into a flexible tool that is capable of pursuing more ambitious enforcement targets.

2.1. Defining the EU Infringement Procedure

The Treaty provisions regulating the application of the infringement procedure have been amended twice, by the Treaty of Maastricht (1992) and the Treaty of Lisbon (2007). The Maastricht Treaty derogated from the initial concept of a 'warning procedure' that had purely political implications, and was for this reason widely criticised in the academic literature of the 1950s–1980s.[245] The amended provision authorised the Commission to request a legal remedy if a Member State had not responded appropriately to an earlier judgment of the Court (Article 260 TFEU).[246] The Commission was enabled to refer the case to the Court for a second time, requesting that the lump sum or penalty payment be paid by the national government.[247] Under the Treaty of Lisbon, the Commission gained even more power in relation to financial penalties. The Maastricht version of Article 260 TFEU required the Commission to submit two types of documents – a formal notice and a reasoned opinion – to provide notification of an alleged breach and to give the Member State concerned the opportunity to submit its observations and take the necessary measures to eliminate the infringement. Under the current Lisbon version a reasoned opinion is no longer required: the

[244] Luca Prete and Ben Smulders, 'The Coming of Age of Infringement Proceedings' (2010) 47 Common Market Law Review 9, 60.

[245] See, eg, Ami Barav, 'Failure of Member States to Fulfil Community Obligations' (1975) 12 Common Market Law Review 369, 371.

[246] Ex Article 171 of the EC Treaty (pre-Amsterdam Treaty numbering), Article 228 of the EC Treaty (post-Amsterdam Treaty numbering).

[247] The first memorandum on the application of these rules and the method of calculating the penalty payments were proposed in 1997. See Commission, IP/97/664.

case can be presented before the Court as soon as the Commission has received the Member State's initial observations in response to a formal notice. The Treaty of Lisbon also strengthened the enforcement mechanism by introducing paragraph 3 to Article 260 TFEU, which authorises the Commission to request the lump sum or penalty payment under Article 258 TFEU if a Member State fails to provide notification of measures transposing a directive adopted under the legislative procedure. These amendments aimed to secure a proper and timely transposition of EU law at the national level.

Although these changes may be important for some policy areas where the Commission often applies Article 260(2) TFEU as the basis for the infringement procedure (e.g. environmental matters, the internal market and services, and transport),[248] they carry less significance for infringement proceedings in the field of direct taxation, where the number of these cases is marginal.[249] Although the Treaty of Lisbon adds more weight to a letter of formal notice under Article 260(2) TFEU and may potentially shorten a pre-litigation stage by eliminating the need to send a reasoned opinion, in practice it seems unlikely that the Commission will rush ahead with the second referral using its new authority. Since the scope of positive harmonisation in direct taxation is limited, the new possibility of imposing financial penalties under Articles 260(3) TFEU can be evoked only occasionally.[250]

The pressure of financial sanctions was further enhanced by the Court through a rather controversial reading of Article 260(2) TFEU. In Case C-304/02 *Commission v France*, interpreting the possibility of imposing 'a lump sum *or* penalty payment' on the Member

[248] 'At the end of 2011, the Commission still had to continue 77 infringement procedures under Article 260(2) TFEU given that Member States failed to comply with Court judgments. Most of these cases concerned Greece (13), Italy (12) and Spain (8). Almost half of the Article 260(2) TFEU infringements related to environment (36) with a few cases also in the fields of internal market & services (10) and transport (8)'. See Commission, '29th Annual Report on Monitoring the Application of EU Law (2011)' (Complete Report) COM(2012) 714, section 2.2.

[249] Since 2005 the European Commission has sent only three letters of formal notice under Article 260(2) TFEU that concern the field of direct taxation, ie, **Spain** (No 2000/4854), **Sweden** (No 2003/4314) and **Greece** (No 2006/4044).

[250] So far, Article 260(3) TFEU has been rarely invoked by the European Commission. The first case with the sanctions for late implementation was referred to the Court in 2011. By the end of 2011, this provision was used in nine cases. See Commission, '29th Annual Report on Monitoring the Application of EU Law (2011)' (Complete Report) COM(2012) 714, section 1.2.

State that failed to implement the judgment that establishes a breach of EU law, the Court held that it allowed imposing lump sums *and* penalty payments simultaneously.[251] Considering that the wording of Article 260(2) TFEU is similar to paragraph 3 of the same article, the Commission concluded that this interpretation applies equally to both.[252] Initially, the Commission was rather careful with regard to seeking financial sanctions, but over time this practice has become more common.[253] Although the use of financial sanctions remains infrequent, the effectiveness of Article 260 TFEU is slowly improving.[254] More generally, some earlier developments in case law that established the mechanism and conditions of state liability for the breach of EU law should be noted as having indirectly created additional stimuli for loyal cooperation at the earlier stages of the infringement procedure.[255] The possibility of introducing amendments to domestic laws as a result of diplomatic negotiations, which are not made public until the second stage of the infringement procedure, helps to manage the risk and scale of remedy claims.[256] In the field of direct taxation where Member States may face substantial budgetary losses, this becomes especially valuable.

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[251] Case C-304/02 *Commission v France* [2005] ECR I-6263, para 82. This possibility was applied, for instance, in Case C-369/07 *Commission v Greece* [2009] ECR I-5703: the Greek authorities were obliged to pay a lump sum of EUR 2 million and a penalty payment of EUR 16,000 for each day of delay in adopting the measures necessary to comply with the judgment regarding the recovery of unlawful state aid.

[252] Commission, 'Implementation of Article 260(3) of the Treaty' (Communication) SEC(2010) 1371 final, paras 20 and 21.

[253] Carol Harlow and Richard Rawlings, 'Accountability and Law Enforcement: The Centralized EU Infringement Procedure' (2006) 31 European Law Review 447, 461. Some authors, however, argue that the non-conformity with EU law is still 'cheap' for EU Member States. See Phedon Nicolaides and Anne-Marie Suren, 'The Rule of Law in the EU: What the Numbers Say' [2007] 1 EIPASCOPE <http://www.eipa.eu/files/repository/eipascope/20070622102127_pniSCOPE2007-1_internet-7.pdf> accessed 28 December 2012.

[254] Pål Wennerås, 'Sanctions against Member States under Article 260 TFEU: Alive, but not Kicking?' (2012) 49 Common Market Law Review 145.

[255] In particular, Joined Cases C-6/90 and C-9/90 *Francovich and Others v Italy* [1991] ECR I-5357; Joined Cases C-46/93 and C-48/93 *Brasserie du Pêcheur v Germany* and *R v Secretary of State for Transport, ex parte Factortame Ltd* [1996] ECR I-1029. In some cases, the absence of formal investigation under Article 258 TFEU may influence the analysis of national courts as regards the finding of a sufficiently serious breach of EU law. See Tobias Lock, 'Is Private Enforcement of EU law through State Liability a Myth? An assessment 20 years after *Francovich*' (2012) 49 Common Market Law Review 1675, 1696-1697.

[256] EU Member States can mitigate the consequences of the alleged breach by introducing changes to domestic laws at an early stage of the infringement procedure and limiting their retrospective effect. See, eg, the UK Budget 2009 in relation to the amendments of inheritance taxation with respect to agricultural property and woodlands relief, which were forced by the Commission's enforcement actions (see Commission, IP/09/170 in relation to the **United Kingdom** (No 2007/2433).

2.2. EU Tax Governance after 2001: Developments in the Commission's Working Methods

The changes in the infringement procedure have not been limited to hard law sources. The most important transformations, which allow a better understanding and a more comprehensive evaluation of enforcement actions in the field of direct taxation, are to be found in the Commission's methods of addressing the potential breach of EU law.

2.2.1. A Selective Approach towards Infringements of EU Law

The exercise of enforcement powers by the Commission has been the subject of repeated academic and political criticism, particularly with respect to its selective approach: where certain infringements of EU law are actively pursued, others cases are left without proper consideration. However, the strategy of selective enforcement is explained by the limited resources available to the Commission, which prevent it from reacting to all cases.[257] A more constructive line of criticism concerns the lack of transparent criteria and procedures that define the regulatory behaviour, and the corresponding weakness of accountability mechanisms.

In 1997, responding to the Parliament's Resolution on the 12th Report on Monitoring the Application of Community Law, the Commission made an attempt to address this criticism by announcing its priorities for enforcement actions.[258] It was a step towards a greater transparency rather than a change in the Commission's working methods, because

[257] See, eg, Miriam Hartlapp and Greda Falkner, 'Problems of Operationalization and Data in EU Compliance Research' (2009) 10 European Union Politics 281, 296-297. Going further, Ibáñez concluded that '[t]he idea of full enforcement is simply chimerical'; see Alberto G Ibáñez, *The Administrative Supervision and Enforcement of EC Law: Powers, Procedures and Limits* (Hart Publishing 1999) 203.

[258] Commission, '14th Annual Report on Monitoring the Application of EC Law (1996)' [1997] OJ C332/1, 9.

these criteria had already been applied 'behind close[d] doors'.[259] With respect to the rights of complainants this step meant that instead of setting clear conditions for admissibility (i.e. grounds for *refusing* to launch an infringement case), the Commission established a set of priorities for *selecting* cases for investigation.[260] The term 'prioritisation' was used to explain 'selectivity', but it has not changed the substance of this approach.

The guidelines were drafted based on 'accumulated experience',[261] and have been rephrased several times. The White Paper on European Governance (2001) defined the key priorities to be cases involving: (i) the proper transposition of directives; (ii) the compatibility of national law with the fundamental principles of EU law; (iii) serious implications or repeated implementation problems, and (iv) EU funding. In all other cases, the Commission suggested exploring alternative means rather than formal infringement proceedings.[262] Later, these priorities were revised and further elaborated in the Communication on Better Monitoring of the Application of Community Law (2003), drawing attention to cases that concerned: (i) fundamental aspects of the rule of law (i.e. primacy and the uniform application of EU law, violations of human rights, and EU financial interests); (ii) the smooth functioning of the EU legal system (i.e. exclusive competences, repetition or systematic infringements, and cross-border implications); and (iii) the failure to transpose EU directives.[263] Finally, in 2007 the Commission modified the list of priority cases once again, declaring that 'priority

[259] Alberto G Ibáñez, 'The "Standard" Administrative Procedure for Supervising and Enforcing EC Law: EC Treaty Articles 226 and 228' (2004) 68 Law and Contemporary Problems 135, 141. For earlier developments see Alberto G Ibáñez, *The Administrative Supervision and Enforcement of EC Law: Powers, Procedures and Limits* (Hart Publishing 1999) 232-233.

[260] It should be noted, however, that along with the 'objective' selection criteria, the Commission can also take into account the special circumstances of each case. For instance, if there is an ongoing proceeding before national courts on a similar issue, the Commission declares that it may refuse to open the case, as it would be 'an inefficient use of its resources if it systematically investigated matters that are pending before national courts' (see DG Environment, 'Letter of 24 September 2010' <http://redabogadosdefensaambiental.es/wp-content/uploads/respuesta-falkenberg-1.pdf> accessed 28 December 2012). The fact that these additional factors cannot be found in the Commission's public documents, however, undermines the transparency of the enforcement policy.

[261] Commission, 'Better Monitoring of the Application of Community Law' (Communication) COM(2002) 725 final, section 3.1.

[262] Commission, COM(2001) 428 final, section 3.3.

[263] Commission, 'Better Monitoring of the Application of Community Law' (Communication) COM(2002) 725 final, section 3.1.

should be attached to those infringements which present the greatest risks, widespread impact (…) and the most persistent infringements confirmed by the Court', in particular: (i) non-communication; (ii) non-compliance with the Court's judgments that acknowledge a breach of EU law; and (iii) the violation of the principles of EU law or cases that have a potentially far-reaching negative impact on EU citizens.[264]

Hence, under the infringement procedure, three categories of cases are distinguished. The failure to communicate national implementation measures and the non-compliance with an earlier decision of the Court are associated with a breach of EU procedures (their distinct nature is illustrated by Article 260 TFEU). As will later be demonstrated, the Commission has limited its own discretion through self-imposed obligations in relation to the initiation and duration of these types of cases. The third category deals with the substance of each infringement and leaves full discretion to the Commission with regard to whether a specific breach 'violates the principles of EU law' or has a 'far-reaching negative impact for citizens'. According to the Commission, the interpretation of this category of cases should be provided on a sector-specific basis with a consideration of available resources.[265] This moves the infringement procedure a long way from being a 'de-politicised' procedure, as it was characterised by Snyder in the early 1990s.[266]

2.2.2. The 'Proactive' Use of Article 258 TFEU

Although the Commission states that the 'priorities, procedures and working methods' in relation to infringement proceedings are 'horizontally defined',[267] in practice, each

[264] Commission, 'A Europe of Results – Applying Community Law' (Communication) COM(2007) 502 final, section 3 (hereafter 'Commission, COM(2007) 502 final').

[265] ibid.

[266] Francis Snyder, 'The Effectiveness of European Community Law: Institutions, Processes, Tools and Techniques' (1993) 56 Modern Law Review 19, 28.

[267] DG Environment, 'Letter of 24 September 2010' <http://redabogadosdefensaambiental.es/wp-content/uploads/respuesta-falkenberg-1.pdf> accessed 28 December 2012. The Commission's internal regulation on infringement proceedings is not public.

Directorate-General develops its distinct approach and largely defines the scope and intensity of enforcement actions.[268] In the context of direct taxation, the role of Articles 258 and 260 TFEU was found to be particularly vital: as mentioned earlier, in 2001 the Commission acknowledged that a proactive enforcement policy should be considered as one of the key regulatory instruments.[269] The Commission's communication explained that

> [w]hile the Commission regularly submits its observations to the ECJ in tax cases brought by individual taxpayers, it has itself brought only a limited number of infringement proceedings against Member States in the area of direct taxation. However, the rapid development of EC case law in the direct tax field over the last few years through cases brought by individual litigants has highlighted the need for more Commission action (…). In short, the Commission now intends to adopt a more pro-active strategy generally in the field of tax infringements and be more ready to initiate action where it believes that Community law is being broken.[270]

Following this declaration, it was reasonable to expect the Commission to use the infringement procedure more frequently and, furthermore, in a more *proactive* way by opening cases on its own initiative. Indeed, the growing pressure was evident: over 500 direct tax cases were opened between 2001 and 2008 (see Diagram 2). This trend can be compared to the total number of all infringement proceedings pursued by the Commission (see Diagram 3). This shows that the increase in the number of newly detected direct tax cases departed from the general declining dynamics of enforcement actions across policy fields. In 2008, however, the two trends became more coherent. The post-2007 drop in the number of all detected cases can be partly explained by the introduction of EU Pilot,[271] which will be

[268] Direct tax cases are managed by DG TAXUD, which acts under the authority of the Commissioner responsible for Taxation and Customs Union, Audit and Anti-Fraud. In 2000 the unit controlling the application of EU legislation and state aid/direct taxation of DG TAXUD drafted a special set of internal rules on the operation of infringement cases, but this act was not adopted (based on interviews with representatives of the European Commission).

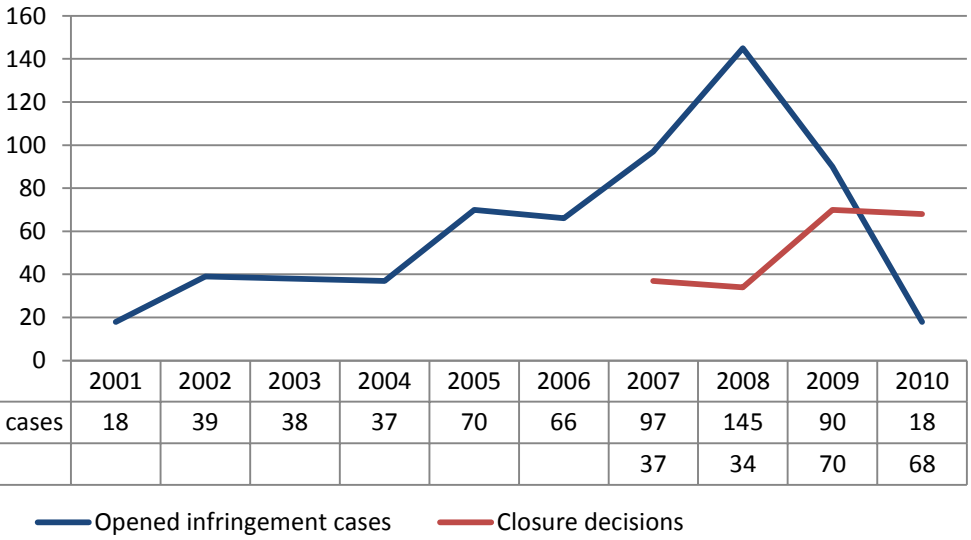
[269] Commission, COM(2001) 260 final, sections 4 and 5.

[270] ibid, section 4.2.

[271] 'Since 2010, the Commission observes a reduction in the volume of new infringement proceedings for the first 15 volunteer EU Pilot Member States. For the remaining 12 Member States, which joined EU Pilot after March 2010, a decrease is also observed, although to a lesser extent. Although it is not possible to identify all the reasons for this tendency, one explanation is the setting up of EU Pilot, which helps to clarify and solve satisfactorily some issues regarding application of EU law raised by the Commission, thus putting an end to problems without the need for recourse to infringement proceedings and, in the case of complaints, providing more rapid results for citizens and businesses' (Commission, 'Second Evaluation Report on EU Pilot' (Report)

discussed in greater detail in Part III Section 2.2.3. Diagram 2 shows that the impact of EU Pilot in the field of direct taxation became visible after a short delay: according to the Commission's reports, the new system was used for 15 direct tax cases in 2009 and 32 cases in 2010.[272] The number of closure decisions in 2009–2010 confirms that the resolution of pending cases remains a high priority, and the Commission's approach under Articles 258 and 260 TFEU has not become less vigorous.

Diagram 2. Newly Detected *Direct Tax* Infringement Cases in 2001–2010[273]



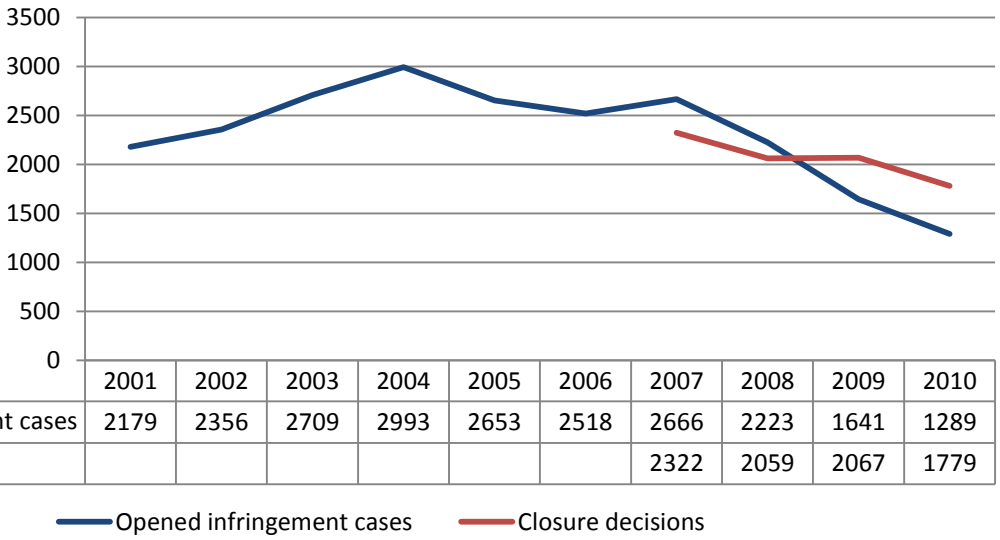
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Opened infringement cases	18	39	38	37	70	66	97	145	90	18
Closure decisions							37	34	70	68

COM(2011) 930 final, section 3 (citations omitted)). Also refer to Commission, 'Internal Market Scoreboard' (September 2012, No 25) 17-18.

[272] Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2010) 1143 accompanying '27th Annual Report on Monitoring the Application of EU Law (2009)' (Report) COM(2010) 538 final, section 11.3.1; Commission, 'Situation in the Different Sectors' (Staff Working Paper) SEC(2011) 1093 final accompanying '28th Annual Report on Monitoring the Application of EU Law (2010)', section 13.3.1.2, as well as the interviews with representatives of the European Commission.

[273] The number of 'opened infringement cases' is based on the data provided by the Commission in correspondence and reported in DG TAXUD Report of 24 January 2007on activities of the European Union in the tax field in 2006; DG TAXUD Report of 15 January 2008 on activities of the European Union in the tax field in 2007; DG TAXUD Report of 4 February 2009 on activities of the European Union in the tax field in 2008; DG TAXUD Report of 3 March 2010 on activities of the European Union in the tax field in 2009; DG TAXUD Report of 9 February 2011 on activities of the European Union in the tax field in 2010. The 'closure decisions' were reported in Commission, '25th Annual Report on Monitoring the Application of Community Law (2007)' (Report) COM(2008) 777 final; Commission, '26th Annual Report on Monitoring the Application of Community Law (2008)' (Report) COM(2009) 675 final; Commission, '27th Annual Report on Monitoring the Application of Community Law (2009)' (Report) COM(2010) 538 final; Commission, '28th Annual Report on Monitoring the Application of EU Law (2010)' (Report) COM(2011) 588 final (see accompanying annexes 'Situation in the Different Sectors').

Diagram 3. Total Number of *All* Newly Detected Infringement Cases in 2001–2010[274]

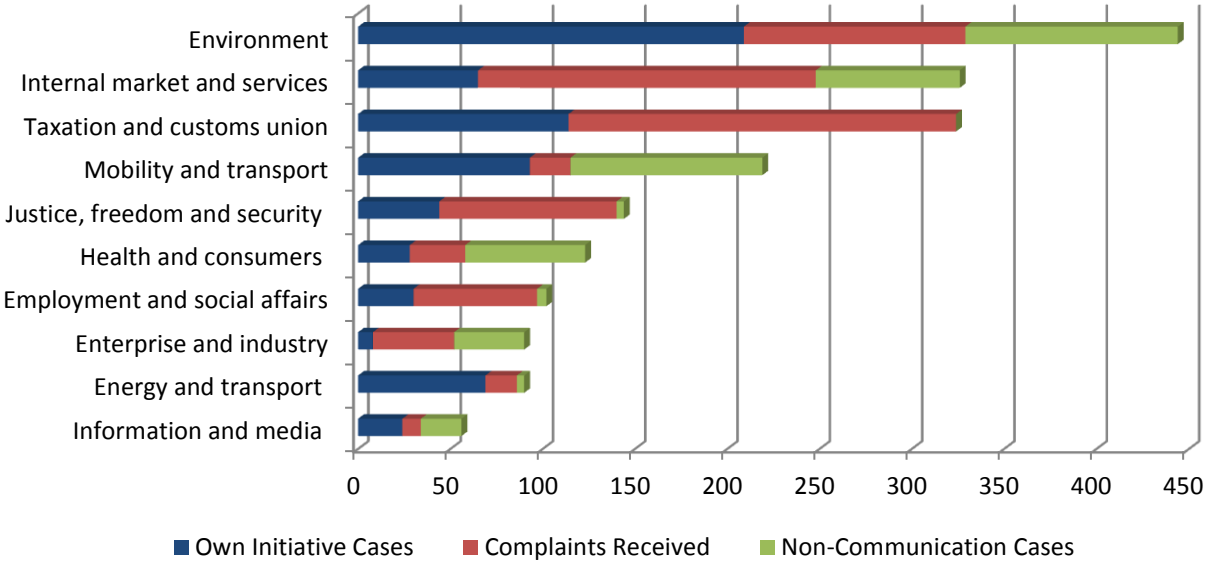


	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Opened infringement cases	2179	2356	2709	2993	2653	2518	2666	2223	1641	1289
Closure decisions							2322	2059	2067	1779

Diagram 4 provides a cross-sector comparison according to the classification used in the Commission's annual reports on monitoring the application of EU law. It shows that the number of infringement proceedings in the tax field is massive if compared to other policies. Considered without technical non-communications, 'Taxation and Customs Union' cases constitute the second largest group of pending investigations after environmental protection.

[274] Based on Commission, 'Statistical Annexes I to III' (Staff Working Paper) SEC(2011) 1094 accompanying '28th Annual Report on Monitoring the Application of EU Law (2010)' (Report) COM(2011) 588 final, tables 2.1 and 2.5.

Diagram 4. 'Taxation and Customs Union' Infringement Cases in a Cross-Sector Comparison *(as of 31 December 2010)*[275]



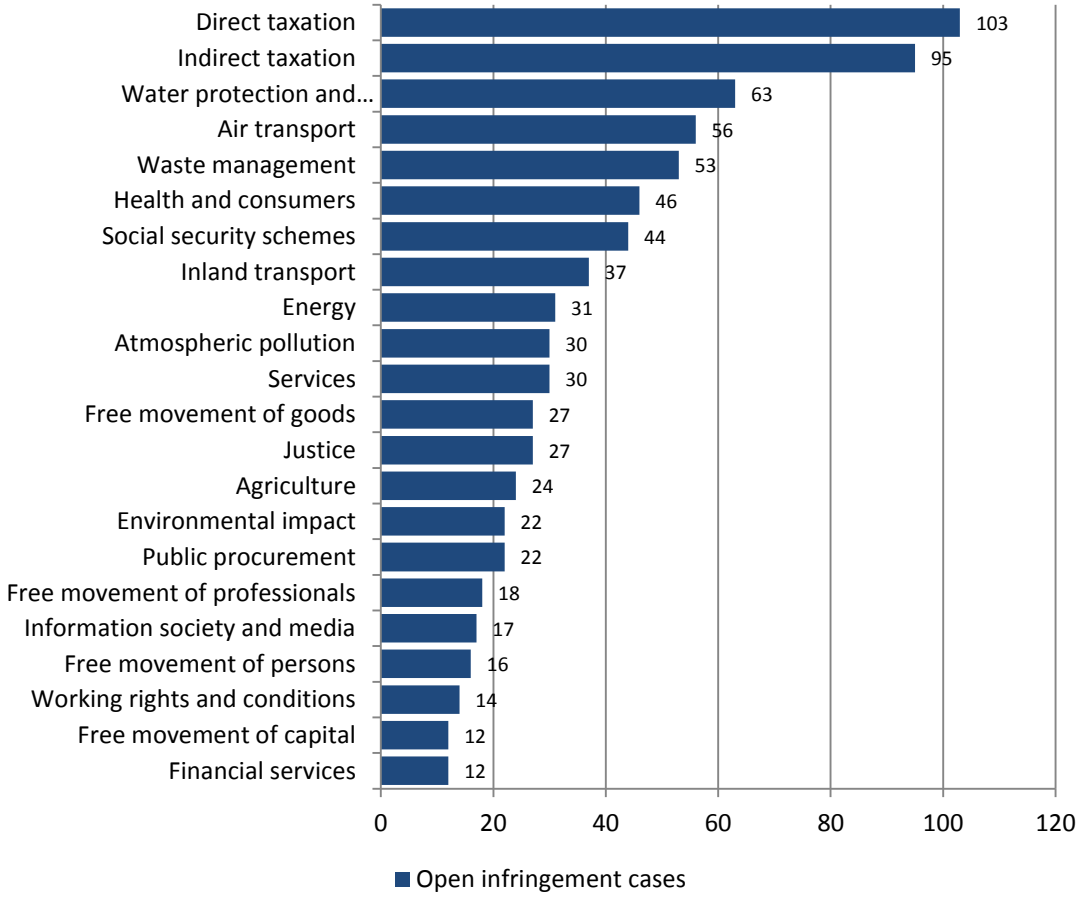
The Internal Market Scoreboard, which focuses on areas directly related to the functioning of the Internal Market and uses a more detailed classification of policies, allows a distinction to be made between direct and indirect tax cases (see Diagram 5). Retrospectively, taxation and customs union cases currently represent 24 per cent of all opened infringement cases, while a decade ago this area accounted for only 10 per cent of cases.[276] Overall, tax and environmental matters account for over 40 per cent of all pending infringement proceedings.[277]

[275] ibid, table 2.4.

[276] Cf Commission, 'Internal Market Scoreboard' (May 2002, No 10) 9 and Commission, 'Internal Market Scoreboard' (September 2012, No 25) 20. Since the 2002 report does not distinguish between the two categories of direct and indirect taxation, a more specific comparison is not possible.

[277] Commission, 'Internal Market Scoreboard' (September 2012, No 25) 20.

Diagram 5. 'Direct Taxation' Infringement Cases in a Cross-Sector Comparison *(as of 1 May 2012)*[278]

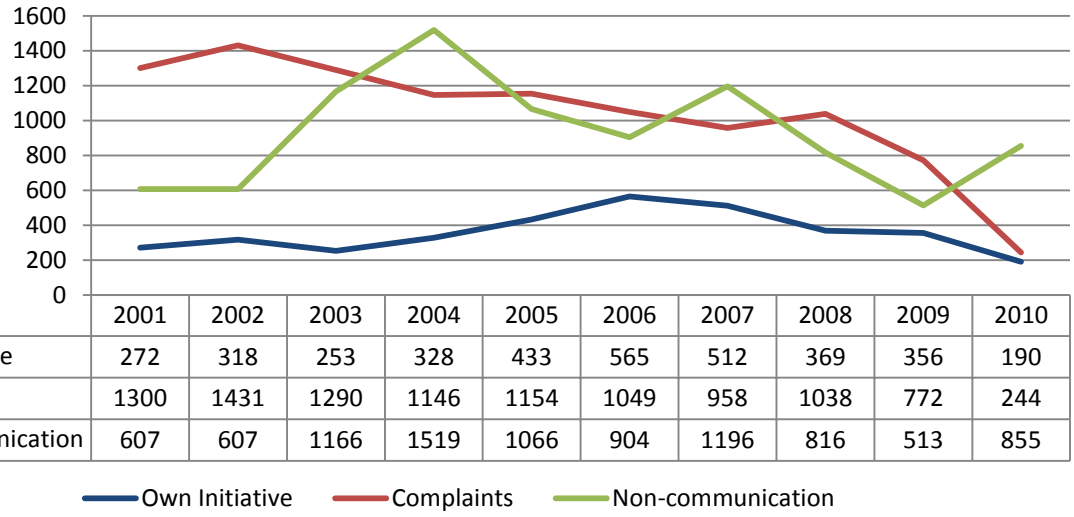


The dropping pattern of infringement cases requires a closer look. Diagram 6 illustrates fundamental internal changes in the nature of formal investigation by showing all new cases opened by the Commission between 2001 and 2010 according to the sources of origin. The magnitude of non-communication cases reflects the failure of Member States to provide notification of national transposition measures. Its fluctuation reflects institutional developments in the EU, with evident peaks in the years of enlargement (2004 and 2007). However, a more important trend is represented in two other curves. In 2001 only one in five cases were opened on the Commission's own initiative, while more than half the cases were complaint-based. The quantity of own initiative cases has since remained stable, while the

[278] ibid.

number of complaint-based cases has sharply dropped (from 60 per cent in 2001 to 20 per cent in 2010). In 2010 the number of cases in these two categories was almost equal (with 190 and 244 cases respectively). With nearly 70 per cent of all cases representing non-communication cases, the infringement procedure has been turned into a tool that defends the proper transposition of EU law. But have these transformations followed a similar logic in the field of direct taxation?

Diagram 6. The Sources of Origin of *All* Infringement Cases Opened in 2001–2010[279]



	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Own Initiative	272	318	253	328	433	565	512	369	356	190
Complaints	1300	1431	1290	1146	1154	1049	958	1038	772	244
Non-communication	607	607	1166	1519	1066	904	1196	816	513	855

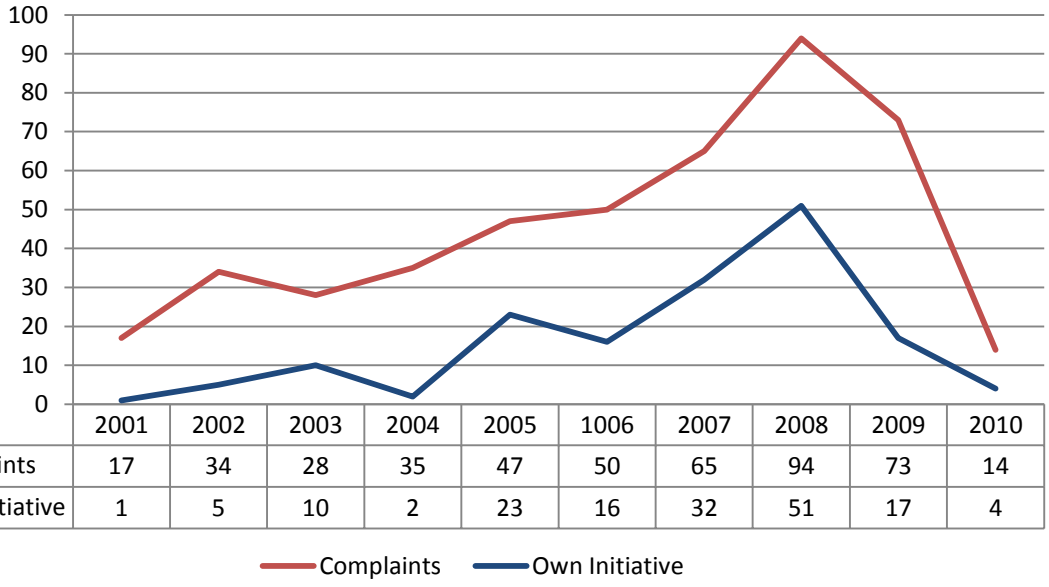
Diagram 7 shows that the proportion of direct tax cases opened in response to claimants remains high, unlike the general dropping pattern for the cross-sector data. The Commission declares that '[m]onitoring application of Community tax law has recently moved from a rather *re*active to a more *pro*-active infringement policy in general',[280] but these figures make the Directorate-General for Taxation and the Customs Union (hereafter 'DG TAXUD') appear rather *reactive* when compared to some other policy areas where the Commission's

[279] Built upon the data reported in Commission, 'Statistical Annexes I to III' (Staff Working Paper) SEC(2011) 1094 accompanying '28th Annual Report on Monitoring the Application of EU Law (2010)' (Report) COM(2011) 588 final, table 1.1.

[280] DG TAXUD, 'Commission Policy: Monitoring Application of Community Law' <http://ec.europa.eu/taxation_customs/common/infringements/commission_policy/index_en.htm> accessed 28 December 2012 (emphases added).

'own initiative' cases are much more common, such as environment, energy and transport, health and consumers, information society and media, and employment and social affairs.[281]

Diagram 7. The Sources of Origin of *Direct Tax* Infringement Cases Opened in 2001–2010[282]



	2001	2002	2003	2004	2005	1006	2007	2008	2009	2010
Complaints	17	34	28	35	47	50	65	94	73	14
Own Initiative	1	5	10	2	23	16	32	51	17	4

The Commission's active intervention in environmental matters is often explained by the limited resources available to non-governmental organisations for seeking protection from national courts and enforcement agents, while private litigants often demonstrate a lack of interest in environmental matters, or have no legal rights to pursue them.[283] The circumstances behind infringement cases in the area of direct taxation are fundamentally different. According to the Commission, this field is characterised by a high level of 'external

[281] Commission, 'Statistical Annexes I to III' (Staff Working Paper) SEC(2011) 1094 accompanying '28th Annual Report on Monitoring the Application of EU Law (2010)' (Report) COM(2011) 588 final, table 1.4.A.

[282] Built upon the data provided by the Commission in correspondence and reported in Commission, '25th Annual Report on Monitoring the Application of Community Law (2007)' (Report) COM(2008) 777 final; Commission, '26th Annual Report on Monitoring the Application of Community Law (2008)' (Report) COM(2009) 675 final; Commission, '27th Annual Report on Monitoring the Application of Community Law (2009)' (Report) COM(2010) 538 final; Commission, '28th Annual Report on Monitoring the Application of EU Law (2010)' (Report) COM(2011) 588 final (see accompanying annexes 'Situation in the Different Sectors').

[283] In these circumstances, '[o]nly the Commission can provide a systematic and strategic approach towards implementation throught the Union.' See Richard Macrory, *Regulation, Enforcement and Governance in Environmental Law* (Hart Publishing 2010) 713-714.

interest'. In 2010, for instance, the Commission received 145 'well-founded' direct tax requests for investigation.[284] Private litigants in this area are usually active – they have sufficient resources and legal rights to litigate the case in domestic courts: often an infringement complaint is sent in parallel to national level proceedings.[285] Even if the infringement procedure is not well placed for protecting the interests of an individual taxpayer due to its procedural framework and legal consequences, it can serve as an efficient tool for lobbying for systematic changes in tax laws by putting pressure on national and European decision-makers.[286]

2.2.3. EU Pilot: A Formalised Pre-Infringement Procedure

The White Paper on European Governance (2001) set two directions for the future development of enforcement policies. First, the Commission declared that a better application of EU law at the domestic level should be considered as a priority and that infringements will therefore be pursued 'with vigour'.[287] Second, admitting the importance of the complaints as a valuable source of information, the Commission emphasised that 'a lengthy legal action against a Member State is not always the most practical solution' for individual claims.[288] Following these principles, the Commission has improved the management of infringement cases and strengthened the problem-solving mechanisms at the pre-infringement stage.

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[284] Commission, 'Situation in the Different Sectors' (Staff Working Paper) SEC(2011) 1093 final accompanying '28th Annual Report on Monitoring the Application of EU Law (2010)', section 13.3.1.2. This number has been high for many years: 270 in 2007, 303 in 2008 and 260 in 2009 (see Commission, 26th–28th Annual Reports on Monitoring the Application of EU Law).

[285] In some cases, the European Commission can refer the case to the Court even if a similar case is pending under Article 267 TFEU. See **Germany** (No 2000/5229): a related request for a preliminary ruling was already pending before the Court since 27 January 2005 (the non-deductibility of school fees, Case C-76/05 *Schwarz and Gootjes-Schwarz* [2007] ECR I-6849). Compare to the declaration of DG Environment in (n 260).

[286] For instance, in 1999 the Commission announced that it received 'hundreds of complaints about the taxes applied by certain Belgian local authorities on satellite dishes' (Commission, '16th Annual Report on Monitoring the Application of Community Law (1998)' [1999] C354/1, 9). See also Commission, IP/00/237.

[287] Commission, COM(2001) 428 final, section 3.2.

[288] ibid.

In 2002, responding to requests from the European Ombudsman,[289] the Commission undertook certain obligations in relation to third parties: in particular, (i) to inform applicants of all the main steps that will be taken in relation to the case, and (ii) to respect the one-year time limit for the initial stage of the investigation, which may result in the opening of an infringement case.[290] In the same year, an alternative problem-solving tool was introduced (SOLVIT), aiming to address the problems of citizens and businesses related to the misapplication of EU law by Member States' authorities.[291] In 2008 the Commission started testing a pre-infringement procedure, EU Pilot, which covered issues concerning the correct application of EU law and the conformity of national laws with the requirements of EU law. In 2009 a special database for handling complaints (CHAP) was created for the more effective management of communication with citizens and businesses. EU Pilot will be discussed in greater detail due to its significant impact on the process of investigation.

EU Pilot was announced as a new working method in the Commission's Communication 'A Europe of Results – Applying Community Law' (2007).[292] The aim was to test the possibility of closer cooperation between the Commission and Member States in order to provide 'quicker and better' solutions regarding the correct application of EU law and

[289] The infringement procedure has been an important area of the European Ombudsman's actions since 1995, when 36 per cent of all complaints questioned the Commission's enforcement actions (Melanie Smith, 'Enforcement, Monitoring, Verification, Outsourcing: The Decline and Decline of the Infringement Process' (2008) 33 European Law Review 777, 789 and 788-792). See also Richard Rawlings, 'Engaged Elites Citizen Action and Institutional Attitudes in Commission Enforcement' (2000) 6 European Law Journal 4, 13-20; Carol Harlow and Richard Rawlings, 'Accountability and Law Enforcement: The Centralized EU Infringement Procedure' (2006) 31 European Law Review 447, 466-472.

[290] Commission, 'Relations with the Complainant in Respect of Infringements of Community Law' (Communication) COM(2002) 141 final, replaced by Commission, 'Updating the Handling of Relations with the Complainant in respect of the Application of Union Law' (Communication) COM(2012) 154 final, paras 8-9.

[291] Commission, 'Effective Problem Solving in the Internal Market ("SOLVIT")' (Communication) COM(2001) 702 final; Commission Recommendation C(2001) 3901 of 7 December 2001 on principles for using 'SOLVIT' – the Internal Market Problem Solving Network [2001] OJ L331/79. For the evaluation and more information see Commission, *Governance Report 2011: Making the Single Market Deliver* (Publications Office of the European Union 2012) and the Annual SOLVIT Reports (2004–2010). Since tax cases are often very complex, 'they are generally difficult to solve informally'. The number of tax cases processed through SOLVIT is small (68 tax cases were opened in 2010) (see Commission, *SOLVIT 2010 Annual Report* (Publications Office of the European Union 2011) 10-11). Typical cases concern VAT returns and double taxation. The role of SOLVIT and its interaction with other tools will not be discussed in this study, but see, for instance, Catharina E Koops, 'EU Compliance Mechanisms: The Interaction between the Infringement Procedures, IMS, SOLVIT and EU-Pilot' (2011) 42 Amsterdam Law School Research Paper.

[292] Commission, COM(2007) 502 final, section 2.2.

the compliance of national legislation with EU law.[293] The EU Pilot project modified the previous pre-infringement stage by establishing a system of electronic communication between the Commission's services and national authorities, which allowed the alleged breach of EU law to be addressed without opening the infringement procedure. In April 2008 it was introduced in 15 volunteer Member States,[294] and following a successful evaluation,[295] it was expanded to all other Member States.[296] Starting from 2011, the annual reports on monitoring the application of EU law integrated the data from EU Pilot.[297] The overall number of cases processed through this system demonstrates its contribution to the declining pattern of formal enforcement actions: in 2011 EU Pilot was used for 1,201 cases with a resolution rate of over 70 per cent.[298]

The Secretariat-General of the Commission registers all complaints and enquiries in CHAP. If after an initial examination the Commission finds the need to clarify whether EU law has been infringed, the case is processed through EU Pilot.[299] The system is also used for the Commission's own initiative cases, for files received from the Parliament Petitions'

[293] Commission, 'EU Pilot Evaluation Report' (Report) COM(2010) 70 final, section 1.

[294] Austria, Czech Republic, Denmark, Germany, Finland, Hungary, Ireland, Italy, Lithuania, the Netherlands, Portugal, Slovenia, Sweden, Spain and the United Kingdom.

[295] See Commission, IP/12/1280. However, some critical comments in relation to EU Pilot have been expressed by the European Parliament, the European Ombudsman, NGOs and academics. For instance, the Parliament asks for more evidence on 'the declared success of (...) "new methods" with detailed pre- and post-EU Pilot data' (see European Parliament Resolution 2011/2027(INI) of 14 September 2011 on the 27th annual report on monitoring the application of European Union law (2009), paras 10 and 23. The criticism from NGOs can be found, for instance, in the European Parliament, 'Public Hearing: Key Notes on Monitoring the Application of Community Law – EU Pilot' (28 April 2010) <http://www.europarl.europa.eu/document/activities/cont/201005/20100510ATT74349/20100510ATT74349EN.pdf> accessed 28 December 2012.

[296] The two last countries that joined were Luxembourg and Malta (June 2012). See Commission, 'Internal Market Scoreboard' (September 2012, No 25) 18.

[297] Commission, 'Annexes I to III' (Staff Working Document) SEC(2010) 1144 accompanying '27th Annual Report on Monitoring the Application of EU Law (2009)' (Report) COM(2010) 538 final, tables 1.5.1 and 1.5.2.

[298] Commission, '29th Annual Report on Monitoring the Application of EU Law (2011)' (Complete Report) COM(2012) 714, section 2.1.3.

[299] In exceptional cases, the infringement procedure can be launched immediately. See Commission, 'Second Evaluation Report on EU Pilot' (Report) COM(2011) 930 final, section 2: 'where urgency or another overriding interest requires the immediate launching of an infringement procedure under Article 258 TFEU, exceptions may be authorised and infringement procedures can be launched without previous contacts through EU Pilot'.

Committee and for letters from Members of the European Parliament (MEPs).[300] Each case is forwarded to the Central Contact Point that has been established in every Member State.[301] The Member State's response is sent back to the Commission for evaluation and the preparation of a notice for the complainant. Among the possible outcomes of this evaluation is the launch of a formal investigation. If this ensues, the case is moved to the database of infringement proceedings (NIF).

EU Pilot did not eliminate any formal stage of the infringement procedure, such as a letter of formal notice or a reasoned opinion, but rather replaced the practice of the 'pre-258 letters' that had been regularly issued by the Commission.[302] Two important changes, however, should be acknowledged. First, EU Pilot introduced a stronger obligation to respond to the Commission's enquiries. According to evaluation reports, Member States refused to reply in only 2 per cent of cases submitted through the new system.[303] Second, the circulation of documents between the Commission and national governments has become more vibrant: under the new procedure a ten-week time limit is provided for Member States' responses. The evaluation exercise undertaken by the Commission should be conducted within the same time frame.[304] Time limits can also be shortened (or lengthened) in exceptional cases if properly justified. In relation to the procedural rights of complainants, however, the Commission kept

[300] In 2007 EU Pilot was presented as a possibility for Member States 'to provide the necessary clarifications, information and solutions directly to the citizens or business concerned and inform the Commission' (Commission, COM(2007) 502 final, section 2.2). Initially, the new system was largely oriented towards complainants, so it was not clear if it would also be used for own-initiative cases (see Commission, 'EU Pilot Evaluation Report' (Report) COM(2010) 70 final, section 3).

[301] In the United Kingdom, for instance, this coordination function is fulfilled by the EU Section of the Cabinet Office responsible for infringement proceedings, whereas the legal work is undertaken by relevant policy departments. See Commission, 'Functioning of the System' (Staff Working Paper) SEC(2011) 1626 final accompanying 'Second Evaluation Report on EU Pilot' (Report) COM(2011) 930 final, section 1.2.

[302] Access to the documents is restricted under Council Regulation (EC) No 1049/2001 of 30 May 2001 regarding public access to European Parliament, Council and Commission documents [2001] OJ L145/43.

[303] These few exceptions were explained by insufficient information provided in the file. See Commission, 'Second Evaluation Report on EU Pilot' (Report) COM(2011) 930 final, section 3.

[304] ibid, section 1.

the ‘old’ 12-month time limit for the closure of the initial examination or the launch of the formal procedure.[305]

2.3. Interim Conclusion

This analysis has demonstrated that the infringement procedure and the Commission’s working methods have been recently reorganised. Currently, the centralised enforcement mechanism deals with three main categories of infringement cases, which are treated in different ways. The most serious breach is non-communication, which leads to an infringement procedure where the Commission is authorised to request financial penalties pursuant to the case under Article 258 TFEU. The next priority is a small group of cases that are referred to the Court under Article 260(2) TFEU as a result of non-compliance with an earlier ruling establishing a breach of EU law. This route has been shortened by the Treaty of Lisbon, which allows such a referral without the issue of a reasoned opinion. And the final category deals with ‘breaches of Community law (…) raising issues of principle or having a particularly far-reaching negative impact for citizens’.[306] This category, in fact, is the most important in terms of the elimination of a breach of EU law in a non-harmonised area of direct taxation. By communicating specific priorities for each policy sector, the Commission has demonstrated its attempt to turn the infringement procedure from a *reactive* enforcement tool into a more flexible instrument able to support its strategic policy objectives.

Following the 2001 declaration about a proactive enforcement strategy, the Commission has been pursuing direct tax infringements more rigorously. The number of formal investigations grew rapidly between 2001 and 2008, but has sharply declined since then. The Commission partly explains this effect by pointing to the introduction of EU Pilot, which

[305] Cf Commission, ‘Relations with the Complainant in Respect of Infringements of Community Law’ (Communication) COM(2002) 141 final, para 8; Commission, ‘Updating the Handling of Relations with the Complainant in respect of the Application of Union Law’ (Communication) COM(2012) 154 final, para 8.

[306] Commission, COM(2007) 502 final, section 3.

delays the opening of the infringement procedure, and also allows a more effective dispute resolution at the pre-infringement stage. The outcomes of this enforcement strategy will be more closely examined in Section 4, based on the direct tax cases pursued in 2005–2012.

Explanations of Commission working methods, which have been provided by the Commission through reports on the application of EU law and other communications, have enabled a better understanding of the initial stage of investigation that could potentially lead to the launch of an infringement procedure. The next section focuses on the procedural aspects of a formal investigation, aiming at identifying the key problems that need to be addressed. It argues that a transparent procedural framework would logically continue the developments that have been discussed in this section.

3. Key Procedural Problems

The legal basis for infringement proceedings has largely been construed through the case law of the Court.[307] The Court accepts the wide discretion of 'the guardian of the Treaties' in relation to an alleged breach of EU law and has established a limited scope of procedural guarantees for Member States. To begin with, Section 3 focuses on the first stage of the infringement procedure and discusses the inner conflict between prioritisation and the objective enforcement of EU law. Next, the analysis moves to the second stage of the infringement procedure, examining the balance of procedural rights and questioning the sufficiency of judge-made procedural guarantees.

[307] A useful summary of procedural framework can be found in Manuel Rebollo-Puig and Antonio Bueno-Armijo, *Administrative Procedures Prior to the Action for Failure to Fulfil an Obligation* (European Parliament 2011).

3.1. Prioritisation v. Objective Enforcement

The first stage of the infringement procedure has a diplomatic nature. The Commission relies upon national governments for the application of EU law and therefore confidence, trust and mutual understanding in relations between two parties play a fundamental role.[308] The confidentiality of negotiations is considered to be an essential condition that contributes to the voluntary compliance of Member States, even though it raises criticism about the 'elitist' nature of the infringement procedure.[309] This model requires a flexible procedural framework, which has been established by the Court.

According to settled case law, the infringement procedure leaves wide discretion to the Commission.[310] The Commission can choose *whether* to open and take any further steps in an infringement case,[311] and also decides whether the case should be referred to the Court.[312] It can decide *which* provision,[313] conduct or its omission[314] will be pursued and *when* to bring an action against a Member State for failure to fulfil its obligations.[315] Such steps are considered

[308] See, eg, Carol Harlow and Richard Rawlings, 'Accountability and Law Enforcement: The Centralized EU Infringement Procedure' (2006) 31 European Law Review 447, 465.

[309] See, for instance, concerns raised by P Nikiforos Diamandouros, 'The European Ombudsman and the Application of EU Law by the Member States' [2008] 1:2 Review of European and Administrative Law 5.

[310] See, inter alia, Case C-255/05 *Commission v Italy* [2007] ECR I-5767, paras 37-39.

[311] See, inter alia, Case C-35/96 *Commission v Italy* [1998] ECR I-3851, para 27; Case C-474/99 *Commission v Spain* [2002] ECR I-5293, para 25; Case C-33/04 *Commission v Luxembourg* [2005] ECR I-10629, para 67.

[312] See, inter alia, Case 247/87 *Star Fruit v Commission* [1989] ECR 291, paras 11-12; Case 87/89 *Sonito and others v Commission* [1990] ECR I-1981, para 7; Case C-209/89 *Commission v Italy* [1991] ECR I-1575, para 6; Case C-562/07 *Commission v Spain* [2009] ECR I-9553, para 19.

[313] See, inter alia, Case C-431/92 *Commission v Germany* [1995] ECR I-2189, para 22; Case C-35/96 *Commission v Italy* [1998] ECR I-3851, para 27; Case C-33/04 *Commission v Luxembourg* [2005] ECR I-10629, para 66; Case C-255/05 *Commission v Italy* [2007] ECR I-5767, para 38.

[314] Case C-476/98 *Commission v Germany* [2002] ECR I-9855, para 38; Case C-394/02 *Commission v Greece* [2005] ECR I-4713, para 16.

[315] See, inter alia, Case 7/68 *Commission v Italy* [1968] ECR 617, 428; Case C-317/92 *Commission v Germany* [1994] ECR I-2039, para 4; Case C-35/96 *Commission v Italy* [1998] ECR I-3851, para 27; Case C-33/04 *Commission v Luxembourg* [2005] ECR I-10629, para 66; Case C-255/05 *Commission v Italy* [2007] ECR I-5767, para 38.

as being 'objective in nature'[316] and the Commission does not have to demonstrate that 'there is a specific interest in bringing an action'.[317]

Many EU scholars have argued that such discretion has 'the potential for abuse', as any selective policy may interfere with the rule of law, the principles of equal justice and non-discrimination.[318] Since the Court refuses to question the 'appropriateness' of bringing actions, this also raises concerns about distorting the purpose of infringement actions and using the infringement procedure to reach political goals that lie beyond the need to ensure the proper enforcement of EU law.[319] In Case C-562/07 *Commission v Spain,* for instance, the government claimed that the Commission misused its powers by bringing an action to the Court notwithstanding the fact that the breach had been eliminated.[320] It argued that the Commission attempted to achieve objectives that were 'extraneous' to the purpose of Article 258 TFEU: first, to penalise the country for the fact that 'the Spanish courts and tribunals have not submitted references for a preliminary ruling to the Court of Justice on the subject of direct taxation', and second, to obtain 'a ruling from the Court (…) in order to ensure that citizens have the benefit of correctly applied Community law, and thereby [the Commission] assimilates the purpose of infringement proceedings to that of the preliminary rulings procedure.'[321] The Court rejected these grounds of inadmissibility: 'the Commission does not have (…) to state the reasons why it is bringing an action.'[322] It consistently refers to the balance of power between EU institutions and takes the position that 'it is not for the Court to

[316] See, inter alia, Case 415/85 *Commission v Ireland* [1988] ECR 3097, para 9; Case C-209/89 *Commission v Italy* [1991] ECR I-1575, para 6; Case C-474/99 *Commission v Spain* [2002] ECR I-5293, para 25.

[317] See Case C-431/92 *Commission v Germany* [1995] ECR I-2189, para 21; Case C-333/99 *Commission v France* [2001] ECR I-1025, para 23; Case C-476/98 *Commission v Germany* [2002] ECR I-9855, para 38; Case C-33/04 *Commission v Luxembourg* [2005] ECR I-10629, para 65.

[318] Alberto G Ibáñez, 'The "Standard" Administrative Procedure for Supervising and Enforcing EC Law: EC Treaty Articles 226 and 228' (2004) 68 Law and Contemporary Problems 135, 139-140.

[319] Case C-562/07 *Commission v Spain* [2009] ECR I-9553, para 22.

[320] ibid, paras 12-15.

[321] ibid, para 15.

[322] ibid, para 25, see also Case C-333/99 *Commission v France* [2001] ECR I-1025, para 24; Case C-474/99 *Commission v Spain* [2002] ECR I-5293, para 25; Case C-33/04 *Commission v Luxembourg* [2005] ECR I-10629, paras 65 and 66.

consider what objectives are [de facto] pursued in an action brought under Article 169 of the Treaty [currently Article 258 TFEU]'.[323]

Prete and Smulders rightly admit that '[a] good enforcement policy (…) necessarily requires some selectivity and prioritization', but the Commission's discretion 'is not absolute and cannot be exercised arbitrarily.'[324] The clarity, transparency, openness and proportionality of actions should guide the exercise of the Commission's enforcement power.[325] To reach a balance, several conditions should be sustained. First, a transparent administrative procedure that leaves only marginal discretion to the Commission must apply to all non-communication and non-compliance cases under Article 260 TFEU. Second, the enforcement policy towards other alleged infringements should be built upon clear priorities, which are set up according to the principles of good governance. Third, a horizontal approach to similar infringements across the EU should become the ultimate goal. These arguments are considered in detail in the following sections.

3.1.1. Member States' Liability for Non-Communication and Non-Compliance with an Earlier Judgment of the Court Establishing a Breach of EU law

Two 'procedural' categories of infringement cases, the non-communication of national measures transposing directives and the non-compliance with the Court's judgment establishing a breach of EU law (Article 260 TFEU), leave limited discretion to the Commission. The Communication 'A Europe of Results – Applying Community Law' (2007) not only prioritises these types of infringements, thus limiting the discretion with regard to

[323] See Case 415/85 *Commission v Ireland* [1988] ECR 3097, para 9.

[324] Luca Prete and Ben Smulders, 'The Coming of Age of Infringement Proceedings' (2010) 47 Common Market Law Review 9, 17.

[325] European Parliament Resolution 2011/2275(INI) of 21 November 2012 on the 28th annual report on monitoring the application of EU law (2010), para 13.

whether such a case should be opened, it also sets provisional *time limits* for infringement proceedings.[326]

If a Member State fails to provide notification of its national implementation measures, the Commission issues a formal notice without additional investigation under EU Pilot.[327] This approach is justified due to the nature and massive scale of the problem: on average, Member States take an additional nine months beyond the deadline to transpose an EU directive.[328] No more than 12 months should elapse between the letter of formal notice and a referral to the Court (or the closure of the case).[329] Empirical studies confirm that when a Member State fails to notify the Commission of implementation measures, the infringement procedure is initiated in nearly 100 per cent of cases not later than a year after the deadline, being 'executed rather rigorously'.[330] The number of initiated cases drops considerably when it comes to the incorrect transposition that follows under the third priority.[331] As will be seen in Section 4, these observations fully apply to the area of direct taxation.

More careful consideration is given to the category of non-compliance cases, which are much less frequent. In 2007 the Commission declared that the average period of time provided to eliminate the non-compliance with an earlier ruling of the Court should be

[326] Commission, COM(2007) 502 final, section 3.

[327] For instance, in the reasoned opinion sent to the **United Kingdom** (No 2005/0440), the Commission stated that 'in view of the fact that the United Kingdom of Great Britain and Northern Ireland *has not informed the Commission of the provisions adopted* to comply with the Directive in question [Directive 2003/123/EC of 22 December amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States] and *the Commission had no other information* enabling it to conclude that the United Kingdom of Great Britain and Northern Ireland had adopted the necessary provisions, *the Commission had to assume* that the United Kingdom of Great Britain and Northern Ireland had not yet adopted such provisions' (access provided through DG TAXUD and Secretariat-General for Openness and Civil Society).

[328] Commission, 'Internal Market Scoreboard' (September 2012, No 25) 6. The number of infringement cases is, therefore, considerable. In 2011, for instance, EU Member States had to transpose 131 directives. Due to late transposition, the Commission opened 1,185 infringement cases. See Commission, '29th Annual Report on Monitoring the Application of EU Law (2011)' (Complete Report) COM(2012) 714, section 1.1.

[329] Commission, COM(2007) 502 final, section 3.

[330] Miriam Hartlapp and Greda Falkner, 'Problems of Operationalization and Data in EU Compliance Research' (2009) 10 European Union Politics 281, 295.

[331] Ibid 295-296.

between 12 and 24 months.[332] Although Member States carry an obligation to take immediate action in response to a Court's judgment that establishes a breach of EU law,[333] this procedure on average takes about 18 months – with some countries such as Ireland requiring two years to introduce changes.[334] The corresponding enforcement actions are also highly inconsistent,[335] as can be illustrated by cases investigated by the Commission under Article 260 TFEU in the area of direct taxation. **Spain** (No 2000/4854)[336] and **Sweden** (No 2003/4314)[337] did not communicate amendments required under the Court's ruling. It took slightly under two years for the Commission to send a letter of formal notice to Spain and only nine months for it to send one to Sweden. In the third example, where changes introduced by **Greece** (No 2006/4044)[338] did not satisfy the Commission, the request for compliance was sent within six months. Once the letter of formal notice was sent, it took less than a year for the Commission to close each case.

Since the Treaty of Lisbon demonstrates an evident attempt to introduce a more severe approach to the 'procedural' type of infringements by enabling the Commission to request

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[332] Commission, COM(2007) 502 final, section 3.

[333] Case 169/87 *Commission v France* [1988] ECR 4093, para 14; Case C-328/90 *Commission v Greece* [1992] ECR I-425, para 6; Case C-101/91 *Commission v Italy* [1993] ECR I-191, para 20; Case C-291/93 *Commission v Italy* [1994] I-859, para 6.

[334] The data are based on 319 cases closed between May 2007 and April 2012. See Commission, 'Internal Market Scoreboard' (September 2012, No 25) 23.

[335] On the one hand, the reasons for this inconsistency can be explained by the course of informal negotiations that take place between the Commission and the national government before the letter of formal notice is sent. For instance, the Commission can take into account the scope of required legislative changes, procedural requirements in relation to the amendment of national fiscal provisions, and political reasons such as the dissolution of a parliament. On the other hand, the Commission's reports illustrate that Member States' reactions, particularly delays with implementation, tend to have constant patterns, which cannot be justified in the long run by specific circumstances.

[336] Spain failed to transmit any information to the Commission on the amendments of its legislation following the judgment of the Court that was delivered in December 2004 (Case C-219/03 *Commission v Spain* [2004] ECR I-0000) in infringement case No 2000/4854 (regarding capital gains on shares of foreign companies). A letter of formal notice was sent to the Spanish government in October 2006. The case was closed in March 2007.

[337] The ruling of the Court following infringement case No 2003/4314 was delivered in January 2007 (Case C-104/06 *Commission v Sweden* [2007] ECR I-671). In July 2007 the Commission sent a letter of formal notice to the Swedish government for not having fully complied with a Court judgment regarding the rules on capital gains tax relief on dwelling sales. The procedure was closed on January 2008.

[338] The letter of formal notice under Article 260 TFEU was sent in January 2010, requesting Greece to comply with a Court judgment concerning the taxation of income from inbound dividends (Case C-406/07 *Commission v Greece* [2009] ECR I-62 delivered in April 2009). The procedure was closed in September 2010 (No 2006/4044).

financial penalties already under Article 258 TFEU in non-communication cases, and excluding the need for a reasoned opinion under Article 260(2) TFEU, it may also affect the provisional time limits of between 12 and 24 months that are given to resolve the case. The Monti Report (2010) calls for a much stricter approach: no more than six months for non-communication cases and 12 months for the non-compliance with an earlier ruling of the Court.[339] The House of Lords of the UK Parliament expressed its support for the Monti Report's proposal.[340] In 2012 the Commission adopted a political target of 12 months for second referrals in several priority areas that have the 'most growth potential'.[341] There is hardly any explanation as to why this should not apply to all cases under Article 260(2) TFEU: any differentiation based on priority areas in relation to 'procedural' types of cases seems questionable.

The third category of infringement cases mentioned earlier – the violation of the principles of EU law or cases that have a far-reaching negative impact on EU citizens – is left to the discretion of the Commission's services, since '[i]t is difficult to set a meaningful general benchmark for other priority cases as they vary considerably in content and context.'[342] Leaving wide discretion in these cases seems to be the most workable solution. The average duration of infringement proceedings could be seen as a benchmark (26.9 months),[343] while some priority areas could be pursued more actively.[344]

Thus, progress towards the proceduralisation of the infringement procedure in relation to non-communication and non-compliance cases is slow, but evident. The next step would be

[339] Mario Monti, 'A New Strategy for the Single Market' (9 May 2010), section 4.2.

[340] UK Parliament – House of Lords, '15th Report on Re-Launching the Single Market' (2011), para 149.

[341] The priority areas are services (including retail and wholesale trade, business services, and construction), financial (intermediation) services, transport, digital economy and energy. Commission, 'Better Governance for the Single Market' (Communication) COM(2012) 259 final (see 'Annex').

[342] Commission, COM(2007) 502 final, section 3.

[343] For cases that were closed or referred to the Court between May 2009 and May 2012. See Commission, 'Internal Market Scoreboard' (September 2012, No 25) 21.

[344] For instance, the benchmark for the priority areas mentioned earlier was set at the level of 18 months from the letter of formal notice to the case resolution. See Commission, 'Better Governance for the Single Market' (Communication) COM(2012) 259 final, section 1.

to apply even shorter time limits for the resolution of the case. These changes further develop the infringement procedure: from a tool that is 'apt to reach only a limited number of the violations of Community law by the Member States'[345] to a procedure that effectively serves the needs of an integrated legal order that otherwise lacks universal enforcement mechanisms.

3.1.2. Transparent Policy Priorities Established According to a Good Governance Agenda

The Commission's prioritisation policy not only defines whether the infringement procedure is to be launched, but also determines the progress of the investigation, since '[p]rioritisation means that some cases will be dealt with (…) more immediately and more intensively than others.'[346] Since the priorities for the third category of cases are subject to policy considerations, they should be established with due respect for the fundamental principles of European governance, in particular openness and participation.[347] Despite recent positive developments in making the Commission's enforcement policy more transparent, some critical comments should be articulated.

The principle of openness dictates that the Commission should aim to work in an open manner – actively communicating its actions and decisions to the public in an accessible and understandable way 'in order to improve the confidence in complex institutions'.[348] Indeed, the priorities for infringements cases in the area of direct taxation were declared publicly by the Commission, but the clarity of this communication is doubtful. In order to construct a priority list, one needs to combine: (i) the general cross-policy selection criteria set up by the

[345] Eric E Bergsten, *Community Law in the French Courts: The Law of Treaties in Modern Attire* (Kluwer Academic Publishers 1973) 6 citing Andrew C Evans, 'The Enforcement Procedure of Article 169 EEC: Commission Discretion' (1979) 4 European Law Review 442, 448.

[346] Commission, COM(2007) 502 final, section 3.

[347] Commission, COM(2001) 428 final. The key principles of good governance also include effectiveness, coherence and accountability, which will be discussed in Part III Section 4.

[348] ibid, section 2.

2007 Commission's Communication;[349] (ii) the policy targets announced in the annual reports on monitoring the application of EU law for direct taxation;[350] and (iii) any other communications, consultations, studies or green papers that demonstrate the Commission's interest in a specific policy issue with reference to possible infringement proceedings in this field. For instance, the reports on the application of EU law in the period between 2006 and 2010 referred to the scope of issues covered by the Commission's Communication on Co-ordinating Member States' Direct Tax Systems in the Internal Market (2006)[351] and also by the subsequent three communications on cross-border losses,[352] exit taxation,[353] and anti-abuse measures.[354] Moreover, in several cases, specific targets were announced *ex post facto*. For instance, the Commission opened 12 cases related to the discriminatory taxation of foreign charities in 2008, but this area was announced as a priority only in the subsequent report on monitoring the application of EU law published in 2009.[355] The empirical data provided in Part III Section 4 will demonstrate that the identification of these policy targets does not always give a clear answer to the question as to why some infringement cases are processed (or why some are processed more rigorously) than others.

The principle of participation has been neglected in nearly all cases, as the priorities for direct taxation were defined without public consultation. The Directorate-General for Internal Market and Services, for instance, developing 'substantive criteria' for selection, opened the question 'which type of infringement cases should we handle as a priority?' to public

[349] Commission, COM(2007) 502 final, section 3.

[350] Can be found in Commission, 25th–28th Annual Reports on Monitoring the Application of EU Law.

[351] Commission, COM(2006) 823 final.

[352] Commission, 'Tax Treatment of Losses in Cross-Border Situations' (Communication) COM(2006) 824 final (hereafter 'Commission, COM(2006) 824 final').

[353] Commission, 'Exit Taxation and the Need for Co-ordination of Member States' Tax Policies' (Communication) COM(2006) 825 final (hereafter 'Commission, COM(2006) 825 final').

[354] Commission, 'The Application of Anti-Abuse Measures in the Area of Direct Taxation – within the EU and in Relation to Third Countries' (Communication) COM(2007) 785 final (hereafter 'Commission, COM(2007) 785 final').

[355] Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2009) 1683 accompanying '26th Annual Report on Monitoring the Application of Community Law (2008)' (Report) COM(2009) 675 final, section 12.3.1.2.

consultation.[356] In view of the fact that a direct tax policy is a particularly complex area for regulation, which raises sensitive subsidiary issues and involves wide circles of interested parties, the practice of public participation should be considered as essential. Since 2010 DG TAXUD has demonstrated a change in its traditional regulatory practices and has initiated several public consultations on direct taxes that may indicate a move towards a more participatory tax policy.[357]

So although the Commission has started to declare its selection criteria, its enforcement strategy should involve better communication with the public. Section 4 will examine the practical importance of the selection criteria, providing further recommendations in this respect.

3.1.3. A Horizontal Approach to Similar Infringements in Various Member States

Pursuing the policy of selective enforcement, the Commission should aim at ensuring a horizontal approach to similar infringements in various Member States. Although the Commission systematically declares this goal,[358] its practice in the field of direct taxation shows that it is far from being maintained in all cases. The failure to detect similar infringements in different Member States is explained by the Commission as resulting from limited human resources.

With the introduction of EU Pilot, the exchange of information between the Commission and Member States has intensified, enabling the Commission to receive

[356] DG Internal Market and Services, 'Consultation on the Future of the Internal Market' (2006) <http://ec.europa.eu/internal_market/strategy/docs/consultation_en.pdf> accessed 28 December 2012.

[357] See DG TAXUD, 'Tax Consultations' <http://ec.europa.eu/taxation_customs/common/consultations/tax/index_en.htm> accessed 28 December 2012.

[358] Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2008) 2854 accompanying '25th Annual Report on the Application of EU Law (2007)', section 11.3.3; Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2009) 1683 accompanying '26th Annual Report on Monitoring the Application of Community Law (2008)' (Report) COM(2009) 675 final, section 12.3.2; Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2010) 1143 accompanying '27th Annual Report on Monitoring the Application of EU Law (2009)' (Report) COM(2010) 538 final, section 11.3.2.

clarifications on national regulation within a 10-week time limit. This may help to strengthen the capacity of the Commission's services to conduct an EU-wide examination of potential infringements. At the same time, it seems that the problem lies in a different area and is not just related to scarce resources. Interviews with representatives from the Commission demonstrate that preference is given to the 'test case' approach. The Commission looks for the most certain example of a breach and proactively moves the case towards the Court. Then, the ruling is used to force compliance in other Member States with similar problems. In practice, several years may pass before the Commission challenges a similar breach in neighbouring states. For instance, in October and December 2006, the Commission sent reasoned opinions to **Poland** (No 2005/2426)[359] and **Spain** (No 2005/2431)[360] respectively, with a request to cease the discriminatory taxation of lottery winnings. In July 2007 Spain was referred to the Court (Case C-153/08 of 21 November 2009), but only after a year, in September 2008, was the same issue raised in a reasoned opinion sent to the Portuguese government.[361] Even more importantly, there is no confidence that a similar breach has not continued to exist in other Member States.

The rationale behind this approach is clear, and the Commission cannot be required to undertake *simultaneous* actions against all Member States.[362] These examples, however, raise the rhetorical question as to whether efficiency can be enhanced at the expense of the principle of good governance. The Court rightly denies this argument as a potential procedural guarantee that may be used as grounds for inadmissibility pleas,[363] but there is no

[359] **Poland** (No 2005/2426), IP/06/1360, closed 19 March 2009.

[360] **Spain** (No 2005/2431), IP/07/1030, Case C-153/08 *Commission v Spain* [2009] ECR I-9735 (Spain failed to fulfil its obligations), closed 5 May 2010 (Spain changed its legislation).

[361] **Portugal** (No 2007/2138), IP/08/1355, IP/09/567, closed 29/10/2009.

[362] See Luca Prete and Ben Smulders, 'The Coming of Age of Infringement Proceedings' (2010) 47 Common Market Law Review 9, 42. The Commission's practice includes many examples of horizontal actions; see, for instance, Commission, IP/10/795 (VAT grouping rules). The direct tax cases will be discussed in Section 4 of Part III.

[363] '[T]he Commission is free to initiate infringement proceedings against only some of the Member States which are in a comparable position from the point of view of compliance with Community law. It may thus, in particular, decide to initiate infringement proceedings against other Member States subsequently, after becoming

reason for refusing this approach as a policy target. A horizontal approach to similar infringements in Member States would be more appropriate in all direct tax cases, considering the complex balance of national fiscal interests that needs to be maintained by the Commission. The Internal Market Scoreboard refers to the 'fragmentation of the Internal Market factor', which is measured based on the transposition of directives: 'if one Member State does not deliver, the economic interests of all Member States are affected.'[364] Similar criticism could be applied in relation to the lack of a horizontal approach for infringements. Potentially, this approach may stimulate the exchange of information between Member States with similar problems and the coordination of policy responses.[365]

To sum up, prioritisation should merely concern the choice of subject matter, whereas a horizontal approach to similar infringements in different Member States should become an ultimate policy target. This argument will be further supported by policy considerations in Section 4, which looks into the impact of infringement proceedings.

3.2. The Balance of Procedural Rights

By submitting a reasoned opinion, the Commission officially declares that it has detected a breach of EU law, which should be eliminated in a prescribed period. Otherwise, the case may be brought before the Court, even if the breach has since been eliminated.[366] It moves the infringement action into a pre-litigation phase that requires detailed procedural regulation.

aware of the outcome of the earlier proceedings' (Case C-531/06 *Commission v Italy* [2009] ECR I-4103, para 24).

[364] Commission, 'Internal Market Scoreboard' (September 2012, No 25) 14.

[365] Access to information about pending investigations against other Member States is currently limited. In this context, Ibáñez recommends the establishment of an Advisory Committee, which will look for cooperative solutions (see Alberto G Ibáñez, 'The "Standard" Administrative Procedure for Supervising and Enforcing EC Law: EC Treaty Articles 226 and 228' (2004) 68 Law and Contemporary Problems 135, 150-151).

[366] See, inter alia, Case C-392/96 *Commission v Ireland* [1999] ECR I-5901, para 86; Case C-173/01 *Commission v Greece* [2002] ECR I-6129, para 7; Case C-177/03 *Commission v France* [2004] ECR I-11671, para 19; Case C-519/03 *Commission v Luxembourg* [2005] ECR I-3067, para 18; Case C-412/04 *Commission v Italy* [2008] ECR I-619, para 42; Case C-562/07 *Commission v Spain* [2009] ECR I-9553, para 23; Case C-487/08 *Commission v Spain* [2010] ECR I-4843, para 34; Case C-75/11 *Commission v Austria* [2012] ECR I-0000, para 25.

The entire 'hard' procedural law applicable to infringement proceedings, however, consists of Articles 258 and 260 TFEU. In its dialogue with EU national governments, the Commission has to respect the judicially created 'essential guarantees' for bringing an action under Articles 258 and 260 TFEU, which aim to ensure a proper conduct of the pre-litigation procedure.[367]

These guarantees can be summarised as ensuring the following: (i) the coherence and precision of infringement documents; (ii) the collegiality of the decision-making process; (iii) reasonable time frames for national authorities to reply to the letter of formal notice, to comply with a reasoned opinion and, if appropriate, to prepare a defence; and (iv) the allocation of the burden of proof that lies with the Commission. In the course of litigation, these procedural rules can be raised by the national government or by the Court on its own motion.[368] The next sections will demonstrate that these procedural rules are insufficient to balance the interests of the Commission and Member States.

3.2.1. The Coherence and Precision of Infringement Documents

In essence, the infringement procedure is a two-stage process that consists of a letter of formal notice followed by a reasoned opinion. The purpose of both documents is: (i) to define the subject matter of the dispute in a way that allows a Member State to prepare its defence and provide observations; and (ii) to enable national authorities to end the infringement before the

[367] See, inter alia, Case C-365/97 *Commission v Italy* [1999] ECR I-7773, para 35; Case C-392/99 *Commission v Portugal* [2003] ECR I-3373, para 133; Case C-221/03 *Commission v Belgium* [2005] ECR I-8307, para 37; Case C-38/10 *Commission v Portugal* [2012] ECR I-0000, para 16.

[368] See, inter alia, Case C-362/90 *Commission v Italy* [1992] ECR I-2353, para 8; Case C-195/04 *Commission v Finland* [2007] ECR I-3351, para 21; Case C-487/08 *Commission v Spain* [2010] ECR I-4843, para 70; Case C-53/08 *Commission v Austria* [2011] ECR I-0000, para 128; Case C-38/10 *Commission v Portugal* [2012] ECR I-0000, para 14; Case C-524/10 *Commission v Portugal* [2012] ECR I-0000, para 64; Case C-39/10 *Commission v Estonia* [2012] ECR I-0000, para 25.

case is referred to the Court.[369] Despite serving the same purpose, these documents are subject to different formal requirements. According to the Court, a reasoned opinion must include 'a coherent and detailed statement of the reasons which have led the Commission to conclude that the State in question has failed to fulfil one of its obligations under the Treaty'.[370] In contrast, the letter of formal notice 'cannot be subject to such strict requirements' and it 'cannot (…) contain anything more than an initial brief summary'.[371] In practice, each infringement case may embrace several formal notices and reasoned opinions resulting either from an exchange of views as part of negotiations,[372] or from the necessity to issue a supplementary document clarifying and/or adding certain details to the initial request.[373]

Since these pre-litigation documents serve an important purpose in defining the scope of the dispute, their coherence and precision constitute an essential guarantee provided by the Treaty.[374] The reasoned opinion must be built upon the same legal ground as the formal notice, and the subject matter cannot be extended when the case is referred to the Court.[375]

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[369] See, inter alia, Case C-1/00 *Commission v France* [2001] ECR I-9989, para 53; Case C-476/98 *Commission v Germany* [2002] ECR I-9855, para 46; Case C-337/05 *Commission v Italy* [2008] ECR I-2173, paras 19-20; Case C-20/09 *Commission v Portugal* [2011] ECR I-2637, paras 17-18.

[370] See, inter alia, Case C-191/95 *Commission v Germany* [1998] ECR I-5449, para 54; Case C-476/98 *Commission v Germany* [2002] ECR I-9855, para 48; Case C-337/05 *Commission v Italy* [2008] ECR I-2173, para 23; Case C-20/09 *Commission v Portugal* [2011] ECR I-2637, para 20.

[371] See, inter alia, Case C-191/95 *Commission v Germany* [1998] ECR I-5449, para 54; Case C-476/98 *Commission v Germany* [2002] ECR I-9855, para 48; Case C-20/09 *Commission v Portugal* [2011] ECR I-2637, para 19.

[372] For instance, in the infringement case against **Ireland** (No 2002/2223) regarding the failure of Ireland to fulfil its obligations under Directive 92/12/EEC on the general arrangement for products subject to excise duty and the holding, movement and monitoring of such products, the correspondence between the Commission and Ireland at the first stage of the infringement procedure consisted of a letter of formal notice (19 December 2002), the response of Ireland (1 April 2003), another formal notice (14 January 2004), and another response (28 March 2004). See the reasoned opinion in this case from 9 July 2004 (access provided through DG TAXUD and the Secretariat-General for Openness and Civil Society).

[373] For instance, a Member State can amend its domestic legislation in the course of an infringement procedure, and thus the Commission needs to clarify its arguments accordingly. See, eg, Commission, IP/10/1565 on exit tax for companies (**Spain**, No 2007/2382): 'The Commission already decided to refer Spain to the Court in October 2009 (Commission, IP/09/1460). However, Spain amended later on its legislation. Taking into account these amendments, the Commission sent an Additional Reasoned Opinion on 18 March 2010'.

[374] See, inter alia, Case C-186/06 *Commission v Spain* [2007] ECR I-12093, para 15 (and the case law cited); in relation to the application for bringing an action under Article 258 TFEU to the Court, see, inter alia, Case C-475/07 *Commission v Poland* [2009] ECR I-19, para 43; Case C-375/10 *Commission v Spain* [2011] ECR I-0000, para 10; Case C-524/10 *Commission v Portugal* [2012] ECR I-0000, para 65.

[375] ibid; see also Case 124/81 *Commission v United Kingdom* [1983] ECR 203, para 6; Case C-191/95 *Commission v Germany* [1998] ECR I-5449, para 55; Case C-340/96 *Commission v United Kingdom* [1999]

However, this requirement should not be carried so far as to mean that 'the complaints set out in the letter of formal notice, the operative part of the reasoned opinion and the form of order sought in the application must be exactly the same, provided that the subject-matter of the proceedings has not been extended or altered.'[376] Moreover, if the relevant domestic provisions have been amended without bringing the issue into compliance with EU law, the Court applies a less formalistic reading and holds that 'the action [of the Commission] may relate to provisions of national law which are not the same as those referred to in the reasoned opinion'.[377]

The coherence of documents within the infringement proceeding regularly raises admissibility pleas, which are resolved by the Court. The problem often appears when a 'brief summary of the complaints' provided in the letter of formal notice is turned into 'a coherent and detailed statement' in the reasoned opinion, which unavoidably involves a certain reformulation. Any 'irregularity' cannot be alleviated by the argument that the Member State submitted observations on the reasoned opinion.[378]

3.2.2. The Collegiality of Decision-Making

The principle of collegiality envisages that all members of the College of Commissioners should be equally involved in the decision-making process; in other words, they should participate in collective deliberation and bear collective responsibility at the political level for

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ECR I-2023, para 36; Case C-422/05 *Commission v Belgium* [2007] ECR I-4749, para 25; Case C-457/07 *Commission v Portugal* [2009] ECR I-8091, para 55; Case C-535/07 *Commission v Austria* [2010] ECR I-9483, para 41.

[376] See, inter alia, Case C-147/03 *Commission v Austria* [2005] ECR I-5969, para 24; Case C-33/04 *Commission v Luxembourg* [2005] ECR I-10629, para 37; Case C-177/04 *Commission v France* [2006] ECR I-2461, para 37; Case C-457/07 *Commission v Portugal* [2009] ECR I-8091, para 57.

[377] See, inter alia, Case C-203/03 *Commission v Austria* [2005] ECR I-935, para 29; Case C-177/04 *Commission v France* [2006] ECR I-2461, paras 37-38; Case C-457/07 *Commission v Portugal* [2009] ECR I-8091, para 58.

[378] See, inter alia, Case 51/83 *Commission v Italy* [1984] ECR 2793, paras 6 and 7; Case C-186/06 *Commission v Spain* [2007] ECR I-12093, para 15; Case C-535/07 *Commission v Austria* [2010] ECR I-9483, para 41; Case C-524/10 *Commission v Portugal* [2012] ECR I-0000, para 15.

any decisions taken.[379] According to case law, issuing a reasoned opinion or bringing proceedings against a Member State to the Court for a failure to fulfil obligations under the Treaty cannot be considered to be 'a measure of administration or management' and therefore 'may not be delegated'.[380] The Members of the College of Commissioners should be provided with relevant information.[381] In practice, not only are decisions regarding reasoned opinions and referrals to the Court taken in accordance with the principle of collegiality, but the letter of formal notice, and the withdrawal and closure of the case are also approved by the College of Commissioners.[382]

The principle of collegiality is respected as soon as the formal requirements of the administrative procedure are met. Infringement cases are included in the agenda of the Commission's meetings under category 'B' items requiring an oral procedure according to Article 8 of the Commission's Rules of Procedure.[383] However, these cases are usually also marked with an asterisk, meaning that a consensus regarding these items has been reached at the weekly meeting of the *Chefs de cabinet*. In practice, a discussion regarding infringement cases is hardly ever held, even at the level of the *Chefs de cabinet*.[384]

The number of infringement cases considered by the College of Commissioners is massive.[385] As a matter of efficiency, the 'Commissioners do not have available draft

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[379] Commission, 'Rules of Procedure of the Commission' C(2000) 3614 [2000] L308/26 as amended by Commission Decision 2010/138/EU of 24 February 2010 amending its Rules of Procedure [2010] OJ L55/60 (see Article 1). For a definition of the principle see Case 5/85 *AKZO Chemie BV and AKZO Chemie UK Ltd v Commission* [1986] ECR 2585, para 30; Case C-137/92 *Commission v BASF AG and Others* [1994] ECR I-2555, paras 62-63. For its application in the context of the infringement procedure see Case C-191/95 *Commission v Germany* [1998] ECR I-5449, paras 33-51.

[380] Case C-191/95 C*ommission v Germany* [1998] ECR I-5449, paras 36-37.

[381] ibid, para 48.

[382] A simplified procedure is used to close those cases that were found to be 'clearly groundless or irrelevant'. See Peter Schonewille, 'Eliminating Tax Barriers via the Infringement Procedure of Article 226 of the EC Treaty' [2006] 3 EC Tax Review 147, 150.

[383] Commission, 'Rules of Procedure of the Commission' C(2000) 3614 [2000] L308/26 as amended by Commission Decision 2010/138/EU of 24 February 2010 amending its Rules of Procedure [2010] OJ L55/60.

[384] Interviews with representatives of the European Commission.

[385] On 18 March 2010, for instance, the Commission decided upon 325 infringements, including approximately 40 tax cases (such meetings are held more than 10 times a year). See Commission, 'Database of the Recent Decisions on Breaches of EU Law' <http://ec.europa.eu/eu_law/infringements/infringements_decisions_en.htm> accessed 28 December 2012.

reasoned opinions when they adopt the decision'.[386] The key facts of an investigation are summarised in 'the infringement sheet', which includes the legal basis for proceedings, the subject matter of the dispute and the results of any negotiations.[387] Some governments have objected to this practice, arguing that the Commission does not have sufficient information to decide upon infringement actions.[388] However, this claim was refuted by the Court: since the Commission's decision 'does not have any binding legal effect for the addressee',[389] the Court considers that it is not necessary 'for the college itself formally to decide on the wording of the acts'.[390]

Considering the priorities promoted by the Commission, some changes to the decision-making process can be introduced. Currently, infringement decisions are taken on a country-by-country basis. A policy-based approach, differentiating cases under different categories and including references to related infringement cases opened against other Member States, seems to be a much needed and logical development.

3.2.3. Reasonable Time Frames for the Response of National Authorities

As a rule, the Commission allows two months for a Member State to reply to a letter of formal notice, to comply with a reasoned opinion and, where appropriate, to prepare a defence. All reasoned opinions that have been published in the area of direct taxation since 2005 apply this standardised time frame.[391] In exceptional cases, a much shorter period of one or two weeks can be assigned by the Commission; in particular 'where there is an urgent need to remedy a breach or where the Member State concerned is fully aware of the Commission's

[386] Case C-191/95 *Commission v Germany* [1998] ECR I-5449, paras 32 and 48.

[387] Case C-1/00 *Commission v France* [2001] ECR I-9989, para 81.

[388] Case C-191/95 *Commission v Germany* [1998] ECR I-5449, para 31.

[389] ibid.

[390] ibid, para 48.

[391] Except **Germany** (No 2003/4610) and **Germany** (No 1998/4684), where the reasoned opinions do not mention the time frame (see Commission, IP/07/1151 and IP/07/1547 respectively).

views long before the procedure starts'.[392] The unusual duration of proceedings may be taken into account only if it 'has made it difficult [for a Member State] to refute its arguments, thus infringing the rights of the defence' and the evidence of such a consequence should be provided by the Member State.[393]

The Court holds that 'the Commission is not obliged to act within a specific period'[394] and that all circumstances should be taken into account when deciding whether the period provided by the Commission was reasonable.[395] Both parties can present arguments defending their position if a conflict regarding time limits arises. In *Commission v Ireland*, the Court held that it was 'unreasonable (…) to allow a Member State five days to amend legislation which has been applied for more than 40 years and which, moreover, has not given rise to any action on the part of the Commission over the period which has elapsed since the accession of that Member State to the Community. Furthermore, it is clear that there was no particular urgency.'[396] Although the behaviour of the Commission in this case was found to be 'regrettable', it did not automatically imply the inadmissibility of actions.[397] Governments have to prove that a short (or excessive) duration of Commission actions infringes the right to either voluntary compliance or the preparation of a defence. In this case, the Court held that the actions were admissible, since Ireland expressed its disagreement with the Commission and a clear attempt was made to retain in force the legislation that was contested.[398]

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[392] Case C-1/00 *Commission v France* [2001] ECR I-9989, para 65 (five working days); see also Case C-328/96 *Commission v Austria* [1999] ECR I-7479, para 51 (fifteen working days).

[393] See, inter alia, Case C-287/03 *Commission v Belgium* [2005] ECR I-3761, para 14; Case C-33/04 *Commission v Luxembourg* [2005] ECR I-10629, para 76. To that effect see also Case C-96/89 *Commission v Netherlands* [1991] ECR I-2461, para 16; Case C-207/97 *Commission v Belgium* [1999] ECR I-275, para 25; Case C-333/99 *Commission v France* [2001] ECR I-1025, para 25; Case C-475/98 *Commission v Austria* [2002] ECR I-9797, para 36; Case C-523/04 *Commission v Netherlands* [2007] ECR I-3267, para 27.

[394] See, inter alia, Case C-207/97 *Commission v Belgium* [1999] ECR I-275, para 25; Case C-475/98 *Commission v Austria* [2002] ECR I-9797, para 36.

[395] See, inter alia, Case C-328/96 *Commission v Austria* [1999] ECR I-7479, para 51; Case C-1/00 *Commission v France* [2001] ECR I-9989, para 65.

[396] Case 74/82 *Commission v Ireland* [1984] ECR 317, para 12.

[397] ibid, para 13.

[398] ibid.

3.2.4. The Burden of Proof

The Commission needs to prove that the Member State has failed to fulfil its obligation under EU law. It should provide conclusive information to the Court and may not rely on any presumptions.[399] Evidence can be given at the written stage of the procedure or at the hearing, due to either the Commission's own consideration or an express request by the Court.[400]

In Case C-105/08 *Commission v Portugal*, the Court considered whether Portugal was breaching its obligations by taxing the interest paid to financial institutions resident in other EU or EEA states more heavily than that paid to financial institutions resident in Portugal.[401] To prove that non-resident entities were subject to a heavier tax burden, the Commission used 'an arithmetical example', which was based on the assumption that the margin of profit is 10 per cent.[402] It was referred to by the Commission as 'theoretical'.[403] The Advocate General, and subsequently the Court, opposed this approach, as the profit margin was one of the key indicators used to define the tax burden on non-resident entities.[404] The Portuguese government challenged the figure, showing that a different profit margin could produce the opposite result – with resident entities being taxed more heavily.[405] The Court agreed with AG Kokott that the Commission had to provide calculations that 'reflect the economic reality', by providing, for instance, 'statistical data or information concerning the level of interest paid on bank loans and relating to the refinancing conditions in order to support the

[399] See, inter alia, Case 96/81 *Commission v Netherlands* [1982] ECR 1791, para 6; Case 290/87 *Commission v Netherlands* [1989] ECR 3083, para 11; Case C-293/07 *Commission v Greece* [2008] ECR I-182, para 32; Case C-241/08 *Commission v France* [2010] ECR I-1697, para 22. For direct tax cases see Case C-105/08 *Commission v Portugal* [2010] ECR I-5331, para 26; Case C-600/10 *Commission v Germany* [2012] ECR I-0000, para 13.

[400] Case C-105/08 *Commission v Portugal* [2010] ECR I-5331, para 30.

[401] Case C-105/08 *Commission v Portugal* [2010] ECR I-5331.

[402] ibid, para 27.

[403] ibid, para 29.

[404] See, in particular, Case C-105/08 *Commission v Portugal* [2010] ECR I-5331, Opinion of AG Kokott, paras 28-48.

[405] Case C-105/08 *Commission v Portugal* [2010] ECR I-5331, para 29.

plausibility of its calculations.'[406] As a result, the Commission's actions were dismissed due to a failure to produce sufficient evidence that the figures provided were based on 'the actual facts' and were not 'purely hypothetical'.[407]

In Case C-600/10 *Commission v Germany*, the Court examined whether Germany infringed its obligations by taxing dividends and interests paid to non-resident pension funds more heavily than those paid to resident pension funds.[408] Dividend and interest payments made by German companies to resident pension funds were taxed at the level of the receiving entity on a net basis, while in the cross-border context they were subject to withholding tax on a gross basis without the possibility of deducting business-related expenses. The Court agreed that the difference in the tax treatment may discourage investment from other Member States. To prove that the resident and non-resident entities are in objectively comparable situations as required by settled case law, the Commission had to demonstrate that business expenses were directly linked to the income-generating activity in that Member State. The Court, however, concluded that the Commission relied upon 'hypothetical examples' without any 'plausible' evidence.[409]

3.3. The Lack of Procedural Regulation and Legal Certainty

The principles of coherence, precision, collegiality and allowing a reasonable amount of time for response – as established by the Court – are frequently raised in pleas of inadmissibility, whereas the failure to provide sufficient evidence could result in the Commission's actions being dismissed by the Court.[410] As demonstrated earlier, a key role is played by the

[406] ibid.

[407] ibid, paras 30-32.

[408] Case C-600/10 *Commission v Germany* [2012] ECR I-0000.

[409] ibid, paras 19-28.

[410] For more examples see Luca Prete and Ben Smulders, 'The Coming of Age of Infringement Proceedings' (2010) 47 Common Market Law Review 9.

requirement for coherence and precision in infringement documentation and by the allocation of the burden of proof. The principle of collegiality is less significant, since this requirement is met as soon as the formal record of approval by the College of Commissioners is in place. The argument that a Member State has not been provided with a reasonable length of time to respond to the Commission has hardly ever been accepted by the Court as grounds for the inadmissibility of actions. Although the existing guarantees set basic principles for enforcement actions and 'may provide some protection against Commission abuses',[411] the uncertainty created by the lack of written procedural regulation often raises conflicts between the Commission and national governments. According to settled case law, however, Member States cannot anticipate a specific line of conduct based on common practice.

In Case C-562/07 *Commission v Spain*, the government referred to 'repeated and uninterrupted practice', which created an expectation that the case would not be referred to the Court should the breach be eliminated.[412] In fact, the case was referred almost a year after the amendment was made. The Court ruled that a legitimate expectation, which may question the admissibility of actions, cannot be created by the Commission's discretion to decide 'where appropriate (…) not to bring an action seeking a declaration that a Member State has failed to fulfil obligations where that Member State had put an end to the alleged failure after the expiry of the time prescribed in the reasoned opinion'.[413] Member States cannot assume the Commission will take a horizontal approach to similar infringements in different Member States or that it will conduct an investigation within a specific time.[414] Reference to the principle of legal certainty was also refused by the Court, as the Commission had not issued a statement on the closure of the infringement procedure before the referral.[415]

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[411] Carol Harlow and Richard Rawlings, 'Accountability and Law Enforcement: The Centralized EU Infringement Procedure' (2006) 31 European Law Review 447, 458.

[412] Case C-562/07 *Commission v Spain* [2009] ECR I-9553, para 13.

[413] ibid, para 19.

[414] Such a possibility was ultimately rejected in the Dutch Open Skies case. See Case C-523/04 *Commission v Netherlands* [2007] ECR I-3267, paras 21-28.

[415] Case C-562/07 *Commission v Spain* [2009] ECR I-9553, para 24.

The uncertainty of enforcement actions also influences taxpayers interested in the outcome of the case. Problems with the application of the Court judgment in Case C-446/03 *Marks & Spencer* illustrate this correlation.[416] In October 2009 the Commission referred the UK government to the Court for the improper implementation of the *Marks & Spencer* ruling on a cross-border loss relief.[417] The referral took place four years after the Court ruling was delivered. However, the Commission's decision had not been carried out and, in November 2010, the Commission sent a complementary reasoned opinion to the United Kingdom, adjusting its initial opinion according to the legislative changes introduced by the government (section 119 of CTA 2010). The press release on this second reasoned opinion was published a year after the decision was made.[418] In October 2012 the case was referred to the Court for the second time. Currently, it remains on the list of cases where the Commission decision to go to the Court has not yet been carried out.[419] Considering some other examples with multiple and delayed referrals, there is no certainty that the infringement case will reached the Court. For instance, the Portuguese case on dividends (No 2004/4353) was referred to the Court four times: in December 2006, June 2007, June 2010 and November 2010. None of these decisions had been carried out and the case was closed in March 2011 after Portugal 'voluntarily' amended its legislation.[420] At the same time, the *HMRC v Marks & Spencer plc* case is pending at the Supreme Court of the United Kingdom, with the hearing to be held in

[416] Case C-446/03 *Marks & Spencer* [2005] ECR I-10837.

[417] The **United Kingdom** (No 2007/4026), 18 September 2008 – reasoned opinion (Commission, IP/08/1365), 8 October 2009 – referral (Commission, IP/09/1461), 24 November 2010 – additional reasoned opinion (IP from 24 November 2010, no number) and 27 September 2012 – second referral (Commission, IP/12/1017). The decision has not yet been carried out.

[418] The decision on the second referral was added to the Commission's database of the recent decisions on breaches of EU law, but this source does not disclose the content of actions.

[419] As of 7 December 2012, based on DG TAXUD, 'CJEU Cases in the Area of, or Particular Interest for, Direct Taxation' <http://ec.europa.eu/taxation_customs/resources/documents/common/infringements/case_law/court_cases_direct_taxation_en.pdf> accessed 28 December 2012.

[420] **Portugal** (No 2004/4353), IP/06/1060, IP/07/66, IP/10/662, closed 14 March 2011.

June 2013. The parties, however, have already requested a second reference for the preliminary ruling to clarify some points of uncertainty.[421]

These examples illustrate that any predictions regarding progress in infringement proceedings are unfounded, and provide an argument for adopting a procedural act that could balance the interests of major actors and bring more certainty.[422] The Parliament requested the Commission 'to propose a "procedural law" in the form of a regulation under the new legal basis of Article 298 TFEU', which would establish a transparent framework for the infringement and pre-infringement procedure.[423] It should guarantee respect for 'the principles of an "open, efficient and independent European administration" as referred to in Article 298 TFEU, and the right to good administration referred to in Article 41 of the Charter of Fundamental Rights of the European Union'.[424] The Parliament explicitly refused the possibility of using a non-binding instrument, while the Commission opposed 'the possibility of adopting any future regulation' in view of the discretionary power granted by Articles 258 and 260 TFEU.[425]

3.4. Interim Conclusion

This overview brings us to the conclusion that Member States, which have firmly protected their fiscal sovereignty by requiring unanimous voting in the Council and a subsidiary monitoring mechanism, have not put enough effort into clarifying the procedural ambiguity of infringement proceedings. Despite the overall strengthening of the Commission's

[421] As reported by Philip Baker in the section on UK cases at the conference 'Recent and Pending Cases at the ECJ on Direct Taxation' (29 November – 1 December 2011, Vienna).

[422] See, eg, Alberto G Ibáñez, 'The "Standard" Administrative Procedure for Supervising and Enforcing EC Law: EC Treaty Articles 226 and 228' (2004) 68 Law and Contemporary Problems 135, 157-159.

[423] European Parliament Resolution 2011/2275(INI) of 21 November 2012 on the 28th annual report on monitoring the application of EU law (2010), paras 17-18.

[424] ibid, para 19.

[425] ibid.

enforcement powers, this problem has not been addressed. The existing uncertainty should be minimised before any progress is made towards applying the enforcement mechanism 'with increased determination', as recommended by the Monti Report (2010).[426]

A selective approach to infringement cases and the objective enforcement of EU law could be reconciled through the following steps: (i) the procedural path for non-communication and non-compliance cases under Article 260 TFEU should be fully transformed into a transparent administrative procedure; (ii) the selection of criteria must apply strictly to the third category of cases (the violation of the principles of EU law or cases that have a far-reaching negative impact on EU citizens) and should be set with full respect for the democratic ideas of openness, participation and accountability; and (iii) similar infringement in various Member States must be targeted horizontally.

In order to ensure the balance of procedural rights, a transparent procedural regulation should be adopted. It should consolidate existing judge-made rules, particularly in relation to: (a) the principle of coherence and precision regarding letters of formal notice and reasoned opinion; (b) the principle of collegiality of decisions regarding reasoned opinions and the commencement of proceedings before the Court; (c) guidelines regarding a reasonable time frame that should be provided for national authorities to comply with the Commission's opinion; and (d) the burden of proof; it should also encompass some other aspects of the infringement procedure that are currently defined by various non-binding instruments, such as the rights of complainants and rules for calculating the amount of lump sum and penalty payments under Article 260 TFEU.

Yet, there is no agreement on the optimal procedural framework for the organisation and the management of infringement proceedings. The final section of Part III will argue that the EU central enforcement mechanism should be understood as having a *multilayered* legal nature, and will propose some procedural developments in the light of this model. It will

[426] Mario Monti, 'A New Strategy for the Single Market' (9 May 2010), section 4.2.

discuss the conflicting positions of major actors, in particular the Commission and the Parliament, and will show how to reconcile them, bringing more certainty into the process of EU enforcement. Before we turn to this analysis, Section 5 examines infringement cases initiated by the Commission in the area of direct taxation. This insight depicts the scope of enforcement actions and their impact on national direct tax laws in 2005-2012, supporting the argument for more certainty and transparency.

4. Assessing the Use of Infringement Proceedings in the Area of Direct Taxation (2005–2012)

Already in the mid-1980s, scholars observed that infringement actions could be used 'as one of the means to *encourage* and *stimulate* a progressive evolution of Community laws and policies in certain areas.'[427] Up to now, however, the impact of infringement proceedings in the area of direct taxation has neither been comprehensively reported on by the Commission, nor critically assessed by EU tax scholarship. This lack of academic discussion can be explained by two objective factors. First, the importance of infringement proceedings started increasing only in 2001, so this trend is relatively recent. Second, the restricted access to information on infringement proceedings provides limited room for research. The available Commission reports provide predominantly quantitative data without analytical interpretation. Only since 2005 has DG TAXUD published a press release (an 'information press' (IP) or, more recently, a memorandum (MEMO)[428]) on its website for each infringement case that has reached the stage of reasoned opinion, which has opened up the possibility of substantive analysis.

[427] Luca Prete and Ben Smulders, 'The Coming of Age of Infringement Proceedings' (2010) 47 Common Market Law Review 9, 14 (citation omitted; emphasis added).

[428] In 2012 the Commission changed its reporting practice: instead of 'informations presse' (IPs), it publishes memoranda (MEMOs). Both types of documents will be referred to as a 'press release'.

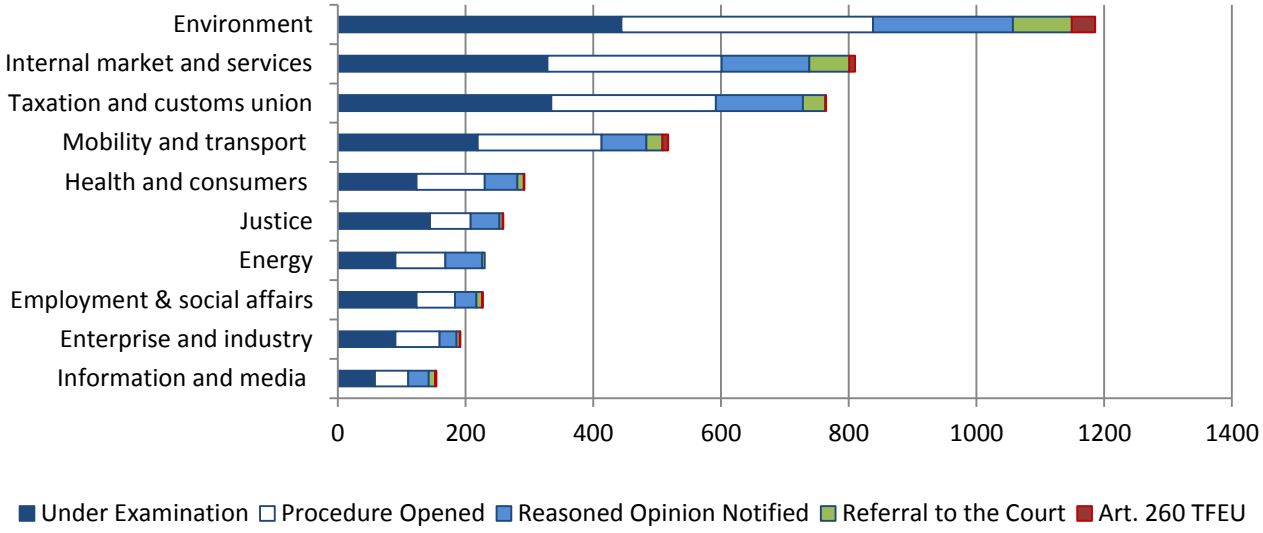
This examination covers the Commission's enforcement actions in 2005–2012. First, it reconciles infringement cases in the area of direct taxation with enforcement priorities declared by the Commission. Next, it maps the factual scope of the application of Articles 258 and 260 TFEU. Attention is drawn to the selected case studies, which explore the Commission's failures and successes in forcing systematic changes on Member States' direct tax systems in areas defined as strategic priorities. Finally, it offers some observations on the Commission's working methods and explains the differences in the progress of various infringement cases. In conclusion, it generates some recommendations in relation to the Commission's approach to infringement cases and calls for an enhancement of the transparency of enforcement actions by changing the practice of reporting.

4.1. Research Design

This study seeks to demonstrate that the Commission's role in eliminating fiscal barriers cannot be assessed with reference to case law initiated through Articles 258 and 260 TFEU.[429] Since 95 per cent of all direct tax disputes are settled before the case is referred to the Court (see Diagram 8), the central object of this analysis will be the administrative stage of infringement proceedings.

[429] For a retrospective analysis, see Heather Mbaye, 'Why National States Comply with Supranational Law: Explaining Implementation Infringements in the European Union 1972–1993' (2001) 2 European Union Politics 259, 266-269.

Diagram 8. Infringement Cases under Examination by Policy Areas *(as of 31 December 2010)*[430]



Such examination, however, is rather challenging due to the limited access to information, and it requires a detailed explanation of the research methodology. There is no secondary source disclosing comprehensive information on infringement proceedings and their impact on national direct tax legislation. Furthermore, access to the primary source – infringement case documents – is restricted under Article 4(2) of the Council Regulation No 1049/2001 on public access to European Parliament, Council, and Commission documents.[431] The observations for this study have been collected through a combination of publicly accessible sources provided by the Commission. Since 2001 the Secretariat-General has created a public database of recent decisions on breaches of EU law, which includes a reference number for each case, its subject matter and the decision taken by the

[430] Built upon the data provided in Commission, 'Statistical Annexes I to III' (Staff Working Paper) SEC(2011) 1094 accompanying '28th Annual Report on Monitoring the Application of EU Law (2010)' (Report) COM(2011) 588 final, table 2.4.

[431] It stipulates that access to a document can be limited for 'the purpose of inspections, investigations and audits [unless there is an overriding public interest in its disclosure]'. See Council Regulation (EC) No 1049/2001 of 30 May 2001 regarding public access to European Parliament, Council and Commission documents [2001] OJ L145/43.

Commission.[432] At the stage of formal notice (*mise en demeure*) only the most important cases are included, but all subsequent stages – the reasoned opinions (*avis motivé*), withdrawals (*désistement*), referrals (*saisine*) and closures (*classement*) – are fully recorded.[433] These basic data are also reproduced in annual reports on monitoring the application of EU law for all cases processed further than the second stage of infringement proceeding in a given year. Another source of information is provided by DG TAXUD, which maintains a database of press releases published by the Commission in the area of direct taxation following each reasoned opinion sent to Member States (since 2005). Typically, it also provides a reference if national tax provisions were amended as a result of enforcement actions. Closed infringement cases 'in principle' can be provided for examination by means of a special case-by-case request,[434] but it would only be possible in relation to those cases that are included in the database of recent decisions on breaches of EU law, or the annual reports on monitoring the application of EU law (so, again, mostly those cases that reach the second stage of infringement procedure), as otherwise even basic information required to request the case documents is unavailable. Regrettably, the information provided by the Commission is often inaccurate, as press releases published by DG TAXUD may omit the case reference number, or differences may occur in the date (or case reference number) provided by different sources.[435] This makes the analysis of the Commission's enforcement actions quite problematic.

The database of infringement cases was built as follows. First, 192 direct tax cases that were communicated through the Commission's press releases between 1 January 2005 and 1 December 2012, were comprised into a single catalogue and classified according to the

[432] COM(2001)309 final, 9. See also Commission, 'Database of the Recent Decisions on Breaches of EU Law' <http://ec.europa.eu/eu_law/infringements/infringements_decisions_en.htm> accessed 28 December 2012.

[433] See Peter Schonewille, 'Eliminating Tax Barriers via the Infringement Procedure of Article 226 of the EC Treaty' [2006] 3 EC Tax Review 147, 149.

[434] The right to access the internal central database of complaints is limited 'even within the Commission' (see ibid 149).

[435] For instance, see **Greece** (No 2006/2241).

subject matter concerned. This index includes all direct tax cases that reached the stage of reasoned opinion, as well as several exceptional cases where a press release was issued at other stages of infringement proceedings.[436] Second, the database of recent decisions on breaches of EU law and the annual reports on monitoring the application of EU law were used to add details not provided by the press releases, as well as to identify the procedural steps (or sometimes cases) that the Commission has not communicated. Third, the implications of each infringement proceeding were explored. As a rule, the Commission does not explain the reasons behind the closure of a case beyond brief records on the successful changes of national legislation provided by DG TAXUD, the regularity and systematic update of which can be questioned. These gaps have been filled through secondary sources. Finally, all cases were reconciled with the Commission's political and legislative agenda in the field of direct taxation. Some selected samples of infringement cases were obtained under the Council Regulation No 1049/2001.[437] The internal operation of direct tax cases was clarified through interviews with representatives of the Commission.

On average only 25 per cent of tax and customs cases move beyond the first stage.[438] Since the content of other investigations remains largely unknown, this sets quantitative limits for this research.[439] At the same time, the cases covered by this study demonstrate the most

[436] Before 1996, press releases on infringement proceedings were published only in exceptional cases. However, as a result of changes in the policy towards greater transparency, the Commission committed to issuing a press release on each reasoned opinion and referral 'unless the Commission decides otherwise'; the letters of formal notice remain fully confidential, except those for non-communication cases (see Commission, IP/97/664). The consistency of this practice varies from year to year. For instance, 40 press releases were published in 1996, 248 in 1997, 334 in 1998, 221 in 1999, 178 in 2000 and 93 in 2001 (see Commission, 16th–19th Annual Reports on Monitoring the Application of Community Law). For direct taxes, the press releases at the second stage of the infringement procedure and when the case is referred to the Court became regular only since 2005. In exceptional cases, the Commission may publish a *communiqué* at other stages of the infringement proceedings.

[437] Council Regulation (EC) No 1049/2001 of 30 May 2001 regarding public access to European Parliament, Council and Commission documents [2001] OJ L145/43. Access to some infringement cases used in this study was obtained through DG TAXUD and the Secretariat-General for Openness and Civil Society. A letter of formal notice, a reasoned opinion, and a Member State's response can be provided for examination; but each Member State involved needs to be consulted before their disclosure, so the process is lengthy.

[438] Commission, 'Statistical Annexes I to III' (Staff Working Paper) SEC(2011) 1094 accompanying '28th Annual Report on Monitoring the Application of EU Law (2010)' (Report) COM(2011) 588 final, table 2.4.

[439] In 2007 the Commission undertook an obligation to provide a summary of each infringement case 'on all stages of infringement proceedings from the letter of formal notice as they progress', but it has not yet been implemented. See Commission, COM(2007) 502 final, section 4.2.

interesting and conflicting examples – it can be assumed that in less certain circumstances Member States will negotiate with the Commission at least until the second stage of the infringement procedure. The other side of the coin is that this approach might underestimate the number of clear-cut cases (in particular, those that constitute a legal follow-up to CJEU rulings). But even if this analysis cannot capture the full picture of the Commission's enforcement actions, it gives a fairly detailed account of patterns of work, procedural problems, typical infringements and the implementation of declarations made through non-binding instruments in enforcement actions. All this – without an ambition to go beyond these goals – can be derived from the analysis of the available data. This study constitutes the first attempt to examine the enforcement activities of the Commission in the area of direct taxation from both quantitative and qualitative perspectives, which makes it a valuable contribution to the field.

4.2. Selection Criteria for Enforcement Actions in the Field of Direct Taxes

As discussed in Section 2, the priority areas for enforcement actions are defined as follows: (i) the non-communication of national implementation measures; (ii) the non-compliance with an earlier judgment of the Court establishing a breach of EU law; and (iii) clear and serious infringements that violate the principles of EU law or have a far-reaching negative impact on EU citizens.[440] This section summarises the empirical observations of the Commission's enforcement actions according to these functional categories, and considers the third category in the context of the Commission's direct tax policy agenda.

[440] ibid.

4.2.1. Non-Communication of National Implementation Measures

Despite the limited number of direct tax directives due to be transposed, between 2005 and 2009 the Commission opened about 130 proceedings.[441] The operation of the non-communication cases was very technical and synchronised: all reasoned opinions were sent within one year after the date when the measure should have been adopted, and were closed within another year. For instance, in March 2005, four months after the amendments to the Mutual Assistance Directive[442] should have been notified, the Commission sent the letters of formal notice to 13 Member States.[443] In July the cases against the **Czech Republic** (No 2005/0293),[444] **Greece** (No 2005/0321),[445] **Ireland** (No 2005/0350),[446] **Italy** (No 2005/0361)[447] and **Luxembourg** (No 2005/0374)[448] were processed to the second stage of infringement proceedings. All cases were closed by the end of 2005, with the exception those of Greece and Luxembourg, which were simultaneously referred to the Court and then closed a year later.

The vast majority of non-communication cases are resolved shortly after the letter of formal notice. The ratio is so high that it must largely define the impressive efficiency of infringement proceedings reported by the Commission (over 70 per cent of all cases are

[441] Commission, '23rd Annual Report on Monitoring the Application of Community Law (2005)' COM(2006) 416 final; Commission, '24th Annual Report on Monitoring the Application of Community Law (2006)' (Report) COM(2007) 398 final; Commission, '25th Annual Report on Monitoring the Application of Community Law (2007)' (Report) COM(2008) 777 final; Commission, '26th Annual Report on Monitoring the Application of Community Law (2008)' (Report) COM(2009) 675 final; Commission, '27th Annual Report on the Application of EU Law (2009)' and accompanying documents.

[442] Council Directive 2004/56/EC of 21 April 2004 amending Directive 77/799/EEC concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, certain excise duties and taxation of insurance premiums [2004] OJ L127/70 (subsequently repealed by Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation [2011] OJ L64/1).

[443] **Belgium** (No 2005/0270), the **Czech Republic** (No 2005/0293), **Denmark** (No 2005/0302), **Cyprus** (No 2005/0281), **Latvia** (No 2005/0382), **Hungary** (No 2005/0342), the **Netherlands** (No 2005/0397), **Poland** (No 2005/0402), **Sweden** (No 2005/0421), the **United Kingdom** (No 2005/0441).

[444] The **Czech Republic** (No 2005/0293), IP/05/941, closed 13 December 2005.

[445] **Greece** (No 2005/0321), IP/05/941, closed 28 June 2006.

[446] **Ireland** (No 2005/0350), IP/05/941, closed 13 December 2005.

[447] **Italy** (No 2005/0361), IP/05/941, closed 13 December 2005.

[448] **Luxembourg** (No 2005/0374), IP/05/941, closed 12 December 2006.

resolved before the second stage of reasoned opinion).[449] In December 2004, for instance, letters of formal notice were sent to 14 Member States concerning the notification of measures required for the transposition of the amendments to the Interest and Royalties Directive 2003/49/EC, which should have been adopted by 1 May 2004.[450] Six months later, only **Greece** (No 2004/0788)[451] had received a reasoned opinion. Another example shows that in 2008 **Belgium** was referred to the Court (No 2006/0196)[452] and received a reasoned opinion (No 2007/0220)[453] for the non-communication of the measures required by the amendments to the Mergers Directive 90/434/EEC,[454] which should have been notified by January 2006 and 2007 respectively. From the list of 25 infringement cases related to the same matter, only the Belgium cases reached the stage of reasoned opinion – other files were closed within a year after the letters of formal notice. It will be shown later that Member States are much less cooperative when it comes to the third category of cases that lies beyond the harmonised tax area.

Since the reports on monitoring the application of EU law provide a full list of enforcement actions in relation to the non-communication of national implementation measures, it becomes clear that only a small number of cases that belong to this category have been communicated to the public through press releases.[455] Even more importantly, the

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[449] Commission, 'Statistical Annexes I to III' (Staff Working Paper) SEC(2011) 1094 accompanying '28th Annual Report on Monitoring the Application of EU Law (2010)' (Report) COM(2011) 588 final, table 2.4.

[450] Namely, **Belgium** (No 2004/0422), the **Czech Republic** (No 2004/0637), **Denmark** (No 2004/0679), **Germany** (No 2004/0653), **Estonia** (No 2004/0757), **Italy** (No 2004/0963), **Cyprus** (No 2004/0491), **Luxembourg** (No 2004/1010), **Malta** (No 2004/1217), **Poland** (No 2004/1277), **Portugal** (No 2004/1313), **Slovakia** (No 2004/1493), the **United Kingdom** (No 2004/1522). See Council Directive 2004/76/EC of 29 April 2004 amending Directive 2003/49/EC as regards the possibility for certain Member States to apply transitional periods for the application of a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2004] OJ L195/33.

[451] **Greece** (No 2004/0788), IP/05/941, closed 13 December 2005.

[452] **Belgium** (No 2006/0196), no IP, closed 19 February 2009. See Commission, '26th Annual Report on Monitoring the Application of Community Law (2008)' (Report) COM(2009) 675 final.

[453] **Belgium** (No 2007/0220), IP/08/132, closed 19 February 2009.

[454] Council Directive 2005/19/EC of 17 February 2005 [2005] OJ L58/19 amending Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States [1990] OJ L225/1 (Merger Directive).

[455] In fact, only 18 cases were communicated through IPs (see Tables 2 and 3).

published press releases provide puzzling information that does not allow a comprehensive understanding of the Commission's enforcement actions on an EU-wide scale. This can be illustrated by the following example. In July 2005 the Commission sent reasoned opinions to **Greece** (No 2005/0318)[456] **Italy** (No 2005/0358)[457] and **Luxembourg** (No 2005/0372)[458] on the non-communication of national implementation measures required by the amendments to the Parent–Subsidiary Directive 90/435/EEC.[459] At the same time, letters of formal notice were sent to seven other Member States not mentioned in the press release.[460] Similar cases were opened against the **Netherlands** (No 2005/0395)[461] and the **United Kingdom** (No 2005/0440),[462] with reasoned opinions sent in December 2005, although these had not been reported either. Within a year the Commission undertook further steps: the press release gives the information that Italy and Luxembourg were referred to the Court, but does not mention that all the other investigations were closed.[463]

To summarise, operations involving non-communication cases are highly formalised, and this contributes to the synchronised transposition of EU directives by Member States. However, the reporting system of non-communication cases must be changed. Since taxpayers can rely upon a non-implemented directive only if the conditions for direct effect set by the Court are fulfilled, more transparency in enforcement actions becomes essential for the adequate protection of their rights provided under EU law. The confidentiality of

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[456] **Greece** (No 2005/0318), IP/05/941, withdrawn 28 June 2006.

[457] **Italy** (No 2005/0358), IP/05/941, IP/06/934, closed 27 June 2007.

[458] **Luxembourg** (No 2005/0372), IP/05/941, IP/06/934, closed 27/06/2007.

[459] Council Directive 2003/123/EC of 22 December 2003 [2004] OJ L7/41 amending Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [1990] OJ L225/6 (Parent–Subsidiary Directive).

[460] **Belgium** (No 2005/0269), **Estonia** (No 2005/0306), **Hungary** (No 2005/0340), **Slovenia** (No 2005/0426), **Sweden** (No 2005/0418), **Spain** (No 2005/0325), **Cyprus** (No 2005/0277).

[461] The **Netherlands** (No 2005/0395), no IP, reasoned opinion sent 19 December 2005, closed 28 June 2006. See Commission, '23rd Annual Report on Monitoring the Application of Community Law (2005)' COM(2006) 416 final and accompanying documents.

[462] The **United Kingdom** (No 2005/0440), no IP, reasoned opinion sent 19 December 2005, closed 28 June 2006. See ibid.

[463] Commission, IP/06/934 in **Italy** (No 2005/0358) and **Luxembourg** (No 2005/0372). Both cases closed before the Court of Justice delivered its rulings.

infringement proceedings and a piecemeal approach to publishing press releases cannot be justified in relation to non-communication cases, where there is no room for negotiation (it should be noted that improper transposition belongs to the third category of cases).[464]

4.2.2. Non-Compliance with an Earlier Judgment of the Court that Acknowledges a Breach of EU Law

Non-compliance with an earlier Court ruling that acknowledges a breach of EU law belongs to the smallest category of infringement cases in direct taxation. Only three times since 2005 has DG TAXUD dealt with Article 260 TFEU.[465] In the first case, **Spain** (No 2000/4854) failed to transmit any information to the Commission on the amendments of legislation on discriminatory capital gains on the shares of foreign companies following Case C-219/03 of 9 December 2004.[466] In the second case, **Sweden** (No 2003/4314) did not implement the ruling of the Court in Case C-104/06 of 18 January 2007 regarding the rules on capital gains tax relief on dwelling sales.[467] And in the third case under Article 260 TFEU, **Greece** (No 2006/4044) was requested to comply with the Court judgment of 23 April 2009 on the taxation of income from inbound dividends.[468] In the period concerned, the case under Article 260(2) TFEU was never referred to the Court. Furthermore, all cases were closed after the letter of formal notice, which differs considerably from the practice in some other policy sectors, such as environmental policy.

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[464] As a rule, under this category the Commission would not accept as satisfactory the response claiming that 'draft legislation aimed at transposing the Directive was awaiting adoption'. See Commission, IP/05/40.

[465] This number is based on the cases that have been reported through press releases. However, some cases, for instance, **Belgium** (No 2008/4242) on higher capital gains tax on foreign investment funds can be found in the database of the recent Commission's decisions on infringement cases, but – since there is no press release – it would not be included in this overview.

[466] Case C-219/03 *Commission v Spain* [2004] ECR I-0000. See Commission, IP/06/1407 in **Spain** (No 2000/4854), closed 21 March 2007.

[467] Case C-104/06 *Commission v Sweden* [2007] ECR I-671. See Commission, IP/07/1162 in **Sweden** (No 2003/4314), closed 31 January 2008.

[468] Case C-406/07 *Commission v Greece* [2009] ECR I-62. See Commission, IP/10/93 in **Greece** (No 2006/4044), closed 30 September 2010.

4.2.3. Infringements that Violate the Principles of EU Law or Have a Far-Reaching Negative Impact on EU Citizens

This category of cases plays the most important role in forcing changes in Member States' tax legislation. The basic priorities for direct taxation, declared through the annual reports on monitoring the application of EU law, are defined as clear and serious infringements of EU law, in particular those related to the application of the fundamental freedoms and differential treatment of domestic and cross-border situations that hamper the progress of EU citizens and businesses in establishing themselves or investing in other Member States.[469]

The Commission's annual reports on monitoring the application of EU law in 2001–2006 provide a very brief reference to infringement cases. In 2003, for instance, the Commission opened several cases to follow up the 2001 Communication on the elimination of tax obstacles to the cross-border provision of occupational pensions.[470] In 2005 it reported an increase in the number of infringement proceedings, in particular *ex officio* cases.[471] The Commission started publishing more information following the increase in DG TAXUD human resources, and a clearer definition of enforcement priorities, which was highlighted in 2006.[472] Since 2007 the Commission's reports include an explanatory statement on the priority categories and policy targets.[473]

In 2007–2010, the Commission prioritised the scope of matters covered by the Communication on Co-ordinating Member States' Direct Tax Systems in the Internal Market

[469] See, eg, Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2008) 2854 accompanying '25th Annual Report on the Application of EU Law (2007)', section 11.3.2.

[470] Commission, 'Situation in the Different Sectors' (Annex A) SEC(2004) 1638 accompanying '21st Annual Report on Monitoring the Application of Community Law (2003)' (Report) COM(2004) 839 final, section 2.12.2.

[471] Commission, 'Situation by Policy Area' (Staff Working Document) SEC(2006) 999 accompanying '23rd Annual Report on Monitoring the Application of Community Law (2005)' (Report) COM(2006) 416 final, section 1.3.

[472] Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2007) 975 accompanying '24th Annual Report on Monitoring the Application of Community Law (2006)' (Report) COM(2007) 398 final, section 1.3.

[473] Following the guidance provided by Commission, COM(2007) 502 final.

(2006).[474] This document announced the Commission's soft coordination initiative aimed at tackling double taxation, preventing inadvertent non-taxation and abuse, and reducing the compliance costs associated with being subject to more than one tax system. It emphasised the need to eliminate fiscal discrimination in the EU or, in other words, situations where a Member State treats cross-border situations differently from those in a domestic context, which cannot be justified by the difference in the taxpayer's circumstances. Four priority targets were defined as: (i) group taxation (e.g. the lack of cross-border loss relief) and the taxation of branches; (ii) exit taxes; (iii) anti-avoidance rules; and (iv) dividend taxation, in particular withholding taxes. Three follow-up communications on group taxation, exit taxes and anti-avoidance rules were published in 2006–2007.[475] In 2006 the Commission also announced the forthcoming communications on withholding taxes on dividends[476] and inheritance taxes,[477] which implied giving particular attention to any alleged infringements in these fields. Along with references to the strategic areas where the Commission sees scope for the coordination of Member States' policies, the annual reports on monitoring the application of EU law mention some 'tactical' priorities for the year concerned. However, these are largely stated retrospectively. Even when the report suggested that 'work on the current priority areas will continue', this was not consistently followed up.[478]

[474] Commission, COM(2006) 823 final.

[475] Commission, COM(2006) 824 final; Commission, COM(2006) 825 final; Commission, COM(2007) 785 final.

[476] Commission Recommendation C(2009) 7924 final of 19 October 2009 on withholding tax relief procedures. See also DG TAXUD, 'Consultation on Withholding Taxes on Cross-Border Dividends – Problems and Possible Solutions' (2011) <http://ec.europa.eu/taxation_customs/common/consultations/tax/2011_withholding_taxes_en.htm> accessed 28 December 2012.

[477] Commission, 'Tackling Cross-Border Inheritance Tax Obstacles within the EU' (Communication) COM(2011) 864 final; Commission Recommendation 2011/856/EU of 15 December 2011 regarding relief for double taxation of inheritances [2011] OJ L336/81; Commission, 'Non-Discriminatory Inheritance Tax Systems: Principles Drawn from EU Case-Law' (Staff Working Paper) SEC(2011) 1488 final.

[478] As happened with R&D, which did not appear in Commission, '26th Annual Report on Monitoring the Application of Community Law (2008)' (Report) COM(2009) 675 final.

Building upon these observations, the direct tax policy targets for enforcement actions announced through the annual reports on monitoring the application of EU law can be construed as follows:

A. Strategic policy priorities for the coordination of Member States' direct tax systems:

(i) Group taxation and taxation of branches.

(ii) Exit taxes.

(iii) Anti-avoidance rules.

(iv) Dividend taxation.

B. 'Tactical' policy targets:

(i) Tax incentives for research and development (R&D) (2005 and 2007).[479]

(ii) Taxation of cross-border dividend payments and pensions (2007–2011).[480]

(iii) Exit tax rules on individuals and companies (2008–2012).[481]

(iv) Tax treatment of foreign charities (2008–2010).[482]

[479] Commission, 'Situation by Policy Area' (Staff Working Document) SEC(2006) 999 accompanying '23rd Annual Report on Monitoring the Application of Community Law (2005)' (Report) COM(2006) 416 final, section 2.12; Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2008) 2854 accompanying '25th Annual Report on the Application of EU Law (2007)', section 11.3.2.

[480] Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2008) 2854 accompanying '25th Annual Report on the Application of EU Law (2007)', section 11.3.2; Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2009) 1683 accompanying '26th Annual Report on Monitoring the Application of Community Law (2008)' (Report) COM(2009) 675 final, section 12.3.1; Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2010) 1143 accompanying '27th Annual Report on Monitoring the Application of EU Law (2009)' (Report) COM(2010) 538 final, section 11.3.1; Commission, 'Situation in the Different Sectors' (Staff Working Paper) SEC(2011) 1093 final accompanying '28th Annual Report on Monitoring the Application of EU Law (2010)', section 13.3.1.

[481] Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2009) 1683 accompanying '26th Annual Report on Monitoring the Application of Community Law (2008)' (Report) COM(2009) 675 final, section 12.3.1; Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2010) 1143 accompanying '27th Annual Report on Monitoring the Application of EU Law (2009)' (Report) COM(2010) 538 final, section 11.3.1; Commission, '29th Annual Report on Monitoring the Application of EU Law (2011)' (Complete Report) COM(2012) 714, Annex 2.

[482] Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2009) 1683 accompanying '26th Annual Report on Monitoring the Application of Community Law (2008)' (Report) COM(2009) 675 final, section 12.3.1; Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2010) 1143 accompanying Commission, '27th Annual Report on Monitoring the Application of EU Law (2009)' (Report) COM(2010) 538 final, section 11.3.1.

(v) Inheritance and gifts (2010–2012).[483]

(vi) Tax obstacles for cross-border workers (2010–2011).[484]

If an alleged breach of EU law belongs to a priority area, the infringement case should be 'commenced *immediately*, unless the situation can be remedied more rapidly by other means'.[485] Furthermore, the Commission is committed to introducing a 'strategic approach to infringement action (…) by focusing on *specific priorities* and adopting a more *horizontal approach* to similar infringements in different Member States.'[486] But has any progress towards these goals been reached in practice?

Table 2 displays infringement cases where the Commission has taken a decision to move the case towards the second and/or third stage of the infringement procedure *and* published a press release in the period between 2005 and 2012. It classifies these cases according to subject matter, which allows their reconciliation with the identified priorities listed earlier. Indeed, some areas declared as being prioritised by the Commission have been vigorously pursued between 2005 and 2012. This has concerned the breach of EU law in relation to the taxation of cross-border dividends (37 cases), inherence taxes (14 cases), foreign charities (12 cases), exit taxation (10 cases) and pensions (9 cases). However, in some other priority areas the levels of activity have been lower. This is particularly evident with respect to group taxation and the taxation of branches (6 cases) and anti-avoidance rules (6 cases). Furthermore, some of the areas that the Commission has actively investigated have not

[483] Commission, 'Situation in the Different Sectors' (Staff Working Paper) SEC(2011) 1093 final accompanying '28th Annual Report on Monitoring the Application of EU Law (2010)', section 13.3.1; Commission, '29th Annual Report on Monitoring the Application of EU Law (2011)' (Complete Report) COM(2012) 714, Annex 2.

[484] Commission, 'Situation in the Different Sectors' (Staff Working Paper) SEC(2011) 1093 final accompanying '28th Annual Report on Monitoring the Application of EU Law (2010)', section 13.3.1.

[485] Commission, COM(2002)725 final/4 (emphasis added).

[486] Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2009) 1683 accompanying '26th Annual Report on Monitoring the Application of Community Law (2008)' (Report) COM(2009) 675 final, section 12.3.2 (emphasis added).

been reported among the ultimate policy priorities, such as the cases on income taxes (29 cases), real estate (14) and national procedural rules (7 cases).

Table 2. Key Areas of Conflict between EU Law and National Direct Tax Laws in 2005–2012 *(as reported by the Commission through IPs/MEMOs until 1 December 2012)*[487]

I. Breach of EU Law in a Non-Harmonised Direct Tax Area

Dividends	**37**
Income Tax	**29**
Real Estate	**14**
Inherence and Gifts	**14**
Charities	**12**
Exit Taxes	**10**
Pensions	**10**
Interests	**9**
National Procedural Arrangements	**7**
Anti-Abuse Measures	**6**
Company Taxation, including Groups and Branches	**6**
Capital Gains	**5**
Research and Development	**4**
Total	**163**

[487] Built upon the reference data collected for this study as explained in Part III Section 4.1. See Table 3 and 'Bibliography' for more details on each category and case.

Non-Communication	**21**
Application of EU Directives	**8**
Total	**29**

This analysis does not find a consistent correlation between the priorities announced by the Commission and the infringement cases that have been publicly communicated. It demonstrates that while promoting a selective approach to infringement proceedings in direct taxes, the Commission has failed to communicate clear criteria for prioritisation, and has also failed to provide effective tools for scrutinising its performance. This conclusion supports the Parliament's request for the Commission: 'to prioritise infringements in different sectors in a more systematic and transparent manner'.[488] The next section draws a more detailed map of infringement cases in the area of direct cases pursued in 2005–2012 and offers a closer examination of selected cases studies.

4.3. Key Areas of National Direct Tax Legislation Targeted by the Infringement Procedure in 2005–2012

4.3.1. The Index of Infringement Cases in the Area of Direct Cases (2005–2012)

The detailed index of infringement cases provided in Table 3 aims to assist navigation through the Commission's enforcement actions. It shows that a large number of cases concern

[488] European Parliament Resolution 2011/2027(INI) of 14 September 2011 on the 27th annual report on monitoring the application of European Union law (2009), para 33.

non-harmonised tax areas and thus contribute to constructing 'negative' tax rules on the basis of fundamental freedoms.

Table 3. Index of Infringement Cases Processed in 2005–2012 *(as reported by the Commission through IPs/MEMOs by 1 December 2012)*[489]

I. Breach of EU Law in a Non-Harmonised Tax Area

1.	**Income Tax**	**29 cases:**
1.1.	Discriminatory taxation of non-resident taxpayers	
	1.1.1. Withholding taxes for non-residents on a gross basis	8
	1.1.2. Restriction of certain types of deductions to resident taxpayers only	4
	1.1.3. Limitation of tax benefits	5
1.2.	Less favourable treatment of foreign source income	
	1.2.1. Restriction of personal deductions ('De Groot' follow-up)[490]	3
	1.2.2. Discriminatory taxation of foreign lottery winnings	3
	1.2.3. Tax benefits provided to some domestic financial instruments	2
1.3.	Discriminatory treatment of expenses incurred abroad	3
1.4.	Discriminatory treatment of property income from abroad	1
2.	**Pensions**	**10 cases:**
2.1.	Discrimination of non-resident taxpayers	4
2.2.	Discriminatory treatment of contributions to foreign pension funds	6
3.	**Interests**	**9 cases:**
3.1.	Discriminatory taxation of inbound interests	6

[489] Built upon the reference data collected for this study as explained in Part III Section 4.1. See 'Bibliography' for more details on each category and case.

[490] Case C-147/04 *De Groot* [2006] ECR I-245.

3.2.	Discriminatory taxation of outbound interests	3
4.	**Dividends**	**37 cases:**
4.1.	Discriminatory treatment of cross-border dividends: companies	13
4.2.	Discriminatory treatment of cross-border dividends: pension funds	14
4.3.	Discriminatory taxation of cross-border dividends: investment companies and dividends on shares	6
4.4.	Discriminatory treatment of cross-border dividends: individuals	4
5.	**Research and Development**	**4 cases:**
5.1.	Tax credit (allowance) for research costs limited to activities carried out domestically	3
5.2.	Deductibility of donations to research and educational institutions	1
6.	**Charities**	**12 cases:**
6.1.	Favourable taxation of domestic charities	1
6.2.	Tax relief for donation to domestic charities	11
7.	**Inheritance and Gifts**	**14 cases:**
7.1.	Additional requirements for non-resident heirs or recipients	2
7.2.	Higher tax burden for non-residents or assets located abroad	8
7.3.	Inheritance tax relief (full or limited)	4
8.	**Company Taxation, including Groups and Branches**	**6 cases:**
8.1.	Limitation of group taxation and transfer of losses in cross-border situations	4
8.2.	Heavier taxation of non-resident entities	2
9.	**Exit Taxation**	**10 cases:**
9.1.	Restrictive exit tax provisions for companies	8

9.2.	Restrictive exit tax provisions for individuals	2
10.	**Capital Gains**	**5 cases**
11.	**Real Estate**	**14 cases:**
11.1.	Tax benefits for operations with real estate domestically located	4
11.2.	Tax exemption conditioned by the residency requirement	5
11.3.	Beneficial tax treatment of the purchase of residential property after the sale of another house in the same Member State	4
11.4.	Income from real estate abroad	1
12.	**Anti-Abuse Measures**	**6 cases**
13.	**National Procedural Arrangements**	**7 cases:**
13.1.	Compulsory requirement for non-resident taxpayers to appoint a fiscal representative	4
13.2.	National procedural autonomy and retrospective abolition of remedies	1
13.3.	Tax amnesty	2

II. Breach of EU Law in a Harmonised Tax Area

14.	**Non-Communication**	**21 cases**
15.	**Application of EU Directives**	**8 cases:**
15.1.	Savings Directive	2
15.2.	Parent–Subsidiary Directive	4
15.3.	Interests and Royalties Directive	1
15.5.	Merger Directive	1

The priority criteria publicly announced by the Commission do little to explain this list of infringement cases. Of course, DG TAXUD is not limited by the declared priorities: even when the Commission defines priorities for competition policy, the Court admits that it 'may not regard as excluded in principle from its purview certain situations which come under the task entrusted to it by the Treaty'.[491] But, as Audretsch notes, it is 'curious that the obligation of the Commission is made to depend on its own view'.[492] It may be expected at least that the 'guardian of the Treaties' will adhere to its self-imposed priorities.[493] The inconsistency of declarations and actions, and the lack of effort made to explain these deviations, contradict the principle of good governance.

4.3.2. The Infringement Procedure and the EU Tax Policy Agenda: Successes and Failures in Pursuing Key Targets

The Commission has demonstrated a different approach towards enforcement action in priority areas. Infringement cases related to group taxation and the transfer of losses in cross-border situations, as well as to anti-avoidance measures, appear to be quite chaotic and inconsistent. This illustrates a lack of synergy between the policies promoted by the Commission through soft law and enforcement actions. Other examples that belong equally to the areas of the Commission's strategic policy priorities, such as exit taxes and dividend taxation, clearly prove the potential of the infringement procedure. These areas will be examined in greater detail, aiming to demonstrate the various levels of the Commission's success in forcing changes. Particular attention will be paid to the transfer of losses and exit taxes.

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[491] Case C-119/97 P *Ufex and Others v Commission* [1999] ECR I-1341, para 92.

[492] HAH Audretsch, *Supervision in European Community Law: Observance by the Member States of Their Treaty Obligations* (North-Holland Publishing 1978) citing Andrew C Evans, 'The Enforcement Procedure of Article 169 EEC: Commission Discretion' (1979) 4 European Law Review 442, 445.

[493] Anthony Arnull, *The European Union and its Court of Justice* (2nd ed, OUP 2006) 40.

4.3.2.1. Group Taxation and the Transfer of Losses in Cross-Border Situations

The elimination of restrictions related to group taxation and to the transfer of losses in cross-border situations is of key importance for the Commission. The need for EU harmonisation in this area was identified at the early stages of European integration, since the lack of the possibility of integrating company losses that are incurred abroad may influence business decisions. However, the abolition of this restriction is constrained in several ways. Losses can generate profits if used to minimise tax liability, and it becomes especially valuable in the cross-border context if companies are allowed to move their profits and losses between jurisdictions with differential tax bases and rates. Any changes to this integrated system should be carefully considered, as they may increase the risk of tax arbitrage. The legislative initiatives proposed by the Commission in this field have failed, and therefore the elimination of obstacles has been left to the process of negative harmonisation.[494] This relatively narrow segment of direct tax legislation has been addressed in several rulings by the Court, covering 'virtually every fact pattern relating to the recognition of cross-border losses'.[495] Notwithstanding this, the solution is far from being found.

The leading case in this area is *Marks & Spencer* (Case C-446/03).[496] Marks & Spencer, a trading company and leading retailer in the United Kingdom, was incorporated and registered in England and Wales and was resident in the United Kingdom for tax purposes. It was also a holding company for a number of EU subsidiaries that conducted retail businesses. The subsidiaries in Germany and Belgium had been making losses before they ceased trading

[494] Commission, 'Proposal for a Council Directive on the Harmonization of the Laws of the Member States relating to Tax Arrangements for the Carry-over of Losses of Undertakings' COM(84) 404 final [1984] OJ C253/5; Commission, 'Amendments to the Proposal for a Council Directive on the Harmonization of the Laws of the Member States relating to Tax Arrangements for the Carry-over of Losses of Undertakings' COM(85) 319 final [1985] OJ C170/3; Commission, 'Proposal for a Council Directive concerning Arrangements for the Taking into Account by Enterprises of the Losses of their Permanent Establishments and Subsidiaries Situated in other Member States' COM(90) 595 final [1991] OJ C53/30. See, eg, Ioanna Mitroyanni, *Integration Approaches to Group Taxation in the European Internal Market* (Wolters Kluwer Law & Business 2011) 49-60.

[495] As referred by Laurent Leclercq and Pauline Trédaniel, 'Impact of the ECJ's Judgement in *Lidl Belgium* on the Deduction of Foreign Branch Losses in France' (2009) 63:5/6 Bulletin for International Taxation 236, 237.

[496] Case C-446/03 *Marks & Spencer* [2005] ECR I-10837.

in 2001, and they were dissolved in 2007. The taxpayer claimed a group relief to surrender the losses, which under UK laws was limited to purely domestic situations. The matter was referred to the Court, which held that the refusal of UK tax authorities to grant a group relief for losses incurred by a subsidiary resident in another Member State constituted a restriction on the freedom of establishment. It concluded, however, that this restriction was justified on the grounds of (i) the need to protect a balanced allocation of the power to impose taxes between Member States;[497] (ii) the danger that losses can be used twice;[498] and (iii) the risk of tax avoidance.[499] Considering the proportionality question, the Court decided that the United Kingdom went beyond what was necessary to pursue a legitimate objective in situations where UK law prevented the deduction of losses, even if

> the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account for the accounting period concerned by the claim for relief and also for previous accounting periods and where there are no possibilities for those losses to be taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party.[500]

Hence, in *Marks & Spencer*, the Court established that, as a rule, Member States are not bound by EU law to provide relief for foreign losses. However, a parent company should not be refused the option of taking into account the losses that occurred in another Member State if other possibilities have been exhausted in the state of its establishment.

The *Marks & Spencer* case can be considered as a step forward towards a more harmonised group treatment in the EU, which has not been achieved so far by means of positive integration. Yet, before making a far-reaching conclusion about the success of negative harmonisation in a 'horizontal' dimension, it is important to consider domestic

[497] ibid, para 43.

[498] ibid, para 47.

[499] ibid, para 49.

[500] ibid, para 59.

reactions to these judgments. The case left several important questions open.[501] First, the Court does not define the notion of 'terminal' (or final) losses, leaving a wide scope of discretion to the referring court. Second, it makes no mention of how the 'no-possibility' test should be satisfied. Finally, the Court does not provide any guidance on which tax rules should be used to define and calculate the losses (those of the home state or those of the state of residence of the subsidiary).

Following the *Marks & Spencer* ruling, the Commission confirmed the need for 'considerable corollary work' and 'follow-up initiatives'.[502] In 2006 it published the Communication on the Tax Treatment of Losses in Cross-Border Situations,[503] explaining that 'the legal consequences of this judgment are not sufficient, so that it will be complemented by political initiatives taken by the Commission in order to broaden the availability of cross-border loss compensation'.[504] Several subsequent judgments on related issues (e.g. *Oy AA*, *Lidl Belgium*, *Krankenheim* and *Papillon*) have been acknowledged by the Commission in the annual reports on monitoring the application of EU law, due to their importance.[505] The enforcement actions in this area, however, have been much less active than in other examples discussed later in this section.

Only four cases in this category have been published by the Commission through press releases of infringement cases that have reached at least the second stage. The first is the *Marks & Spencer* case. The long duration and complexity of the steps made in relation to the

[501] For more of these see Michael Lang, 'The *Marks & Spencer* Case – The Open Issues Following the ECJ's Final Word' (2006) 46 European Taxation 54.

[502] Commission, 'Situation by Policy Area' (Staff Working Document) SEC(2006) 999 accompanying '23rd Annual Report on Monitoring the Application of Community Law (2005)' (Report) COM(2006) 416 final, section 2.12; see also Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2007) 975 accompanying '24th Annual Report on Monitoring the Application of Community Law (2006)' (Report) COM(2007) 398 final, section 2.11.

[503] Commission, COM(2006) 824 final.

[504] Commission, 'Situation by Policy Area' (Staff Working Document) SEC(2006) 999 accompanying '23rd Annual Report on Monitoring the Application of Community Law (2005)' (Report) COM(2006) 416 final, section 2.12.

[505] Case C-231/05 *Oy AA* [2007] ECR I-6373; Case C-414/06 *Lidl Belgium* [2008] ECR I-3601; Case C-157/07 *Krankenheim* [2008] ECR I-8061; Case C-418/07 *Papillion* [2008] ECR I-8947. See Commission, 'Situation in the Different Sectors' (Staff Working Document) SEC(2008) 2854 accompanying '25th Annual Report on the Application of EU Law (2007)', section 11.3.1.2.

improper implementation of the *Marks & Spencer* ruling by the **United Kingdom** (No 2007/4026)[506] have already been briefly acknowledged in Part III Section 3.3. The judgment of the Court was delivered in 2005. Following the changes introduced by the Finance Act (2006), the Commission sent a letter of formal notice to the UK government in July 2007, and then a reasoned opinion in September 2008.[507] It expressed a disagreement with the conditions that in practice make it 'impossible or virtually impossible for the taxpayer to benefit from such relief in accordance with the judgment in *Marks & Spencer*'.[508] In October 2009 the case was referred to the Court, but the Commission decision, however, was not carried out. Then, in November 2010 the Commission sent a complementary reasoned opinion to enlarge the scope of the case following the changes introduced by the Corporate Tax Act (2010), which repealed the provisions of the Income and Corporation Taxes Act (1988) and the Finance Act (2006) (subject to previous actions). For the second time the case was referred to the Court, in September 2012,[509] but again, the decision to initiate a Court case has still not been carried out.[510] The changes announced in the Autumn Budgetary Statement may further influence whether or not this case moves towards the Court.[511]

The second case in this category was opened against **Germany** (No 2008/4909).[512] In its reasoned opinion sent in September 2010, the Commission argued that German tax provisions – which do not allow a company that is established in another Member State but has the place of effective management in Germany to benefit from the fiscal unity regime (*Organschaft*) –

[506] The **United Kingdom** (No 2007/4026), IP/08/1365, IP/09/1461, referred to the Court on 8 October 2009 (the Commission's decision to go to the Court has not yet been carried out).

[507] Commission, IP/08/1365.

[508] ibid.

[509] Commission, IP/12/1017.

[510] As of 7 December 2012, based on DG TAXUD, 'CJEU Cases in the Area of, or Particular Interest for, Direct Taxation' <http://ec.europa.eu/taxation_customs/resources/documents/common/infringements/case_law/court_cases_direct_taxation_en.pdf> accessed 28 December 2012.

[511] HM Treasury, 'Autumn Statement 2012' (5 December 2012) <http://www.hm-treasury.gov.uk/as2012_documents.htm> accessed 28 December 2012.

[512] **Germany** (No 2008/4909), IP/10/1253, IP/12/283, referred to the Court on 22 March 2012, the Commission's decision to go to the Court has not yet been carried out.

must be changed, as they restrict the freedom of establishment.[513] Following this reasoned opinion, the German tax authorities published an administrative circular, which abolished this dual residency requirement in 2011. In response, the Commission requested that the changes be introduced through a legislative act. Since the amendment was not made in the one-year period provided for this purpose, the case was referred to the Court in March 2012.[514] Again, as with the UK case discussed earlier, a decision has not yet been carried out. This could be explained by the ongoing adoption of changes through the Annual Tax Act (2013) and the Business Tax Reform Act (2012).[515]

The third case, also against **Germany** (No 1998/4684)[516] concerned the tax rules on cross-border loss deduction, which restricted the deductibility of losses to the same income category and applied to both resident individuals and companies (German Income Tax Law, §2a, paragraph 1). The reasoned opinion was sent in 2007. It was based on Case C-347/04 *Rewe Zentralfinanz* and the Commission's communication on the tax treatment of losses in cross-border situations.[517] The case was closed in 2009, following changes made to Germany's laws.

The fourth and final case in this category concerns the **Dutch** fiscal unity regime (No 2008/4616).[518] The Commission requested a change in the restrictive conditions for forming a fiscal unity. Under Article 15.3.c of the Dutch Corporation Tax Law, companies that were Dutch residents but were held by a parent company in another Member State were not allowed to consolidate their profits and losses. The case was a follow up to Case C-418/07 *Papillion* [2008] ECR I-8947.

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[513] Commission, IP/10/1253.

[514] Commission, IP/12/283.

[515] Ernst & Young, 'International Tax Alert' (14 December 2012) <http://www.ey.com/Publication/vwLUAssets/International-Tax-Alert-German-2013-Annual-Tax-Act-and-Business-Tax-Reform-Act-2012/$FILE/EY_tax_news_2012121802.pdf> accessed 28 December 2012.

[516] **Germany** (No 1998/4684), IP/07/1547, closed 14 May 2009.

[517] Case C-347/04 *Rewe Zentralfinanz eG* [2007] I-2647.

[518] The **Netherlands** (No 2008/4616), IP/11/719 (under examination).

Considering the large number of rulings that have been delivered by the Court in this field – such as *Deutsche Shell*,[519] *Lidl Belgium*,[520] *Krankenheim*[521] (for the tax treatment of losses attributed to permanent establishments (PEs)), *Oy AA*,[522] *Rewe Zentralfinanz eG*,[523] *Papillion*,[524] *X Holding*,[525] and *Philips Electronics UK*[526] (subsidiaries) – the Commission's enforcement actions appear to be quite inert, especially considering that all four cases discussed here were initiated in response to taxpayers' complaints. Even assuming that some cases may remain at earlier stages, the delay in the follow-up to the seminal *Marks & Spencer* case demonstrates that the approach to this category of cases is considerably different from that which can be observed in other priority areas. At the same time, many EU tax scholars question the lack of reaction from national legislators and courts in relation to the most obvious examples of non-conformity (see Table 4).[527]

[519] Case C-293/06 *Deutsche Shell* [2008] ECR I-1129.

[520] Case C-414/06 *Lidl Belgium* [2008] ECR I-3601.

[521] Case C-157/07 *Krankenheim* [2008] ECR I-8061.

[522] Case C-231/05 *Oy AA* [2007] ECR I-6373.

[523] Case C-347/04 *Rewe Zentralfinanz eG* [2007] I-2647.

[524] Case C-418/07 *Papillion* [2008] ECR I-8947.

[525] Case C-337/08 *X Holding* [2010] ECR I-1215.

[526] Case C-18/11 *Philips Electronics UK* [2012] ECR I-0000.

[527] Christiana HJI Panayi, 'Reverse Subsidiary and EU Tax Law: Can Member States Be Left to Their Own Devices?' [2010] 3 British Tax Review 267; Ola Van Boeijen-Ostaszewska and Marnix Schellekens (eds), *European Tax Handbook* (IBFD 2012), 181 (Cyprus) and 597 (Malta); Rita de la Feria and Clemens Fuest, 'Closer to an Internal Market? The Economic Effects of EU Tax Jurisprudence' (2011) 11/12 CBT Working Papers.

Table 4. The Transfer of Losses in Cross-Border Situations Following the *Marks & Spencer* Judgment *(as of November 2012)*[528]

Member State	Type of group regime	Before *Marks & Spencer*	After *Marks & Spencer*
Netherlands	Fiscal unity	-	-
Finland	Group contributions	-	-
Sweden	Group contributions	-	+
Cyprus	Group relief	-	-
Ireland	Group relief	-	+
Latvia	Group relief	-	+
Lithuania	Group relief	-	+
Malta	Group relief	-	-
United Kingdom	Group relief	-	+
Austria	Tax consolidation	+	+ (special regime)
Denmark	Tax consolidation	+	+ (special regime)
France	Tax consolidation	+	+ (special regime)
Germany	Tax consolidation	-	+
Italy	Tax consolidation	+	+ (special regime)
Luxembourg	Tax consolidation	-	-
Poland	Tax consolidation	-	-
Portugal	Tax consolidation	-	-

[528] Based on IBFD Tax Research Platform <http://online.ibfd.org/kbase> accessed 30 November 2012. For a brief overview see Ola Van Boeijen-Ostaszewska and Marnix Schellekens (eds), *European Tax Handbook* (IBFD 2012): Netherlands (652), Finland (260), Sweden (843), Cyprus (181), Ireland (434), Latvia (512), Lithuania (541), Malta (597), the United Kingdom (951), Austria (71), Denmark (221), France (284), Germany (327), Italy (473-474), Luxembourg (563), Poland (694), Portugal (716), Spain (820), Belgium (127), Bulgaria (152), Czech Republic (199), Estonia (241), Greece (364), Hungary (396), Romania (742), Slovakia (786), Slovenia (802).

Spain	Tax consolidation	-	+ (special regime)
Belgium	No group tax regime	-	-
Bulgaria	No group tax regime	-	-
Czech Republic	No group tax regime	-	-
Estonia	No group tax regime	-	-
Greece	No group tax regime	-	-
Hungary	No group tax regime	-	-
Romania	No group tax regime	-	-
Slovakia	No group tax regime	-	-
Slovenia	No group tax regime	-	-

4.3.2.2. Exit Taxation

Exit taxation has been another priority area for the Commission. The Communication on Exit Taxation and the Need for Co-ordination of Member States' Tax Policies[529] and the annual reports on monitoring the application of EU law put this area at the forefront of the Commission's attention for 2007–2012. Building upon existing case law, in particular Case C-9/02 of 11 March 2004 (*De Lasteyrie*) and Case C-470/04 of 7 September 2006 (*N*), the Commission expressed the view that the principles established in these cases in relation to individuals should be also applied to exit taxes for companies.[530]

In the *De Lasteyrie* case, the Court interpreted that the Treaty precludes 'a Member State from establishing (…) a mechanism for taxing as yet unrealised increases in value [of company shares] (…), where a taxpayer transfers his tax residence outside that State'.[531] This

[529] Commission, COM(2006) 825 final.

[530] ibid, section 3.

[531] Case C-9/02 *De Lasteyrie* [2004] ECR I-2409.

was further elaborated in the *N* case: the freedom of establishment precludes a Member State from levying a tax on the increase in the value of rights in a company in the event of a taxpayer transferring a place of residence outside that Member State, where the deferral of payment is conditioned by the provision of guarantees and is not adjusted in the view of subsequent reductions in value.[532] None of these cases state explicitly that the principles established by the Court in relation to individual taxpayers would fully (or partially) apply to companies. The Commission, however, not only took the position that 'the interpretation of the freedom of establishment given by the ECJ in *de Lasteyrie* in respect of exit tax rules on individuals also has direct implications for (…) [Member States'] exit tax rules on companies',[533] but it also processed a number of infringement cases in view of this interpretation.

4.3.2.2.1. Exit Tax Provisions for Companies

Some Member States changed their laws in view of CJEU case law, such as Austria and Sweden.[534] The governments that did not react voluntarily were approached by the Commission under Article 258 TFEU. The Commission initiated seven infringement cases regarding exit tax provisions for companies. The negotiations within the first and second stages of infringement proceedings, however, did not produce the expected outcomes: four out of eight infringement cases have already been referred to the Court, which makes this

[532] Case C-470/04 *N v Inspecteur* [2006] ECR I-7409.

[533] Commission, COM(2006) 825 final, section 3.1.

[534] The amendments to Swedish legislation entered into force in July 2010 with retrospective effect from December 2009. The changes were already underway in 2008, when the Swedish Supreme Administrative Court found that the national exit tax rules contradicted EU law, going beyond what is necessary for anti-abuse measures (Supreme Administrative Court, Case 6639-06 of 24 April 2008). The legislative response to this decision permitted the deferment of the payment of exit taxes. See Carl Pihlgren and Martin Rabe, 'Ernst & Young: Sweden Update in World Tax' accessed 28 December 2012; also refer to Eric CCM Kemmeren, 'Comment on the European Requests Belgium, Denmark and the Netherlands to Change Restrictive Exit Tax Provisions for Companies and Closes Similar Case against Sweden' [2010] 6 Vakstudie Highlights & Insights on European Taxation 67.

category of cases one of the most conflicting issues raised under Article 258 TFEU since 2005.

All infringement cases under this priority category concern old Member States, which, contrary to new Member States, would usually maintain some form of exit taxation.[535] In February 2008 letters of formal notice were sent to **Portugal** (No 2007/2365),[536] **Sweden** (No 2007/2372)[537] and **Spain** (No 2007/2382).[538] The determination of the Commission to tackle restrictive exit taxation for companies resulted in a prompt follow-up to these letters. Three reasoned opinions were sent in November 2008. In addition, the Commission opened infringement proceedings against **Denmark** (No 2008/2157),[539] the **Netherlands** (No 2008/2207)[540] and **Belgium** (No 2008/4250):[541] reasoned opinions were sent in March 2010. Finally, the two most recent reasoned opinions on the discriminatory treatment of companies when they transfer tax residence to another Member State, were sent to **Ireland** (No 2009/2117)[542] and the **United Kingdom** (No 2008/4923)[543] in 2011 and 2012 respectively.

The first cases were referred to the Court in 2009 (**Portugal** and **Spain**). The judgment in Case C-38/10 *Commission v Portugal* was delivered in September 2012. The Spanish case went back to the second stage of the infringement procedure due to changes that were introduced to national tax provisions. Since the Commission was not satisfied with the amendments, it sent a complementary reasoned opinion. Following the refusal of the Spanish

[535] The only exception that can be found in the public database is the case on exit taxation of Estonian permanent establishments, which was closed in 2010 (No 2008/2334).

[536] **Portugal** (No 2007/2365), IP/08/1813, IP/09/1460, Case C-38/10 *Commission v Portugal* [2012] ECR I-0000.

[537] **Sweden** (No 2007/2372), IP/08/1362, IP/10/299, closed 18 March 2010.

[538] **Spain** (No 2007/2382), IP/08/1813, IP/09/1460, IP/10/299, IP/10/1565, Case C-64/11 *Commission v Spain* (pending).

[539] **Denmark** (No 2008/2157), IP/10/299, IP/10/1565, referred to the Court 24/11/2010, Case C-261/11 (pending).

[540] The **Netherlands** (No 2008/2207), IP/10/299, IP/10/1565, referred to the Court 24/11/2010, Case C-301/11 (pending).

[541] **Belgium** (No 2008/4250), IP/10/299, closed 29 September 2011 (Belgium changed its legislation).

[542] **Ireland** (No 2009/2117), IP/11/78 (under examination).

[543] The **United Kingdom** (No 2008/4923), IP/12/285 (under examination).

government to proceed with further amendments, the case was for the second time referred to the Court in November 2010.[544] On the same day, the **Danish** and **Dutch** cases were also moved to the litigation stage. All three cases (Cases C-64/11 *Commission v Spain*, C-261/11 *Commission v Netherlands* and C-301/11 *Commission v Denmark*) are currently pending in the Court. Despite these active enforcement actions, the first case that clarified the application of Treaty freedoms to exit taxes for companies was delivered under the preliminary ruling procedure. The compatibility of the Dutch corporate exit taxation was questioned by the Amsterdam Court of Appeal (Case C-371/10 of 29 November 2011 *National Grid Indus BV*).[545]

4.3.2.2.2. Exit Tax Provisions for Individuals

Two cases in this category requested the cessation of the discriminatory treatment of individuals who transfer their residence abroad in line with *De Lasteyrie*. Letters of formal notice were sent to **Spain** (No 2007/2373)[546] and **Portugal** (No 2007/2381)[547] in 2008. Case C-269/09 *Commission v Spain* was decided in favour of the Commission in July 2012. The Portuguese case is still under examination.

To sum up, the Commission has actively pursued the breach of EU law in relation to countries maintaining restrictive exit tax regimes. Potentially, the number of proceedings in this category could be much wider, but this analysis has covered only those cases that have reached the public stage of infringement procedure since 2005.[548] As the recent UK example demonstrates, some new cases may still be published. Despite the proactive initiation of its

[544] See also Alfonso Sanz Clavijo, 'The European Commission's Infringement Cases about Spanish Exit Taxes Provisions for Individuals and Companies' (2010) 38 Intertax 371.

[545] Case C-371/10 *National Grid Indus BV* [2011] ECR I-0000. For a detailed analysis of the Dutch exit tax regime see Reinout Kok, 'Compatibility of Exit Taxes and Community Law' (2011) 20 EC Tax Review 62.

[546] **Spain** (No 2007/2373), IP/08/1531, IP/09/431, Case C-269/09 *Commission v Spain* [2012] ECR I-0000 (Spain failed to fulfil its obligations).

[547] **Portugal** (No 2007/2381), IP/09/1635 (under examination).

[548] In some cases the reasoned opinion was sent before the period that is covered by this research (see Commission, IP/04/493).

own initiative cases in this domain, the enforcement actions have not been as systematic as in the dividend cases that are examined in the next section. Three cases on exit tax provisions for companies are pending in the Court and two cases are still under the examination of the Commission. The poor results obtained from the pre-litigation stage could be explained by the fact that before *National Grid Indus BV* there was no certainty as to whether the case law on exit taxes for individuals should be extended to apply to companies.[549]

4.3.2.3. Cross-Border Dividend Payments

Tackling the discriminatory tax treatment of dividend distribution in cross-border situations is declared as one of the central areas of activity for DG TAXUD. In 2003 the Commission published the Communication 'Dividend Taxation of Individuals in the Internal Market'.[550] Then, it adopted a recommendation on withholding tax relief procedures, which aimed at simplifying the process of claiming the withholding of tax relief on securities income received from another Member State (2009),[551] and undertook consultations on withholding taxes faced by non-resident portfolio and individual investors (2011).[552] In the period covered by this research (2005–2012), the Commission actively pursued changes in Member States' laws on dividends through the infringement procedure. The course of enforcement action and the key implications are discussed in this section.

[549] See, eg, Hermann Schneeweiss, 'Exit Taxation after *Cartesio*: The European Fundamental Freedom's Impact on Taxing Migrating Companies' (2009) 37 Intertax 363; Henk PAM van Arendonk, 'Editorial – *Exit Taxes: Separation of Powers?*' (2010) 19 EC Tax Review 60; Reinout Kok, 'Compatibility of Exit Taxes and Community Law' (2011) 20 EC Tax Review 62.

[550] Commission, 'Dividend Taxation of Individuals in the Internal Market' (Communication) COM(2003) 810 final.

[551] Commission Recommendation C(2009) 7924 final of 19 October 2009 on withholding tax relief procedures.

[552] DG TAXUD, 'Consultation on Withholding Taxes on Cross-Border Dividends – Problems and Possible Solutions' (2011) <http://ec.europa.eu/taxation_customs/common/consultations/tax/2011_withholding_taxes_en.htm> accessed 28 December 2012.

4.3.2.3.1. Discriminatory Treatment of Cross-Border Dividends: Companies

The majority of cases relate to the tax treatment of domestic companies that pay dividends to other Member States (outbound dividends). The Commission has considered whether the conditions for foreign recipients are comparable with a tax regime applicable to a situation where dividends are paid by a resident company to another domestic establishment. In a few cases, the more favourable tax treatment of dividends received by residents from domestic companies compared to dividends received from non-resident companies (inbound dividends) has also been examined. As many as 13 infringement cases on dividends have been communicated through the Commission's press releases and reports.

The letters of formal notice were sent in two stages. In 2005 the Commission addressed several old Member States. Clarifications on the tax treatment of outbound dividend payments were requested from **Austria** (No 2004/4346),[553] **Belgium** (No 2004/4347),[554] **Germany** (No 2004/4349),[555] **Italy** (No 2004/4350),[556] **Luxembourg** (No 2004/4351),[557] **the Netherlands** (No 2004/4352),[558] **Portugal** (No 2004/4353)[559] and **Spain** (No 2004/4354).[560] Under the national provisions of these countries, domestic dividends were subject to full exemption from corporate income tax or were subject to a very low tax rate, while outbound dividends were charged at the level of 5–25 per cent of withholding taxes.

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[553] **Austria** (No 2004/4346), IP/07/1152, closed 8 October 2009.

[554] **Belgium** (No 2004/4347), IP/06/1060, IP/07/66, closed 18 September 2008.

[555] **Germany** (No 2004/4349), 27 June 2007 – reasoned opinion (IP/07/1152), 28 February 2008 – additional reasoned opinion and 19 March 2009 – referral (IP/09/435), Case C-284/09 *Commission v Germany* [2011] ECR I-0000 confirmed the failure to fulfil its obligation under EU law, but the case has not yet been closed.

[556] **Italy** (No 2004/4350), IP/06/1060, IP/07/66, Case C-540/07 *Commission v Italy* [2009] ECR I-10983 confirmed the failure of Italy to fulfil obligation under EU law, closed 31 May 2012.

[557] Unlike other states, **Luxembourg** (No 2004/4351) received a reasoned opinion with this case only in July 2008 (IP/06/1060), closed 6 May 2008.

[558] The **Netherlands** (No 2004/4352), IP/06/1060, IP/07/66, Case C-521/07 *Commission v Netherlands* [2009] ECR I-4873 confirmed the failure of the Netherlands to fulfil its obligation under EU law, closed 30 September 2010.

[559] **Portugal** (No 2004/4353), IP/06/1060, IP/07/66, IP/10/662, closed 14 March 2011.

[560] **Spain** (No 2004/4354), IP/06/1060, IP/07/66, Case C-487/08 *Commission v Spain* [2010] ECR I-4843 confirmed the failure to fulfil its obligation under EU law, closed 14 March 2011.

Next, the Commission sought explanations from the governments of new Member States. By 2008 letters of formal notice were sent to **the Czech Republic** (No 2005/4752),[561] **Latvia** (No 2005/4753),[562] **Bulgaria** (No 2007/4443 and No 2007/4883)[563] and **Romania** (No 2008/2048).[564] The Czech case concerned outbound dividends paid to companies resident in Iceland subject to a withholding tax of 15 per cent, whereas domestic dividends under certain conditions were exempt from taxes. The Latvian, Romanian and Bulgarian governments received warnings against the discriminatory tax treatment of outbound dividends to companies that were established in the EU/EEA. Bulgaria was also requested to eliminate a breach of EU law in relation to the dividends paid from these countries to its resident companies (inbound dividends).

All the letters of formal notice sent to old Member States were followed up by reasoned opinions, while new Member States committed to amend national tax laws.[565] As a result of an unsatisfactory response at the second stage of the infringement proceedings, **Belgium** (No 2004/4347), **Germany** (No 2004/4349), **Italy** (No 2004/4350), **the Netherlands** (No 2004/4352), **Portugal** (No 2004/4353) and **Spain** (No 2004/4354) were referred to the Court.

At the EU level, the results of these infringement cases have been profound – by 2012 almost all cases were closed. Most Member States changed their national regulations of dividends payments at the administrative stage of infringement proceedings – i.e. **Austria** (No 2004/4346), **Belgium** (No 2004/4347), **Luxembourg** (No 2004/4351), **Portugal** (No 2004/4353), **the Czech Republic** (No 2005/4752), **Latvia** (No 2005/4753), **Bulgaria** (No 2007/4883 and No 2007/4443) and **Romania** (No 2008/2048). Furthermore, the Court

[561] The **Czech Republic** (No 2005/4752), IP/08/143, closed 25 June 2009.

[562] **Latvia** (No 2005/4753), IP/07/66, closed 31 January 2008.

[563] **Bulgaria** (No 2007/4883, for inbound dividends) and (No 2007/4333, for outbound dividends), IP/08/172, closed 27 November 2008.

[564] **Romania** (No 2008/2048), IP/08/172, closed 14 May 2009.

[565] The only exception is Latvia, which received a reasoned opinion in relation to outbound dividends paid to companies, but the case was soon closed following changes in national tax provisions.

delivered three rulings in favour of the Commission's position, confirming the breach of EU law by **Italy** (No 2004/4350), **the Netherlands** (No 2004/4352), **Spain** (No 2004/4354) and **Germany** (No 2004/4349). All these cases, except Germany, have been closed, as the Commission has found the changes introduced into the Dutch, Spanish and Italian legislation satisfactory.

4.3.2.3.2. Discriminatory Treatment of Cross-Border Dividends: Pension Funds

The initiative of interest groups has widened the scope of dividend cases to the tax treatment of dividends and interest paid to pension funds. National tax rules for these types of entities are usually different from those for companies; therefore, this triggered another set of investigations. The complaint, which was prepared in 2006 by the joint efforts of PricewaterhouseCoopers' EU Direct Tax Group and the European Federation for Retirement Provision, gave rise to one of the largest group of horizontal infringement cases in the area of direct taxation. It was submitted to the Commission targeting 18 Member States: Austria, the Czech Republic, France, Germany, Lithuania, Poland, Portugal and Slovenia were all challenged for the discriminatory tax treatment of dividend and interest payments made to foreign pension funds; Denmark, Estonia, Finland, Hungary, Italy, Latvia, the Netherlands, Spain and Sweden for dividend taxation; and the United Kingdom in relation to outbound interest payments only.[566]

The cases against 14 Member States reached the second stage of the infringement procedure, which provides the possibility of restoring the path of enforcement action. In spring 2007 the Commission sent a letter of formal notice requesting clarification on the 'pension funds issue' from **Poland** (No 2006/4093),[567] **Lithuania** (No 2006/4095),[568] **the**

[566] European Federation for Retirement Provision and PricewaterhouseCoopers, 'Discriminatory Treatment of EU Pension Funds Making Cross-Border Portfolio Investments in Bonds and Shares within the European Union' (2006) <http://www.efrp.org/LinkClick.aspx?fileticket=A2oE2tzHLhQ%3D&tabid=1564> accessed 28 December 2012, 2.

[567] **Poland** (No 2006/4093), 21 March 2007 – formal notice (IP/07/616), 14 May 2009 – reasoned opinion (IP/09/780) and 16 June 2011 – additional reasoned opinion (under examination).

Czech Republic (No 2006/4102),[569] **Denmark** (No 2006/4103),[570] **Portugal** (No 2006/4104),[571] **Slovenia** (No 2006/4105),[572] **Spain** (No 2006/4106),[573] **Sweden** (No 2006/4107),[574] and **the Netherlands** (No 2006/4108).[575] In the second wave, by January 2008, similar requests were sent to **Italy** (No 2006/4094),[576] **Finland** (No 2006/4096),[577] **Germany** (No 2006/4098),[578] and **Estonia** (No 2006/4101).[579] All of these countries, except the Netherlands and Estonia, provided unsatisfactory responses and were moved towards the second stage of infringement proceedings in 2008–2009.

Two cases against **Spain** (No 2006/4106) and **Portugal** (No 2006/4104) were referred to the Court in November 2008. Case C-293/09 of 6 October 2011 (*Commission v Portugal*) was decided in favour of the Commission, whereas the Commission's decision regarding Spain has not yet been carried out. As in other similar examples, the reason for the delay has not been disclosed. In the **German** case (No 2006/4098, Case C-600/10 of 22 November 2012 *Commission v Germany*), the Court dismissed the Commission's actions due to the lack of evidence to support the argument of discriminatory tax treatment. In the case of **France**

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[568] **Lithuania** (No 2006/4095), IP/07/616, IP/08/334, closed 24 November 2010.

[569] The **Czech Republic** (No 2006/4102), IP/07/616, IP/08/1022, closed 19 March 2009.

[570] **Denmark** (No 2006/4103), IP/07/616, IP/09/1018, closed 24 October 2012.

[571] **Portugal** (No 2006/4104), IP/07/616, IP/08/712, IP/08/1817, Case C-493/09 *Commission v Portugal* [2011] ECR I-0000 (Portugal failed to fulfil its obligations)

[572] **Slovenia** (No 2006/4105), IP/07/616, closed 27 November 2008.

[573] **Spain** (No 2006/4106), IP/07/616, IP/08/712, IP/08/1817, referred to the Court on 27 November 2008; however, the Commission's decision to go to the Court has not yet been carried out.

[574] **Sweden** (No 2006/4107), 28 March 2007 – formal notice (IP/07/616), 28 October 2010 – reasoned opinion and 22 March 2012 – additional reasoned opinion (under examination).

[575] The **Netherlands** (No 2006/4108), IP/07/616, closed 30 September 2010.

[576] **Italy** (No 2006/4094), IP/07/1152, IP/08/1022, closed 8 October 2009.

[577] **Finland** (No 2006/4096), IP/07/1152, IP/09/1018, referred to the Court on 5 May 2010 (IP/10/513), Case C-342/10 *Commission v Finland* delivered on 8 November 2012 (Finland failed to fulfil its obligations).

[578] **Germany** (No 2006/4098), IP/08/143, IP/09/1640, IP/10/662, referred to the Court on 3 June 2010 (IP/10/662) and 24 November 2010, Case C-600/10 *Commission v Germany* delivered on 22 November 2012 (Commission failed to prove the infringement).

[579] **Estonia** (No 2006/4101), IP/08/143, closed 18 September 2008.

(No 2006/4097), which is being processed more slowly, the Court has not yet delivered a judgment (Case C-76/12 *Commission v France*).[580]

The vast majority of cases were closed at the administrative stage in 2008–2010, after the required amendments to national tax laws were introduced: this pertained to **Estonia** (No 2006/4101) and **Slovenia** (No 2006/4105) in 2008, **Italy** (No 2006/4094) and **the Czech Republic** (No 2006/4102) in 2009, **Lithuania** (No 2006/4095) and **the Netherlands** (No 2006/4108) in 2010 and **Denmark** (No 2006/4103) in 2012. The developments in many cases were initiated by the domestic judicial or tax authorities. For instance, in the Netherlands the refunding of dividend withholding taxes paid to pension funds established in the EU was initiated in 2009 by national tax authorities in response to the decisions of the Court and the Dutch Supreme Court.[581] Two cases remain under examination: **Poland** (No 2006/4093) and **Sweden** (No 2006/4107).[582] According to the PricewaterhouseCoopers' reports, amendments in the tax treatment of foreign pension funds have also been made in **Austria**, **Hungary**, **Latvia**, **Luxembourg**, and **Romania**,[583] but the cases against these Member States have not reached the 'public' stage of infringement proceedings.

[580] **France** (No 2006/4097), IP/10/300, IP/11/603, referred to the Court on 19 May 2011, Case C-76/12 *Commission v France* (pending). In February 2009, the French Supreme Administrative Court decided that the favourable provisions of the French tax law exempting dividends received by domestic pension funds should 'be extended to EU non-profit organisations of the same nature' (See Daniel Gutmann and others, 'Tax Treatment of Foreign Pension Funds' (2009) 49 European Taxation 21). The legislative changes were introduced in 2010, but according to the Commission the new rules 'have not been applied in practice in the absence of more detailed administrative implementing rules' (see Commission, IP/11/603).

[581] Bob van der Made, 'European Union: Direct Tax Policy in 2010' [2010] 3 International Tax Review 76.

[582] The Polish tax authorities announced a turning-point decision to refund withholding tax unlawfully levied on dividends paid to the Dutch Pension Fund in February 2010. The tax administration confirmed that the provisions of the Polish corporate income tax law, which considers only domestic pension funds as subject to exemption, should be interpreted in compliance with the free movement of capital under Article 63 TFEU (see PwC – EU Direct Tax Group, 'Polish Tax Authorities Order the Refund of Unduly Withheld Dividend Withholding Tax Levied on a Dutch Pension Fund' [2010] 1 EU Tax News 14-15). Later, the national legislator introduced changes to the law effective from 1 January 2011 (see PwC – EU Direct Tax Group, 'Poland – End of Discriminatory Treatment of Foreign Investment and Pension Funds' [2011] 1 EU Tax News 17).

[583] See, eg, PwC – Financial Services/EU Direct Tax Group, 'Pension Funds Can Claim EU Refunds of WHT on Dividends and Interest – Latest Developments' [2012] 6 PwC News Update 4-5.

4.3.2.3.3. Discriminatory Taxation of Cross-Border Dividends: Investment Companies and Dividends on Shares

In 2009–2012, the Commission sent five reasoned opinions to **Belgium**, tackling different aspects of tax regulation. The Commission requested a change of tax provisions that provide: (i) a more favourable tax regime for share dividends/bearer shares held in an open deposit and for share dividends or dematerialised shares held in securities accounts in Belgium, as compared to similar arrangements with a financial institution established in another country of the EEA (No 2008/4084);[584] (ii) a heavier taxation of dividends and interest paid to foreign investment funds compared to similar payments made to domestic investment funds (No 2007/4791);[585] (iii) a discriminatory withholding tax regime for dividends paid by Belgian investment funds investing less than 60 per cent of all their assets in real estate situated in Belgium (No 2008/4156);[586] (iv) the discriminatory treatment of foreign investment companies that pay taxes on their Belgian interest and dividend income, while Belgium companies get a refund for withholding taxes they have paid (No 2008/4624);[587] and finally, (v) a discriminatory limitation on the application of a reduced rate of withholding tax for dividends on quoted shares – for the shares quoted on a stock market of other Member States, the beneficial tax regime is limited to dividends related to securities issued after 1 January 1994 (No 2008/4802).[588] Case No 2007/4791 was closed after Belgium changed its laws. In Case C-387/11 of 25 October 2012 *Commission v Belgium*, the Court confirmed a breach of EU law in No 2008/4624. Three other cases remain under examination. Another case in this category was opened against **France** (No 2008/4439)[589] for the lack of a withholding tax exemption on dividends distributed by resident companies to investment funds established in

[584] **Belgium** (No 2008/4084), IP/09/1452 (under examination).

[585] **Belgium** (No 2007/4791), IP/10/94, closed 19 May 2011.

[586] **Belgium** (No 2008/4156), IP/10/91 (under examination).

[587] **Belgium** (No 2008/4624), IP/10/663, IP/11/422, Case C-387/11 of 25 October 2012 *Commission v Belgium* (Belgium failed to fulfil its obligations), closed 29 September 2011.

[588] **Belgium** (No 2008/4802), MEMO/12/794 (under examination).

[589] **France** (No 2008/4439), IP/10/300, IP/11/603, Case C-76/12 *Commission v France* (pending).

the EU/EEA states, while providing such an exemption for investment funds established in France. The case was referred to the Court in May 2011 and is still pending (Case C-76/12).

4.3.2.3.4. Discriminatory Treatment of Cross-Border Dividends: Individuals

Only a few cases in relation to the discriminatory treatment of dividends paid by foreign companies to a private shareholder (inbound dividends) were subject to investigation in 2005–2011. In 2006 reasoned opinions requesting the cessation of infringements were sent to **Belgium** (No 2005/4504)[590] and **Greece** (No 2006/4044).[591] Both cases were referred to the Court. Greece amended its legislation following the judgment of the Court establishing a breach of EU law, so the case was closed in 2010. Case C-307/08 *Commission v Belgium* was withdrawn from the Court with a new infringement case opened under No 2008/4155.[592] The Commission also forced a change of law in **Latvia** (No 2007/2458).[593]

The dividend cases provide an example of systematic horizontal actions where separate infringement proceedings contribute to a common tax policy goal. This demonstrates the interaction between the Commission and Member States' authorities, as well as the use of infringement proceedings by the EU and domestic interest groups to force the compliance of national fiscal provisions with EU law. Even if the ability of the infringement procedure to substitute positive harmonisation can still be questioned, Article 258 TFEU shows the potential for bringing systematic changes on an EU-wide scale.

[590] **Belgium** (No 2005/4504), IP/06/1045, IP/07/67, Case C-307/08 *Commission v Belgium* (withdrawn, see [2010] OJ C148/22), closed 28 January 2010.

[591] **Greece** (No 2006/4044), IP/06/1410, IP/07/1019, Case C-406/07 *Commission v Greece* [2009] ECR I-62 delivered on 23 April 2009 confirmed the failure of Greece to fulfil obligation under EU law, closed 30 September 2010.

[592] **Belgium** (No 2008/4155), IP/10/663, closed 29 September 2011.

[593] **Latvia** (No 2007/2458), IP/07/66, closed 31 January 2008.

4.3.2.4. Anti-Abuse Measures

The Commission's Communication on the Application of Anti-Abuse Measures in the Area of Direct Taxation clearly demonstrates an attempt to limit the anti-avoidance rules to the 'wholly artificial arrangements' as formulated by the Court in Case C-196/04 *Cadbury Schweppes*.[594] According to the Commission, disproportionate obstacles to cross-border activities in the Internal Market must be eliminated.[595] However, the approach taken by the Commission in this domain differs from the synchronised actions seen in relation to the discriminatory taxation of dividends or exit taxation. The enforcement actions have been largely reactive, targeting various tax provisions in Germany, the United Kingdom and Spain.

In 2009 two infringement proceedings against **Spain** (No 2005/4290)[596] and **Germany** (No 2003/4610)[597] were closed following amendments in national legislation. Spain changed several discriminatory provisions: (i) the refusal of tax deductions for dividends distributed by companies established in certain Member States or territories of the EU; (ii) the application of Controlled Foreign Companies (CFC) provisions in situations that go beyond 'wholly artificial arrangements'; and (iii) rules that discouraged residents from investing abroad through a non-deductibility of depreciation provision. In turn, Germany amended the discriminatory tax treatment of non-resident family foundations (*Familienstiftungen*), where the application of anti-avoidance measures went beyond the limits set by *Cadbury Schweppes*.

In 2010 the Commission sent a reasoned opinion to **Germany** (No 2007/4435).[598] The request concerned tax provisions that were set up to prevent a resident taxpayer who is not entitled to claim withholding tax relief from obtaining this through a foreign company

[594] Commission, COM(2007) 785 final. Case C-196/04 *Cadbury Schweppes* [2006] ECR I-7995.

[595] For an analysis of the Communication, see Luc De Broe, 'Some Observations on the 2007 Communication from the Commission: "The Application of Anti-Abuse Measures in the Area of Direct Taxation within the EU and in relation to Third Countries"' (2008) 17 EC Tax Review 142.

[596] **Spain** (No 2005/4290), IP/08/342, closed 25 June 2009.

[597] **Germany** (No 2003/4610), IP/07/1151, closed 19 March 2009.

[598] **Germany** (No 2007/4435), IP/10/298, closed 27 September 2012.

established for this purpose. German tax authorities could refuse a request for withholding tax relief if one of the prescribed conditions is met (e.g. when the foreign company 'does not earn more than 10% of its gross income from its own economic activity').[599] The Commission claimed that these provisions go beyond what is necessary to attain the policy objective. The case was closed in September 2012 following changes in Germany's laws.

The **United Kingdom** has the largest number of alleged infringements related to the application of anti-avoidance rules, which are currently being considered by the Commission. The first case concerns the improper implementation of Cases C-196/04 *Cadbury Schweppes* [2006] ECR I-7995 and C-201/05 *Test Claimants in the CFC and Dividend GLO* [2008] ECR I-2875 (No 2009/4105).[600] It was closed in November 2012, as the Commission accepted the subsequent change of law as satisfactory. The Commission also challenged the anti-abuse measures in relation to the transfer of assets abroad by a UK resident investor (No 2009/4130)[601] and the attribution of gains to a UK resident company if its share in a company located abroad exceeds 10 per cent (No 2009/4131).[602] Both cases were referred to the Court in October 2012, but decisions have not yet been carried out.

The anti-abuse cases demonstrate the lack of a horizontal approach, as well as a lack of timely progress and readiness to involve judicial means to force legislative amendments. The UK saga with the discriminatory tax treatment of controlled foreign corporations looked particularly appealing, as such a delay in the proper application of the judgment would have been considered as unacceptable under any national enforcement system.

[599] Commission, IP/10/298.

[600] The **United Kingdom** (No 2009/4105), IP/11/606, closed 21 November 2012.

[601] The **United Kingdom** (No 2009/4130), IP/11/158, referred to the Court 24/10/2012 (IP/12/1147), the Commission's decision to go to the Court has not yet been carried out.

[602] The **United Kingdom** (No 2009/4131), IP/11/158, referred to the Court 24 October 2012 (IP/12/1146).

4.4. The Diverse Scenario of Enforcement Actions

As demonstrated in Part III Sections 4.2 and 4.3, in its processing of non-communication and non-compliance cases DG TAXUD adhered to a definite time frame, while progress in the third category of cases is much less predictable. The analysis of enforcement actions in the selected areas allows the identification of various approaches that the Commission takes to tackle a breach of EU law. These observations help to find some explanations for variations and to clarify the logic of the Commission's steps.

4.4.1. Different Types of Infringement Cases

4.4.1.1. 'Test' Cases

Article 258 TFEU allows the Commission to raise an issue where a breach of EU law has not yet been confirmed by the Court: in other words, to initiate a 'test' case.[603] The possibility of starting a new line of case law demonstrates a particularly valuable feature of Article 258 TFEU, since taxpayers would usually be cautious of bearing the costs of uncertain test litigation.[604] In practice, it can often be seen that one infringement case is referred to the Court while other cases of a similar nature are still under examination; this would be much more common for cases that belong to this type. The Commission 'tests' the ground before putting more resources into tackling other potential infringements of the same type. 'Pioneer' cases are moved relatively quickly towards the Court, unlike in some other situations where the Commission can negotiate the issue for several years; the aim is to establish a precedent.

[603] See, eg, Case C-105/08 *Commission v Portugal* [2010] ECR I-5331, Opinion of AG Kokott, para 5.

[604] Philipp Genschel, 'One Trap, Many Exits, But No Free Lunch: How the Joint-Decision Trap Shapes EU Tax Policy' in Gerda Falkner (ed), *The EU's Decision Traps: Comparing Policies* (OUP 2011) 54, 61.

4.4.1.2. 'Package' Cases

In several examples the Commission has initiated infringement proceedings in a very strategic manner, pushing systematic changes across the EU. The 'package' cases demonstrate an important role that can be played by the infringement procedure from a policymaking perspective. A horizontal approach to potential infringements is the most appropriate for far-reaching policy goals on an EU-wide scale. These cases are more likely to be moved towards the next stage of infringement proceedings simultaneously.

4.4.1.3. 'Follow-Up' Cases

The third type can be described as 'follow-up' cases, which ensure the proper and uniform application of EU law as interpreted by the Court. Typically, these cases would be built upon analogous or very similar facts to those considered earlier in Luxembourg: they aim to force compliance with existing case law in other Member States rather than create a new precedent. Sometimes this route is used as an opportunity to clarify the interpretation of EU law, especially when the approach taken by the Court is inconsistant or has changed over time. According to the Commission, the increased number of CJEU cases on direct taxation 'focused the Commission's priorities on consistent follow-up and implementation of the judgments in the different Member States'.[605] The empirical observations presented in this study illustrate a fair proportion of 'follow up' lines, such as *De Groot* (restrictions of personal deductions),[606] *Gerritse* (withholding taxes for non-residents),[607] *Schumacker* (discriminatory income taxation of non-residents),[608] *De Lasteyrie* (exit taxes)[609] and *Cadbury*

[605] See DG TAXUD, 'Commission Policy: Monitoring Application of Community Law' <http://ec.europa.eu/taxation_customs/common/infringements/commission_policy/index_en.htm> accessed 28 December 2012.

[606] Case C-147/04 *De Groot* [2006] ECR I-245.

[607] Case C-234/01 *Gerritse* [2003] ECR I-5933.

[608] Case C-279/93 *Schumacker* [1995] ECR I-225.

[609] Case C-9/02 *De Lasteyrie* [2004] ECR I-2409.

Schweppes (anti-avoidance measures).[610] It should be admitted, however, that the data used for this examination may undermine the number of cases in this category: if a breach is certain, Member States are more likely to amend their legislation before a reasoned opinion is sent.

4.4.1.4. Special Cases

Finally, the Commission can initiate cases that have a very limited application, which are relevant in the context of a specific country. For instance, in 2007 infringement cases were opened against **Ireland** (No 2005/4950)[611] and the **United Kingdom** (No 2007/2003)[612] to investigate the mutually discriminatory provisions concerning remittance base taxation applied by these countries. Procedurally, the Commission prefers to resolve these types of cases through negotiations without putting additional resources into litigation. Considering the prioritisation approach to infringement cases, and the fact that priority should be given to infringements that have a far-reaching impact on an EU-wide scale, these 'one-off cases' would be much more appropriately pursued through alternative tools.

4.4.2. Country-Specific Variations

The number of infringement cases differs between Member States. Two observations can be made in this respect. First, all countries with a high number of direct tax infringement cases also lead in the cross-sector comparison (see Table 5). Hence, it cannot justifiably be argued that the Commission prioritises certain countries specifically in the context of tax-related infringements. Second, Spain, which referred only one request for preliminary rulings under Article 267 TFEU, has been particularly frequently challenged by the Commission. The

[610] Case C-196/04 *Cadbury Schweppes* [2006] ECR I-7995.

[611] **Ireland** (No 2005/4950), IP/07/445, closed 27 November 2008.

[612] The **United Kingdom** (No 2007/2003), IP/07/445, closed 29 January 2009.

correlation in relation to other countries that are rarely engaged in the dialogue with the Court is less obvious.

Table 5. Direct Tax Infringement Cases in 2005–2012 according to Member State *(as of 1 December 2012)*[613]

Member State[614]	**Direct tax infringement cases in 2005–2012** *(as of 1 December 2012)*	**Average number of *all* infringement cases per country** *(as of 1 May 2012)*[615]
Belgium*	40	64
Spain***	19	62
United Kingdom*	14	38
Germany*	12	44
Portugal**	12	46
Netherlands*	9	39
Greece***	7	68
France*	7	56
Italy***	5	69
Sweden**	5	33
Ireland***	5	26
Austria**	5	25
Estonia****	5	9
Bulgaria****	4	25
Czech Republic****	4	20
Finland**	4	17
Luxembourg**	4	15
Poland****	3	42
Hungary****	2	22
Denmark***	3	18

[613] Built upon the results of empirical examination, as explained in Part III Section 4.1.

[614] 'Active multilevel players' (*), 'occasional players' (**), 'passive players' (***), and 'newcomers' (****): as defined in Part II Section 3.3.1.

[615] Commission, 'Internal Market Scoreboard' (September 2012, No 25) 19.

Latvia****	2	10
Romania****	1	23
Slovenia****	1	14
Lithuania****	1	7
Cyprus****	0	14
Malta****	0	17
Slovakia****	0	20

The variations could potentially be explained by the negotiation position of Member States and the unwillingness of some governments to settle a dispute at the earlier stages of infringement proceedings. For instance, a growing number of Belgian tax cases took place in line with a 65 per cent increase of all infringement proceedings against Belgium between 2007 and 2010.[616] The number of infringement cases may also have been influenced by well-grounded submissions from taxpayers.

4.5. The Mechanisms of Accountability and Transparency Standards

These differences – if not explained – raise criticisms against the Commission's working methods, increasing a lack of trust in EU bureaucracy. The annual reports on monitoring the application of EU law cannot be seen as sufficient. As early as in 2001, in response to the Parliament's request, the Commission committed to changing its approach to reporting on enforcement actions to be 'more analytical' and 'less descriptive'.[617] It also committed to assess the application of the priority criteria and present the results to the Parliament during public deliberation.[618] In 2007 the Staff Working Document accompanying the Single Market

[616] Commission, 'Internal Market Scoreboard' (December 2010, No 22) 16.

[617] Commission, '19th Annual Report on Monitoring the Application of Community Law (2001)' (Report) COM(2002) 324, section 1.

[618] Commission, COM(2002)725 final/4, 12.

Strategy emphasised the need to develop better communication on enforcement actions, as 'infringement policy (…) tends to be known too little, even amongst the legal profession.'[619] Despite obvious improvements, which were made in 2007 and 2012, the reports still lack an insightful explanation of the Commission's actions.[620] Until 2012 reporting standards had been developing towards opening more information on enforcement actions, particularly the quantative data; but it was too complex for evaluation exercises. The most recent report, which was published in 2012, is much more accessible, but has become less informative.[621] Most importantly, the critical evaluation of Commission practices still holds true: '[i]t is a report on what the Member States are doing, not on what the Commission is doing in the discharge of its guardian functions'.[622]

The Commission's reports should enable two levels of scrutiny: the fulfilment of obligations for the correct application of EU law by Member States and the exercise of enforcement powers by the Commission.[623] The increased transparency brought much clearer benchmarking with a view to comparing the performance of various Member States. This allows better scrutiny on one level, but the assessment of the Commission's use of discretion has not improved much. The piecemeal information on enforcement actions provided through press releases does not make the Commission's actions fully accountable. It is extremely difficult for taxpayers to 'restore' the logic behind the separate steps reported by the Commission. For instance, in 2012 the Commission announced that 'in all tax issues raised by the European Parliament in complaints or petitions during 2011, the Commission had already

[619] Commission, 'Instruments for a Modernised Single Market Policy' (Staff Working Document) SEC(2007) 1518 final accompanying 'A Single Market for 21st Century Europe' (Communication) COM(2007) 724 final, section 2.5.

[620] The post-2007 version provided hundreds of pages of data, which was difficult to comprehend, while the post-2012 version is more analytical but significantly reduces the available data.

[621] Commission, '29th Annual Report on Monitoring the Application of EU Law (2011)' (Complete Report) COM(2012) 714.

[622] Melanie Smith, 'Enforcement, Monitoring, Verification, Outsourcing: The Decline and Decline of the Infringement Process' (2008) 33 European Law Review 777, 787.

[623] Melanie Smith, *Administrative Procedures Linked with Article 258 TFEU Proceedings: An Academic Perspective* (European Parliament 2011) 16.

engaged in discussions with the Member States'.[624] This demonstrates how limited public understanding is of the substantive matters that are investigated under the infringement procedure. These critical comments are especially relevant for DG TAXUD, since some other departments (e.g. Directorate-General for the Internal Market and Services) provide much more comprehensive information.[625]

Three committees of the Parliament are actively involved in the scrutiny of the Commission's actions: the Committee on Legal Affairs, the Committee on Petitions and the Committee on Constitutional Affairs. This explains the nature of the Parliament's follow-up resolutions, which provide a brief review of procedural aspects without referring to specific policies. The involvement of specialised committees could be beneficial, as it would enable the analysis of policy sectors.[626] This would be possible if the Commission were to fulfil the commitment it made in the new framework agreement to 'make available to Parliament summary information concerning all infringement procedures from the letter of formal notice'.[627]

The annual reports on monitoring the application of EU law must go beyond quantitative data supplemented by a simplified policy overview. Transparency can be improved by summarising the progress made in enforcement actions in the light of sector-specific priorities. The Commission may also consider the possibility of introducing a common index for all infringement cases related to the same subject matter, which is currently provided only for transposition measures. More inclusive information would enable

[624] Commission, '29th Annual Report on Monitoring the Application of EU Law (2011)' (Complete Report) COM(2012) 714, Annex 2.

[625] DG Internal Market and Services, '2009 Annual Management Plan' <http://ec.europa.eu/dgs/internal_market/docs/amp_2009_en.pdf> accessed 28 December 2012.

[626] Melanie Smith, *Administrative Procedures Linked with Article 258 TFEU Proceedings: An Academic Perspective* (European Parliament 2011) 16.

[627] European Parliament and European Commission, 'Framework Agreement on Relations between the European Parliament and the European Commission' (Interinstitutional Agreement) [2010] OJ L304/47, para 44. European Parliament Resolution 2011/2275(INI) of 21 November 2012 on the 28th annual report on monitoring the application of EU law (2010) emphasised that 'this clause [is expected] to be applied in good faith in practice' (para 20).

the Parliament, as well as other interested parties, to evaluate the Commission's actions and to advocate changes if needed. It would reinforce the mechanisms of parliamentary scrutiny and would increase public control over the Commission's actions.

4.6. Interim Conclusions

The analysis provided in Section 4 shows that the application of Articles 258 and 260 TFEU in the area of direct taxes is much wider that it appears from public reports on monitoring the application of EU law. Non-communication cases are quite common despite the limited scope of positive harmonisation. They are dealt with in a very technical manner and are usually resolved at the earliest stages of infringement proceedings. The group of non-compliance cases is negligibly small. The innovation contained in the Treaty of Lisbon that excludes the need for a reasoned opinion for Article 260 TFEU lacks any impact in direct taxation where no reasoned opinion has been sent during the period under examination. And the third category of cases, serious prioritised infringement, plays the most evident 'policymaking' role.

As expected, the dominance of infringements in a non-harmonised tax area is clear. However, the assumption that the areas of strategic priority will be pursued more rigorously by the Commission has been disproved. Only some priority areas have received evident 'follow-up' through enforcement actions, such as dividend taxation and exit taxes. In relation to group taxation and anti-abuse measures, the Commission's approach was much less systematic and determined. The analysis of selected case studies confirms the great potential of the infringement procedure, which is fully revealed through a strategic and horizontal approach. Based on observations of the Commission's enforcement actions in 2005–2012, Section 4 has demonstrated that in promoting a selective approach to infringement proceedings in direct taxes, the Commission has failed to communicate clear criteria for

prioritisation, or to provide effective tools for scrutinising its performance. The index of infringement cases provided in Section 4.3 can serve as a guideline for taxpayers to balance the uncertainty of declared targets. It also confirms the possibility of providing a more comprehensive account of the Commission's enforcement actions while maintaining the confidentiality of infringement proceedings.

This section has also made an attempt to explain the differences in the progress of infringement cases, which are usually used to criticise the discretion of the Commission. Although the list of variables could be much longer, it focuses on the type of cases pursued, the responsiveness of national governments to the Commission's enforcement actions and the engagement of citizens and businesses in submitting complaints. It concludes that the reporting on infringement proceedings – which is quantitative, lacks analytical interpretation, and is presented through a variety of sources that are difficult to link – contributes to a lack of understanding of the Commission's actions and deepens the public mistrust of complex EU bureaucracy. It contradicts the basic principles of good administration, and as the Parliament states: 'absolute discretion coupled with an absolute lack of transparency is fundamentally contrary to the rule of law.' Therefore, the Commission's approach to reporting should be substantially improved.

5. Towards the Proceduralisation of the Infringement Procedure

The legal nature of the infringement procedure remains controversial both for practitioners and academics. It is considered to be a diplomatic dispute resolution tool, a pre-litigation stage with an investigative purpose, an administrative procedure for processing individual claims, an objective enforcement mechanism, and finally, a political tool closely linked to the Commission's policy agenda. This study argues that the EU central enforcement mechanism

should be understood as having a *multilayered* legal nature, and the procedural framework should be built accordingly.

5.1. The Multilayered Nature of the Infringement Procedure

All the major actors involved demonstrate a different and often conflicting understanding of the infringement procedure.[628] First, the Commission emphasises that this procedure is provided for *bilateral* negotiations pursuing the voluntary compliance of Member States with regard to their obligations under EU law.[629] The case can *occasionally* be referred to the Court if a consensus cannot be reached through diplomatic channels.[630] Second, according to the Court, Article 258 TFEU constitutes an important *pre-litigation stage* that fulfils the *purpose of the investigation*.[631] It discloses a breach of EU law, enables the Commission to delimit the subject matter of the dispute and provides the possibility for a Member State to prepare its defence and/or to take necessary measures before a case is referred to the Court. In addition, Article 260 TFEU is recognised as 'a special judicial procedure for the enforcement of

[628] A similar line of arguments can be found in other contributions, eg, Francis Snyder, 'The Effectiveness of European Community Law: Institutions, Processes, Tools and Techniques' (1993) 56 Modern Law Review 19, 30; it was further developed in Richard Rawlings, 'Engaged Elites Citizen Action and Institutional Attitudes in Commission Enforcement' (2000) 6 European Law Journal 4; Carol Harlow and Richard Rawlings, 'Accountability and Law Enforcement: The Centralized EU Infringement Procedure' (2006) 31 European Law Review 447.

[629] When the EU Pilot project was introduced, a Member State would have the choice either to submit its official response to the Commission (so that it could be forwarded to the complainant), or to send it directly to the complainant (notifying the Commission). Under the optimised procedure, the complainants do not engage in direct communication with a Member State, but receive the Commission's evaluation. The EU response was considered as 'generally more appropriate', as it could simultaneously include 'elements' of the response from the national authorities and the conclusion made by the Commission's services (Commission, 'EU Pilot Evaluation Report' (Report) COM(2010) 70 final, section 3). The infringement procedure thus kept a strictly bilateral nature.

[630] Ami Barav, 'Failure of Member States to Fulfil Community Obligations' (1975) 12 Common Market Law Review 369, 383; Francis Snyder, 'The Effectiveness of European Community Law: Institutions, Processes, Tools and Techniques' (1993) 56 Modern Law Review 19, 30; Richard Rawlings, 'Engaged Elites Citizen Action and Institutional Attitudes in Commission Enforcement' (2000) 6 European Law Journal 4, 8-13; Carol Harlow and Richard Rawlings, 'Accountability and Law Enforcement: The Centralized EU Infringement Procedure' (2006) 31 European Law Review 447, 454-455. AG Colomer refers to the Commission as 'the body responsible for settling disputes within the Union' (Case C-387/97 *Commission v Greece* [2000] ECR I-5047, Opinion of AG Colomer, para 86).

[631] Carol Harlow and Richard Rawlings, 'Accountability and Law Enforcement: The Centralized EU Infringement Procedure' (2006) 31 European Law Review 447, 458-459.

judgments of the Court of Justice'.[632] Third, the European Ombudsman underlines the *trilateral* nature of the procedure. Since complainants play an important role in detecting the infringement, they should also be included in the process as a third party with rights and obligations.[633] Fourth, the Parliament promotes its own role, emphasising that the Commission's accountability should be enhanced and enforcement actions must be subject to tighter *parliamentary scrutiny*.[634] Fifth, complainants consider Article 258 TFEU to be an additional *mechanism for the protection of their interests* in a situation where a Member State fails to fulfil its obligations under EU law. Although natural persons and legal entities have other instruments to ensure the proper exercise of their rights under EU law, if the matter is not related to the protection of individual rights but concerns public interests, or if the evidence of factual damage is not available,[635] or if the complainants have some reason to remain anonymous in their actions against national authorities, there is hardly any alternative to the infringement procedure.[636] Sixth and finally, the governments of the EU consider the infringement procedure to be a framework for diplomatic negotiations that do not imply a legal obligation to respond to the Commission's requests, which can be delayed or even ignored,[637] since Article 258 TFEU does not impose any obligations on national authorities. The Commission in its requests has to rely upon Article 4(3) TEU, which declares the

[632] Case C-457/07 *Commission v Portugal* [2009] ECR I-8091, para 54.

[633] European Ombudsman, *Annual Report 2010* (Publications Office of the European Union 2012), 42-45; see also Richard Rawlings, 'Engaged Elites Citizen Action and Institutional Attitudes in Commission Enforcement' (2000) 6 European Law Journal 4, 13-20; Carol Harlow and Richard Rawlings, 'Accountability and Law Enforcement: The Centralized EU Infringement Procedure' (2006) 31 European Law Review 447, 466-472.

[634] See, eg, European Parliament Resolution 2011/2275(INI) of 21 November 2012 on the 28th annual report on monitoring the application of EU law (2010), para 15.

[635] As concerns infringement proceedings, the Court held that there is no *de minimis* rule. See, inter alia, Case 95/77 *Commission v Netherlands* [1978] ECR 863, para 13; Case C-209/88 *Commission v Italy* [1990] ECR I-4313, para 14, including the Opinion of AG Mischo, para 6; Case C-209/89 *Commission v Italy* [1991] ECR I-1575, para 6; Case C-150/97 *Commission v Portugal* [1999] ECR I-259, para 22; Case C-348/97 *Commission v Germany* [2000] ECR I-4429, para 62.

[636] Some alternative tools include the possibility of submitting the complaint to the European Ombudsman, a petition to the European Parliament, or a request to the SOLVIT system. However, if the subject matter concerns a breach of EU law, this complaint will be sent to the European Commission.

[637] See, eg, Commission, IP/06/919 in **Germany** (No 2003/2067).

principle of sincere cooperation of the EU and the Member States and a full mutual respect in carrying out tasks which stem from the Treaties.

Different views also flourish in the academic community. Harlow and Rawlings distinguish three 'stages of evolution' of the infringement procedure.[638] Initially, in the first stage, the infringement procedure was an 'elite model' of dispute settlement orchestrated by the Commission.[639] The second stage of evolution was brought about by the Court, with its introduction of 'essential procedural guarantees'.[640] And the third and final stage was initiated by the Maastricht Treaty, which added financial penalties and converted the infringement procedure into a pre-trial procedure.[641] Ibáñez refers to Article 258 TFEU as a 'standard' European administrative enforcement procedure, considering it to be a *dialogue* between the Commission and Member States and arguing the need to adopt an administrative enforcement act.[642] Smith analyses Article 258 TFEU through the lens of a good governance agenda, emphasising its political nature and criticising the lack of input legitimacy.[643]

These discussions have not been introduced with a purely theoretical purpose. In fact, many procedural problems can only be resolved by first finding the answer to a very basic question about the nature of the infringement procedure. For instance, if Article 258 TFEU is considered to be a *dispute resolution tool* then the confidentiality of negotiations and an 'elite' model are certainly justified, while the criticism of EU scholars regarding a lack of transparency becomes less persuasive. If it is a *pre-litigation stage* and the Commission acts

[638] Initially, Rawlings considers the idea of three faces of an infringement procedure (see Richard Rawlings, 'Engaged Elites Citizen Action and Institutional Attitudes in Commission Enforcement' (2000) 6 European Law Journal 4). Later, however, this concept was 'redressed' into the three stage evolution in Carol Harlow and Richard Rawlings, 'Accountability and Law Enforcement: The Centralized EU Infringement Procedure' (2006) 31 European Law Review 447, 473-474.

[639] Carol Harlow and Richard Rawlings, 'Accountability and Law Enforcement: The Centralized EU Infringement Procedure' (2006) 31 European Law Review 447, 473.

[640] ibid 473.

[641] ibid 473-474.

[642] Alberto G Ibáñez, 'The "Standard" Administrative Procedure for Supervising and Enforcing EC Law: EC Treaty Articles 226 and 228' (2004) 68 Law and Contemporary Problems 135.

[643] Melanie Smith, 'Enforcement, Monitoring, Verification, Outsourcing: The Decline and Decline of the Infringement Process' (2008) 33 European Law Review 777.

as a formal investigating agent then a Member State must respond to its official requests, respecting the provided time limits. Moreover, the procedure necessitates the adoption of clear procedural regulation. Considering Article 258 TFEU to be among the tools for the *protection of public and individual interests* casts some doubts on the Commission's strategy of selective enforcement and requires more procedural rights to be granted to third parties. If it is an *'objective' enforcement mechanism* then particular attention should be paid to a horizontal approach to non-compliance practices in different Member States, and the Commission's discretion regarding 'whether' and 'when' to process the case should be scrutinised more rigorously. Finally, if the Commission accepts a *policy element* in pursuing the infringements of EU law, it should respect the principles of good governance and open the decision-making process regarding selection criteria to public consultation.

In response to these discussions, this study argues that the EU central enforcement mechanism should be understood as having a *multilayered* legal nature.[644] It consists of three stages, which involve different actors, imply different procedural rules and reflect different legal concepts.

5.2. The Pre-Infringement (Administrative) Stage

In brief, the pre-infringement stage as formally introduced by the EU Pilot system is based on the concept of *administrative procedure* that deals with all claims and enquiries, aiming to protect individual and public interests with respect to an alleged violation of EU law by national authorities.

[644] Traditionally, two phases are distinguished: 'administrative' and 'judicial' (see, eg, Alan Dashwood and Robin White, 'Enforcement Actions under Articles 169 and 170 EEC' (1989) 14 European Law Review 388). The attempt to divide the infringement procedure into more stages had been made earlier by other scholars, but their suggested approaches differed. See, eg, Carol Harlow and Richard Rawlings, 'Accountability and Law Enforcement: The Centralized EU Infringement Procedure' (2006) 31 European Law Review 447, 455 ('[t]he idea emerges of a front-loaded procedure, which starts with a negotiatory, diplomatic phase; continues through a formal, bureaucratic phase, culminating only if unsuccessful in a Court ruling').

The introduction of alternative dispute resolution tools, which allow the resolution of the majority of cases without launching a formal investigation, created a better balance between the Commission's selective approach and the principles of good administration in relation to the complainants. Publishing the Single Market Strategy in 2007, the Commission explained that 'setting priorities does not mean "selectivity" – it rather means pursuing some cases as a matter of priority whilst finding suitable solutions to others (including securing a resolution via alternative means)'.[645]

In the most recent report on the application of EU law (2012) the language of 'priorities', which was actively used by the Commission in the context of complaint-based and own initiative cases in 2001–2010, was limited to the own initiative cases.[646] Out of 3,115 new complaints received by the Commission in 2011, bilateral discussions under EU Pilot to examine if a Member State had breached EU law were initiated in just over 600 cases.[647] For the other complainants, the Commission seemingly provided a 'full response'; these cases were not taken further either because (i) EU law was not breached, (ii) the complaint was beyond the competence of the Commission or (iii) 'the correspondence did not qualify as a complaint'.[648] The EU Pilot cases are closed when the Commission is satisfied by the explanation provided by a Member State. The remaining cases are dealt with by initiating the infringement procedure. Previously, cases that did not meet the 'priority criteria' were closed without further consideration.[649]

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[645] ibid.

[646] Commission, '29th Annual Report on Monitoring the Application of EU Law (2011)' (Complete Report) COM(2012) 714. Compare it to the declaration made in the mid-1990s, when the Commission argued against considering the infringement procedure to be a tool 'capable of solving every individual situation – a kind of Community Supercourt' (Ian Harden, 'What Future for the Centralized Enforcement of Community Law?' (2002) 55 Current Legal Problems 495, 498).

[647] ibid.

[648] ibid.

[649] See, eg, Maria IR Valero, *Administrative Procedure in Environment Files Linked with Article 258 TFEU Proceedings: A Lawyer's Perspective* (European Parliament 2010) 17 and 21.

5.3. The First (Negotiation) Stage of the Infringement Procedure

The first stage of the infringement procedure takes place from the official opening of an investigation until the sending of a reasoned opinion. It has a *diplomatic nature* and presumes the wide discretionary power of the Commission attributed to it by the Treaty provisions, thus the confidentiality of negotiations in relation to the case's progress must be maintained. At the same time, the initiation of an infringement case is conditioned by transparent selection criteria, which should respect the idea of objective enforcement and the principles of good governance.

As discussed in Part III Section 3, a policy of proactive enforcement should ensure the priority and speedy handling of cases with a potentially widespread positive impact.[650] Non-communication and non-compliance cases under Article 260 TFEU require a clear-cut administrative procedure, which leaves limited discretion to the Commission in relation to whether the case is initiated and if it is, in relation to the dynamics of its progress. The prioritisation in relation to the third category of cases should be set in accordance with the principles of good governance: although the Commission has started to declare its selection criteria, further developments should provide more openness to its strategy and better communication with the public. Finally, selectivity should merely be concerned with the subject matter, whereas a horizontal approach to similar infringements in different Member States should become the norm.

5.4. The Second (Pre-Litigation) Stage of the Infringement Procedure

The second stage, which comes after the reasoned opinion has been issued, shall be considered as a *pre-litigation phase*. The Commission officially declares the existence of a

[650] This recommendation was already reflected in Commission, 'Instruments for a Modernised Single Market Policy' (Staff Working Document) SEC(2007) 1518 final accompanying 'A Single Market for 21st Century Europe' (Communication) COM(2007) 724 final, section 2.5.

breach of EU law and its right to refer the case to the Court within a certain period of time. Moreover, this stage carries legal consequences for national authorities by establishing the date when a Member State is recognised to have failed to fulfil its obligations under EU law, and can be sued, even if the breach is subsequently eliminated.[651] The second stage, therefore, requires detailed procedural regulation. It should address the key problems traditionally associated with the infringement procedure, namely the lack of a formalised procedural framework, the need to balance the confidentiality of an investigation with the transparency of EU bureaucracy, and the need to reconcile the wide discretion of the Commission with effective benchmarking for enforcement actions.[652] Part III Section 3 has summarised the existing procedural rules that need to be codified. In addition, some crucial adjustments are recommended here in relation to reasoned opinions and referrals to the Court in order to improve existing practices.

5.4.1. Reasoned Opinion

From the moment a reasoned opinion is announced through a press release, it creates uncertainty for potentially interested parties. Indeed, the obligation of the Commission to refer the case to the Court is explicitly excluded by the wording of the Treaty, which stipulates that the Commission '*may* bring the matter before the Court of Justice of the European Union'.[653]

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[651] Under settled case law, 'the question whether there has been a failure to fulfil obligations must be examined on the basis of the position in which the Member State found itself at the end of the period laid down in the reasoned opinion'. Furthermore, 'the Commission still has an interest in bringing an action under Article 258 TFEU even when the alleged infringement has been remedied after the expiry of the period prescribed in the reasoned opinion'. See Case C-519/03 *Commission v Luxembourg* [2005] ECR I-3067, paras 18-19; Case C-562/07 *Commission v Spain* [2009] ECR I-9553, para 23.

[652] See, eg, Adam Tomkins, 'Of Institutions and Individuals: The Enforcement of EC Law' in Paul Craig and Richard Rawlings (eds), *Law and Administration in Europe: Essays in Honour of Carol Harlow* (OUP 2003) 273, 288; Ian Harden, 'What Future for the Centralized Enforcement of Community Law?' (2002) 55 Current Legal Problems 495.

[653] The discussion about a proper reading of this paragraph was held at the early stages of European integration. In *Commission v Italy* (the case concerns taxation on the exportation of articles of artistic and historic interest), the Court concludes that 'Article 155 of the Treaty states that the Commission shall ensure that the provisions of the Treaty are applied, and it was therefore both *entitled and bound*, in view of the length of time which had already passed and the lapse of the Government's draft law owing to the dissolution of the Parliament, to have to

However, this paragraph should be read in the light of the principle of good administration as one that requires a follow-up within a reasonable period of time. It may result in one of the following outcomes: (i) the closure of the case, (ii) a referral to the Court, or (iii) an extension of the examination period if further clarification is required. Whatever decision is adopted by the Commission upon the expiry of the set deadline, it should be publicly announced. Considering the effectiveness of the time limits that are currently used at the pre-infringement stage, the Member State and the Commission may consider expanding this practice to the stage of reasoned opinion.

A pre-requisite for these developments would be the consistent reporting of the reasoned opinions sent to Member States. Although the Commission has declared that all direct tax cases that reach the second and third stages of the infringement procedure are communicated to the public through a press release, there have still been exceptions in the period covered by this examination.[654] Furthermore, this rule does not extend to complementary reasoned opinions, so the Commission rarely reports on them in a direct tax case. A complementary reasoned opinion is important as it moves a case back to the second stage if it has already been referred to the Court. Hence, the lack of information about this decision results in the taxpayer easily 'losing track' of the case's progress. A complementary reasoned opinion may also clarify important details, especially if national provisions have been amended (which often becomes a reason for a complementary letter).[655]

The press releases are important for notifying taxpayers about the potential impact of cases on their rights. However, they are limited to a summary of an alleged infringement,

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bring the matter before the Court at the time when it did so' (Case 7/68 *Commission v Italy* [1968] ECR 617, 426, emphasis added). The attempt to introduce an obligation of the Commission was not supported in subsequent judgments, so the traditional reading of Article 258 TFEU provides full discretion to the Commission.

[654] The 'gaps' can be identified by comparing the Commission's press releases with the list of infringement cases provided in the Annual Report on Monitoring the Application of EU law.

[655] For instance, see Commission, IP/11/1424: 'In November 2010 the Commission officially called on Belgium to amend its legislation within two months (IP/10/1563). The request took the form of a "reasoned opinion", which constitutes the second stage of infringement proceedings. Belgian legislation was amended in May 2011 to reflect the ruling of the Court of Justice of the European Union of 1 July 2010 in the *Dijkman and Dijkman-Lavaleije* case, Case C-233/09. The amendments, however, only partly corrected the infringement.'

which is provided in a few paragraphs – often omitting any reference to the specific article (act) that is considered to be a breach of EU law. These briefs could be insufficient for understanding legal arguments. A greater transparency of the infringement procedure can be ensured without putting the investigation at risk. Since the issues at stake are publicised through a press release, they can hardly be considered as confidential – the Commission's concerns may prompt domestic taxpayers to raise similar issues through domestic courts. There can be no justifiable arguments, therefore, against publishing a fuller overview of reasoned opinions. In state aid cases, for instance, the Commission warns a Member State that a reasoned opinion will be published unless any objection is raised within a specific period of time. This can provide a good example for infringement cases. In 2001 the Commission – explaining the need to publish its recent decisions arising from infringement cases – argued that 'there is no doubt that public dissemination immediately after the Commission has taken its decision will give the national authorities an incentive to come quickly into line with Community law'.[656] Essentially the same logic supports the idea of publishing more comprehensive information at the stage of reasoned opinions. In October 2012, however, the Commission changed its reporting practice in the opposite direction: instead of press releases, it now publishes a monthly infringement package, which includes an even shorter summary of the most important cases.[657]

5.4.2. Referral to the Court

Referral to the Court has thus far proved to be the most complex stage of the infringement procedure. In essence, if the Commission is not satisfied by the response of a Member State,

[656] Commission, '18th Annual Report on Monitoring the Application of Community Law (2000)' (Report) COM(2001) 309 final, section 2.1.

[657] Academics and practitioners who are accustomed to referring to the number of the press release when discussing particular infringement cases, will now have to refer to the number of each case. The Annex to this thesis allows the linking of both for all direct tax cases that have been made public since 2005.

the case may be referred to the Court. However, is it clear what could be considered to be an 'unsatisfactory response'? The Commission may refer the case to the Court when a Member State: (i) fails to reply to a reasoned opinion;[658] (ii) rejects changing national tax provisions by either not admitting the breach or considering it to be one that can be justified;[659] (iii) submits a formal or manipulative reply, accepting the infringement without indicating 'when and how it would eliminate it, nor how it would apply EU law in the period before any new rules would enter into force';[660] (iv) undertakes an obligation and even reports the (forthcoming) amendments, but the Commission is not satisfied by the scope of the changes;[661] and finally, (v) communicates changes that fully satisfy the Commission, but if they were made after the period of time that was provided by a reasoned opinion, the case may still be referred to the Court.[662]

In practice, it is not the wide discretion of the Commission that causes the main concern: it is the lack of legal certainty, which appears to be most striking when the case is referred to the Court but the Commission's decision is not carried out. As shown earlier, some cases were referred as many as four times and spent several years waiting for their registration in the Court. Since a press release can be published after any of these multiple referral decisions have been made, this brings further confusion. The reports on monitoring the application of EU law, therefore, only include a reference to the referral if the case was *in fact* registered in the Court. The bare minimum in this situation would be to publish a press release *only* when the decision has been carried out, or to provide an explanatory notice.

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[658] See Commission, IP/09/288 in **Portugal** (No 2006/5036).

[659] See Commission, IP/07/1030 in **Spain** (No 2005/2431).

[660] This type of practice is common for Belgium. See Commission, IP/08/337 in **Belgium** (No 2006/2375 and No 2005/5063), IP/07/13 in **Belgium** (No 2005/4576) and IP/06/1879 in **Belgium** (No 2005/5062).

[661] See Commission, IP/09/567 in **Portugal** (No 2007/2138), IP/08/144 in **Germany** (No 1999/4852), and IP/11/162 in **Spain** (No 2004/4090). Sometimes, this may result in a complementary reasoned opinion being sent to Member States, but the Court is less strict with the documentary requirement when it comes to amended provisions, so a complementary reasoned opinion is not essential.

[662] Case C-562/07 *Commission v Spain* [2009] ECR I-9553; **Spain** (No 2004/4314).

Finally, the third stage of the infringement procedure is a *litigation process* at the Court, which will not be discussed in this study.

5.5. Interim Conclusions

Since the model of the EU infringement procedure has not yet been fixed through a procedural act, current practice could be rethought. The idea of the *multilayered* nature of the infringement procedure is suggested as a starting point for further developments. Conceptually, improvements could be made by introducing a clear differentiation between the negotiation and pre-litigation stages of infringement proceedings in relation to the scope of the Commission's discretion, the rights and obligations of the guardian of the Treaties and Member States, and transparency standards. This would be in line with Snyder's observation made in the early nineties that '[w]e usually think of negotiation and adjudication as alternative forms of dispute settlement (...) but in the daily practice and working ideology of the Commission, the two are not alternatives but instead are complementary'.[663] The procedural regulation should reflect this approach.

The procedural framework for the infringement procedure should codify existing rules that can be found in the case law of the Court and the soft law of the Commission, as discussed in Part III Section 3. While the Parliament opposed the possibility of using a soft law act for this purpose, because it would exclude the Parliament from the decision-making process,[664] the Commission questioned the Parliament's proposal to choose a legal act with a binding force, because it could potentially limit the discretion attributed to the Commission by

[663] Francis Snyder, 'The Effectiveness of European Community Law: Institutions, Processes, Tools and Techniques' (1993) 56 Modern Law Review 19, 30 (citations omitted).

[664] European Parliament Resolution 2011/2275(INI) of 21 November 2012 on the 28th annual report on monitoring the application of EU law (2010), para 8; see also European Parliament Resolution 2011/2027(INI) of 14 September 2011 on the 27th annual report on monitoring the application of European Union law (2009), para 22.

the Treaty.[665] To ensure that the principles of good administration are respected, the procedural rights of complainants should be stipulated in a regulation adopted under Article 298 TFEU. As the Parliament proposes, it should cover the issues of 'notifications, binding time-limits, the right to be heard, the obligation to state reasons, and the right for every person to have access to her or his file, in order to reinforce citizens' rights and guarantee transparency'.[666] At the same time, the organisation and management of infringement cases requires a flexible policy framework, based on a clear differentiation of negotiation and pre-litigation stages in the infringement procedure.

6. Conclusion to Part III

Part III demonstrates the important role played by the infringement procedure in the field of direct taxes. Although the enforcement actions cannot be a substitute for the lack of positive harmonisation, they have forced significant changes in many areas of national tax regulation. Notwithstanding 'the financial crisis and the need for Member States' [*sic*] to preserve and expand their tax revenues', the Commission declares that its interest in this field 'is likely to continue and intensify over the coming years'.[667]

The most crucial function of the infringement procedure is represented by the 'follow-up' cases. When case law becomes a primary source of harmonisation as in the field of direct taxes, the horizontal effect of judgments and their effective enforcement becomes particularly important. Article 258 TFEU has been used to remind Member States that have identical tax provisions about their obligations to respond in a timely manner to EU law, and it has also been used to apply the principles that follow from the interpretations provided by the Court, to

[665] This possibility was briefly discussed in Editorial Comments, 'A Revival of the Commission's Role as Guardian of the Treaties' (2012) 49 Common Market Law Review 1553, 1563.

[666] European Parliament Resolution 2011/2275(INI) of 21 November 2012 on the 28th annual report on monitoring the application of EU law (2010), para 17.

[667] Commission, 'Situation in the Different Sectors' (Staff Working Paper) SEC(2011) 1093 final accompanying '28th Annual Report on Monitoring the Application of EU Law (2010)', section 13.3.1.2.

sufficiently similar fiscal barriers that are maintained in other Member States. By using the possibility of testing tax matters that have not yet been referred to the Court, and adopting a horizontal approach to similar infringements across the EU, the Commission changes from being a supporting agent of the Court into a much more independent player, capable of bypassing the Council in pursuit of its tax policy objectives.

As acknowledged earlier, while the interventionist approach of the Court in the field of direct taxation is widely criticised, the role of the Commission as guardian of the Treaties has gained only limited attention. The great potential of the infringement procedure demonstrated by this study fully supports the conclusion of the Monti Report (2010), which underlines the importance of 'reinforcing enforcement'.[668] However, it also highlights the need for changes in the Commission's enforcement actions before it begins to use its 'existing infringement powers more rigorously'.[669] If the procedural regulation is left in its current state, the more active use of the infringement procedure could multiply legal uncertainty for taxpayers who show a great interest in the Commission's enforcement actions.

From a legal perspective, the infringement procedure requires procedural improvements, as proposed in Part III Section 5 with reference to the *multilayered* nature of infringement proceedings. From a policy perspective, further efforts should be made towards a more strategic, horizontal and transparent approach to enforcement actions. The Commission should carry out comparative fiscal studies and consult the Parliament and interest groups in order to define its priority areas. The implementation of these recommendations will contribute to a more balanced tax integration and the better functioning of the Internal Market.

[668] Mario Monti, 'A New Strategy for the Single Market' (9 May 2010), section 4.2.

[669] As called upon by the UK Parliament – House of Lords, '15th Report on Re-Launching the Single Market' (2011), para 149.

PART IV. Non-Binding Coordination of Member States' Direct Tax Systems

1. Outline

Soft law is not a new phenomenon in European governance. Non-binding regulatory approaches have been used since the earliest stages of European integration, taking on a wide range of forms and functions. Already in 1980 the Commission introduced the practice of interpretative guidance on the application of case law to address the uncertainty of negative harmonisation.[670] A few years later, in 1985, soft law was called to balance the drawbacks of 'piecemeal' infringement proceedings.[671] According to the Commission, by publishing communications that explain the obligations of Member States in various legal situations, it can tackle the breach of EU law in a more systematic way. The Edinburgh European Council (1992) legitimised the use of soft law instruments with a regulatory purpose, concluding that the principle of subsidiarity requires prioritising 'soft' measures over legally binding instruments where it deems possible.[672] Thus, this type of regulation had been widely

[670] Commission, 'Concerning the Consequences of the Judgment given by the Court of Justice on 20 February 1979 in Case 120/78 ("Cassis de Dijon")' (Communication) [1980] OJ C256/2.

[671] Commission, 'White Paper on Completing the Internal Market' (Communication) COM(85) 310 final, para 155.

[672] European Council Conclusions of 11–12 December 1992, section 2: 'The Community should legislate only to the extent necessary. Other things being equal directives should be preferred to regulations and framework directives to detailed measures. Non-binding measures such as recommendations should be preferred where appropriate. Consideration should also be given where appropriate to the use of voluntary codes of conduct.'

recognised in the EU, when the very first 'recommendation' was adopted in the field of direct taxation (1993).[673]

Since the Commission constantly faces difficulties in securing the unanimous support of Member States for its legislative proposals, alternative instruments of regulation have been found to be particularly valuable. In 2001 the Commission officially declared that '[t]he use of non-legislative approaches or "soft legislation" may be an additional means of making progress in the tax field.'[674] Protecting their fiscal sovereignty, Member States agree that tax coordination is a preferable regulatory choice for the Internal Market and 'there is no need to pursue tax harmonisation as such.'[675] At the same time, coordination raises some constitutional and legal concerns. The constitutional dimension relates to its impact on the division of competences between the EU and Member States, as well as on the institutional balance set by the EU Treaties, in particular when a non-binding instrument is adopted as a substitute to legislative action and as a way of bypassing the unanimity rule. The legal concern relates to the ambiguity of procedural aspects (e.g. adoption, revision and control), as well as the legal and practical effects of soft law measures. Although the effectiveness of soft law has so far been found to be very low, a recent document published by the Commission, 'Growth-Friendly Tax Policies in Member States and Better Tax Coordination in the EU', has demonstrated that this instrument is considered to have great potential that could be more fully utilised in the future.[676]

Against this background, Part IV aims at exploring procedural and substantive challenges that are related to the use of non-binding regulatory instruments for tax coordination purposes, as their better understanding can help to increase the efficacy of soft

[673] Commission Recommendation 94/079/EC of 21 December 1993 on the taxation of certain items of income received by non-residents in a Member State other than that in which they are resident [1994] OJ L39/22. For some earlier communications in the field of direct taxation, see Part II Section 2.

[674] Commission, COM(2001) 260 final, section 4.3.

[675] See, eg, Mario Monti, 'A New Strategy for the Single Market' (9 May 2010); see also UK Parliament – House of Lords, '15th Report on Re-Launching the Single Market' (2011), para 137.

[676] Commission, 'Growth Friendly Tax Policies in Member States and Better Tax Coordination' (Annex IV to the Annual Growth Survey 2012) COM(2011) 815 final.

measures in this field. Methodologically, Part IV combines normative and empirical perspectives: it discusses the theoretical underpinnings of soft law as a regulatory tool, and assesses the outcomes of the complex tax coordination initiative launched by the Commission in 2006.

The analysis is structured as follows. Section 2 explains the concept of soft law developed by EU law scholarship and places it in the context of direct tax policy, explaining how non-binding instruments have been applied in this field. Section 3 takes a closer look at the key constitutional and legal problems, discussing the limits of EU competences, the institutional balance established by the Treaties, the principles of good governance, and the (indirect) legal and practical effects of non-binding instruments. Section 4 takes an empirical angle. It examines the 2006 Commission tax coordination initiative, asking whether its goals have been reached.[677] This initiative aimed at coordinating Member States' direct tax systems through communications, which were used to provide guidance to Member States on the principles developed in case law and to offer coordinated policy solutions where unilateral measures could not resolve the problem. Three initial targets addressed under the 2006 coordination initiative were: (i) the tax treatment of losses in cross-border situations, (ii) exit taxes and (iii) anti-abuse measures.[678] As discussed in Part III, these areas were also declared as the strategic priorities for infringement proceedings. Part IV thus not only assesses the role of soft law on its own, but also links it with the Commission's enforcement policy explored in Part III. This will help to build a fuller picture of the Commission's steps in its pursuit of the elimination of fiscal obstacles to the Internal Market. Section 5 then draws together a theoretical analysis with empirical observations, and suggests recommendations on how to increase the efficacy of tax coordination.

[677] Commission, COM(2006) 823 final.

[678] Commission, COM(2006) 824 final; Commission, COM(2006) 825 final; Commission, COM(2007) 785 final.

2. Soft Law in the Field of Direct Taxation

2.1. Defining Soft Law Instruments

What is 'soft law'? Responding to this question in 1989, Wellens and Borchardt concluded that there is a 'lack of an unambiguous description that could be sanctioned by a doctrinal majority'.[679] Although the importance of soft law instruments has increased since then, stimulating growing academic attention, this conclusion remains valid: international public law, the theory of international relations, EU law and national legal orders all provide different definitions. Furthermore, even referring to 'soft law' in EU governance, academic contributions represent a broad spectrum of views on its exact scope. At one end of the spectrum, some academics argue that ambiguous obligations created by abnormal instruments 'are neither "soft law" nor "hard law": they are simply not law at all' (Weil).[680] At the other end, other scholars conclude that any 'rules of conduct which, in principle, have no legally binding force but which nevertheless may have practical effect' should be considered as soft law, distinguishing between acts adopted with informative, declaratory and interpretative purposes (Snyder).[681]

These margins can be reconciled by distinguishing *three* categories, namely 'non-law', 'soft law' and 'hard law'. Although it is important to identify which characteristics differentiate 'soft law' from 'hard law', the initial concern should be which elements turn a

[679] Karel C Wellens and Gustaaf M Borchardt, 'Soft Law in European Community Law' (1989) 14 European Law Review 267, 271. For a brief overview see Ulrika Mörth, 'Introduction' in Ulrika Mörth (ed), *Soft Law in Governance and Regulation: An Interdisciplinary Analysis* (Edward Elgar Publishing 2004).

[680] Prosper Weil, 'Towards Relative Normativity in International Law?' (1983) 77 American Journal of International Law 413, footnote 7: see also Jan Klabbers, 'The Undesirability of Soft Law' (1998) 67 Nordic Journal of International Law 381, who discusses the applicability of theoretical concepts designed by international law in the EU context.

[681] Francis Snyder, 'The Effectiveness of European Community Law: Institutions, Processes, Tools and Techniques' (1993) 56 Modern Law Review 19, 33; see also Francis Snyder, 'Soft Law and Institutional Practice in the European Community' in Stephen D Martin (ed), *The Construction of Europe – Essays in Honour of Emile Noël* (Kluwer Academic Publishers 1994) 197.

non-legal document into a 'quasi-legal' act.[682] Senden offers a convenient demarcation tool by classifying non-binding instruments into the following three groups according to their purpose: (i) preparatory and informative acts that have a 'pre-law' function; (ii) interpretative and decisional acts with a 'post-law' function; and (iii) steering acts with a 'para-law' function.[683] To be regarded as 'soft law', the non-binding act must be adopted with the expectation of producing a regulatory effect. This condition distinguishes 'soft law' from preparatory acts that are published in the course of the policymaking process, such as green papers, white papers and action programmes, as well as informative communications that explain the actions of EU institutions.[684] For instance, the Commission's communication on progress towards CCCTB (2006),[685] similarly to several other reports and studies on the development of tax policies published by the Commission, is not intended to produce a regulatory impact on its own and, therefore, should not be regarded as 'soft law'.

If a regulatory purpose lies at the heart of both 'soft' and 'hard' law, then what makes these two phenomena different? An intuitive explanation would be that 'soft law' is non-binding. However, this single condition is insufficient. If each provision that cannot be enforced is 'soft' law, then this category captures all the declaratory norms contained in hard-law acts; for instance, an EU Treaty provision that does not satisfy the conditions for a direct effect may well be considered as such (e.g. ex Article 293 of the EC Treaty on double taxation). At the same time, some 'soft' provisions may be fairly detailed and produce 'hard' legal consequences (e.g. the Commission's Communication on Calculating Lump Sum and

[682] Timothy Meyer, 'Soft Law as Delegation' (2009) 32 Fordham International Law Journal 888, 890.

[683] Senden L, *Soft Law in European Community Law* (Hart Publishing 2004) 107-224; Linda Senden, 'Soft Law and Its Implications for Institutional Balance in the EC' [2005] 1 Utrecht Law Review 79, 81-83; adopted, inter alia, by Hans Gribnau, 'Soft Law and Taxation: EU and International Aspects' [2008] 2:2 Legisprudence 67, 101-106.

[684] See, eg, Linda Senden, 'Soft Law, Self-regulation and Co-regulation in European Law: Where Do They Meet?' [2005] 9:1 Electronic Journal of Comparative Law 1, 23-24; Hans Gribnau, 'Soft Law and Taxation: EU and International Aspects' [2008] 2:2 Legisprudence 67, 102-104.

[685] Commission, 'Implementing the Community Lisbon Programme – Progress to Date and Next Steps towards a Common Consolidated Corporate Tax Base (CCCTB)' (Communication) COM(2006) 157 final.

Penalty Payments under Article 260 TFEU[686]). This ambiguity forces some scholars to conclude that 'there is no "bright line" between hard and soft law',[687] and requires an additional condition to be introduced into the definition of soft law.

Considering these observations, the definition adopted for the purpose of this study combines two core elements, namely (i) a normative value of soft law reflected in its regulatory aim, and (ii) the lack of a decision-making procedure that creates directly enforceable rights and obligations. Therefore, 'soft law' is defined as an act that has not been adopted under a rule-making procedure that can generate a legally binding force, but nevertheless is intended to have a regulatory impact.

The variety of soft law instruments is remarkable: neither EU legislative acts nor policy documents have provided a comprehensive account of them.[688] Considering this lack of uniformity, Trubek, Cottrell and Nance rightly conclude that 'soft law' is a very ambiguous term: '[t]he only common thread among these (…) [instruments] is that while all have normative content they are not formally binding.'[689] Blutman goes even further, arguing that this 'phraseology of convenience in legal discourse' is 'meaningless'.[690] The Commission and the Parliament, which disagree on many aspects related to new modes of governance, also reached the conclusion that the expression 'soft law' should be avoided in all official documents of EU institutions, and that specific instruments commonly generalised under this heading should be discussed separately:

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[686] Commission, 'Updating of Data Used to Calculate Lump Sum and Penalty Payments to be Proposed by the Commission to the Court of Justice in Infringement Proceedings' (Communication) C(2012) 6106 final.

[687] Anne Peters, 'Soft Law as a New Mode of Governance' in Udo Diedrichs and others (eds), *The Dynamics of Change in EU Governance* (Edward Elgar Publishing 2011) 21, 32.

[688] For instance, the White Paper on European Governance encourages the use of guidelines, recommendations, co-regulatory mechanisms and OMC (see Commission, COM(2001) 428 final, section 3.2). The Commission's Action Plan 'Simplifying and Improving the Regulatory Environment' refers to non-legislative instruments, such as 'recommendation, coregulation, self-regulation, voluntary sectoral agreements, open coordination method, financial assistance, information campaign' (COM(2002) 278 final, section 1.1).

[689] David M Trubek and others, '"Soft Law," "Hard Law," and European Integration: Toward a Theory of Hybridity' (2005) 1002 University of Wisconsin Legal Studies Research Paper.

[690] László Blutman, 'In the Trap of a Legal Metaphor: International Soft Law' (2010) 59 International and Comparative Law Quarterly 605, 624.

> In any future debates on the use of 'soft law' it would be best to avoid a blanket discussion, and make a clear distinction between for instance recommendations, interpretative communications and guidelines. Only in this way can it be avoided that isolated concerns about some specific applications of a specific instrument lead to wide-ranging horizontal measures that pose unnecessary restrictions to an otherwise desirable practice.[691]

Since a combined analysis covering procedural and institutional problems, good governance standards and benchmarks of effectiveness could produce different results for various instruments covered by the general term 'soft law', this study classifies these instruments into more specific groups. The most basic distinction should be made between three categories, namely (i) institutional instruments, (ii) self-regulation and (iii) co-regulation. In the Interinstitutional Agreement on Better Lawmaking (2003), the Parliament, the Council and the Commission for the first time agreed upon common definitions for 'co-regulation' and 'self-regulation'.[692] The Agreement established a 'stable framework' for these instruments by defining basic procedural requirements, which would ensure that EU law and the prerogatives of EU legislators are respected. However, the Agreement has no reference to institutional soft law, which covers acts adopted by institutionalised public bodies, such as the Commission.[693]

The most widely used classification of institutional soft law has been offered by Senden; this classification has been widely accepted by EU law literature[694] and subsequently

[691] Commission Response SP(2007) 5402 of 24 October 2007 to European Parliament Resolution 2007/2028(INI) of 4 September 2007 on Institutional and Legal Implications of the Use of 'Soft Law' Instruments'. See also European Parliament Resolution 2007/2028(INI) of 4 September 2007 on institutional and legal implications of the use of 'soft law' instruments: 'the expression of soft law, as well as its invocation, should be avoided at all times in any official documents of the European institutions' (para 19).

[692] 'Co-regulation' was defined as 'the mechanism whereby a Community legislative act entrusts the attainment of the objectives defined by the legislative authority to parties which are recognised in the field (such as economic operators, the social partners, NGOs or associations)'; and 'self-regulation' as 'the possibility for economic operators, the social partners, NGOs or associations to adopt amongst themselves and for themselves common guidelines at European level (particularly codes of practices or sectoral agreements).' See European Parliament, Council and Commission, 'Interinstitutional Agreement on Better Law-Making' [2003] OJ C321/01, paras 16-23.

[693] This and other acts adopted under the Better Regulation initiative refer to co-regulation and self-regulation when the term 'soft law' is used. See, eg, Commission, 'Better Regulation for Growth and Jobs in the European Union' (Communication) COM(2005) 97 final, section 1.

[694] Linda Senden, *Soft law in European Community Law* (Hart Publishing 2004) 107.

borrowed by EU tax scholarship.[695] Putting aside preparatory and informative instruments, which, contrary to the views of some scholars, should not be considered as 'soft law', Senden distinguishes two categories, namely (i) *interpretative and decisional acts*, which explain the application of EU law: interpretative acts elaborate the ambiguous provision of EU legislation and/or case law, whereas decisional acts clarify how the EU institution would apply EU law in individual cases within the scope of discretion provided by the Treaties; and (ii) *steering acts*, which aim at establishing closer cooperation between Member States by encouraging certain developments: formal steering instruments are mentioned in the EU Treaties (recommendations and opinions), whereas informal steering instruments usually take the form of declarations, conclusions (adopted by the Council), joint declarations, inter-institutional agreements and codes of conduct. The most widely discussed 'informal steering' tool in EU governance is the open method of coordination (OMC).

This classification has some clear limitations: taking the purpose of a non-binding act as a starting point, it disregards a number of important characteristics, such as the diversity of institutional actors that can produce 'soft law', the variety of procedures and settings, and, in particular, the differences between the (indirect) legal and practical consequences of different types of soft law. In order to avoid general statements that may not be applicable to some types of soft law, the analysis of procedural problems provided later in Section 3 will focus on the types of instruments that are most commonly used for the purpose of tax coordination in the EU – these are identified in the following section.

[695] Hans Gribnau, 'Improving the Legitimacy of Soft Law in EU Tax Law' (2007) 35 Intertax 30.

2.2. EU Tax Governance after 2001: Developments in the Commission's Working Methods

As shown in Part II, some initial attempts at using non-binding instruments in the field of direct taxation can be found in the earliest stages of integration. In the 1990s, admitting the need to respect the division of competences between the EU and Member States, the Commission declared that the Union intervention should be limited to 'the minimum necessary to ensure that the internal market functions smoothly',[696] and that in those cases where uniform tax harmonisation cannot easily be justified, priority should be given to the coordination of tax policies.[697] However, progress in this area was slow and the use of tax coordination was infrequent before 2001.

2.2.1. Earlier Examples of Tax Coordination in the EU (before 2001)

Initially, the Commission published several recommendations, the first of which was on the taxation of non-resident workers (1993). A non-binding form was used after the Commission's unsuccessful attempts to reach an agreement with Member States on a proposal for a directive concerning the harmonisation of income taxation provisions with respect to the freedom of movement for workers within the EU (1979). The legislative proposal was withdrawn. Instead, the Commission adopted the common rules of conduct, inviting Member States to amend their tax laws voluntarily; the Commission then initiated several infringement proceedings against those countries that kept the discriminatory provisions. The need for this recommendation was explained by the fact that a lack of coordination creates 'a risk that very

[696] Commission, 'Subsequent to the Conclusions of the Ruding Committee Indicating Guidelines on Company Taxation Linked to the Further Development of the Internal Market' (Communication) SEC(92) 1118 final, para 20.

[697] Commission, SEC(90) 601 final, para 30.

divergent new rules will be introduced in various Member States'.[698] At this point in time, the Court had already delivered its opinion on this matter in the *Werner* case (1993),[699] whereas the *Schumacker* case was still under consideration.[700] Subsequently, the Commission concluded that the 1993 recommendation was successful, since some Member States changed their laws and the Court took the Commission's view on board in its *Schumacker* ruling.[701] This forerunning initiative was followed by two recommendations on SMEs (1994), requesting Member States to decrease the difference between tax rates for incorporated and non-incorporated businesses and to improve fiscal conditions in the event of the transfer of ownership of SMEs.[702]

Next, the Commission approbated a new approach to tax coordination by adopting a non-binding instrument, the Code of Conduct for Business Taxation.[703] Subsequently approved by the Parliament and the Council, the Code is monitored by the 'Primarolo Group', which is formed of high representatives of Member States. The Commission considers the Code of Conduct as a 'particular form of non-binding intervention (…) developed in the direct taxation area.'[704] According to Radaelli, it was a predecessor of OMC.[705]

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[698] Commission Recommendation 94/079/EC of 21 December 1993 on the taxation of certain items of income received by non-residents in a Member State other than that in which they are resident [1994] OJ L39/22, para 5.

[699] Case C-112/91 *Werner v Finanzamt Aachen-Innenstadt* [1993] ECR I-429.

[700] Case C-279/93 *Schumacker* [1995] ECR I-225.

[701] Commission, COM(2001) 260 final, section 3.2.3. Pistone gives a positive evaluation to this recommendation, noting that 'this instrument was used to achieve a constructive approach to voluntary compliance within the European Union also because it did not contain an *actual interpretation* of European law, but rather the vision of the European Commission on how integration could be achieved by addressing the problems of frontier workers'. See Pasquale Pistone, 'Soft Tax Law: Steering Legal Pluralism towards International Tax Coordination' in Dennis Weber (ed), *Traditional and Alternative Routes to European Tax Integration* (IBFD 2010) 97, 112.

[702] Commission Recommendation 94/390/EC of 25 May 1994 on taxation of small and medium-sized enterprises [1994] OJ L177/1; Commission Recommendation of 7 December 1994 on the transfer of small and medium-sized enterprises [1994] OJ L385/14. See also Commission, 'The Improvement of the Tax Environment of Small and Medium-Sized Enterprises' (Communication) [1994] OJ C187/5; Commission, 'On the Recommendation of 7 December 1994 on the Transfer of Small and Medium-Sized Enterprises' (Communication) [1994] OJ C400/1.

[703] ECOFIN Council Meeting Conclusions of 1 December 1997 concerning taxation policy (Annex 1: Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997 on a code of conduct for business taxation) [1998] OJ C2/1. For an analysis see, eg, William W Bratton and Joseph A McCahery, 'Tax Coordination and Tax Competition in the European Union: Evaluating the Code of Conduct on Business Taxation (2001) 38 Common Market Law Review 677.

[704] Commission, 'Instruments for a Modernised Single Market Policy' (Staff Working Document) SEC(2007) 1518 final accompanying 'A Single Market for 21st Century Europe' (Communication) COM(2007) 724 final.

2.2.2. 'Autonomous' Tax Coordination in Response to Negative Harmonisation (2001–2009)

The White Paper on European Governance and the Communication on Tax Policy Priorities (2001) added a much needed impetus.[706] As discussed in Part II, the Commission declared that a non-binding approach, the infringement procedure and enhanced cooperation, should all be recognised as alternative instruments that can widen the scope of available tools for promoting further tax integration within the EU.[707] Following this declaration, the Commission introduced interpretative and steering communications, and also enhanced the role of new governance techniques in transfer pricing.

The Commission published a communication on the taxation of pensions in 2001 and on the dividend taxation of individuals in 2003; these were the first examples of a new approach aimed at stimulating a coordinated response from Member States to the case law of the Court.[708] The integrated initiative of coordinating Member States' direct tax systems, launched in 2006, became the next step in this direction.[709] Under this initiative, the Commission published a complex plan of soft regulatory actions (rather than a one-off

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[705] Claudio M Radaelli and Ulrike S Kraemer, 'Governance Arenas in EU Direct Taxation' (2008) 46 Journal of Common Market Studies 315, 325-326.

[706] Commission, COM(2001) 428 final; Commission, COM(2001) 260 final.

[707] Commission, COM(2001) 260 final, sections 2.4 and 5.

[708] Commission, 'The Elimination of Tax Obstacles to the Cross-Border Provision of Occupational Pensions' (Communication) COM(2001) 214 final; Commission, 'Dividend Taxation of Individuals in the Internal Market' (Communication) COM(2003) 810 final.

[709] Commission, COM(2006) 823 final. Other examples of explicit references to the importance of tax coordination include, for instance, Commission, 'Towards an Internal Market without Tax Obstacles: A Strategy for Providing Companies with a Consolidated Corporate Tax Base for their EU-wide Activities' (Communication) COM(2001) 582 final, where the Commission committed to explain the impact of CJEU jurisprudence on company tax rules and double taxation treaties in order to 'facilitate compliance with the Treaty and make a significant contribution to the removal of tax obstacles to the Internal Market' (section 4); Commission, 'The Contribution of Taxation and Customs Policies to the Lisbon Strategy' (Communication) COM(2005) 532 final, which called for further coordination of Member States' actions against fiscal fraud (section 2.1.5).

measure) within set priority areas, covering the tax treatment of losses in cross-border situations, exit taxes, anti-avoidance provisions, and the taxation of cross-border dividends.[710]

This initiative was used as a catalyst for negative harmonisation, aiming to make it more balanced and effective. The core idea was to respond to increasing litigation in the field of direct taxation, to ensure a more consistent application of principles established by the Court and to stimulate coordinated policy responses. Another distinct feature of tax coordination at this stage was that the communications were adopted by the Commission with very little or no coordination with other actors, such as the Parliament, the Council, Member States and stakeholders. At this stage, therefore, 'autonomous' decision-making prevailed.

2.2.3. Strengthening Fiscal Policy Coordination: Towards More Participatory Approaches and Building the Internal Market beyond the Reach of the Court (after 2009)

In 2009 the eurozone countries faced a debt crisis that moved the issue of the coordination of Member States' fiscal policies to the top of the EU's agenda. The question that was widely discussed was whether the European Monetary Union required a fiscal union. Closer cooperation was considered inescapable, but its form was much disputed.[711] According to some commentators in its most radical form, the European fiscal union could have gone as far as introducing a binding mechanism of fiscal coordination, where national fiscal decisions including tax rates and public spending 'would no longer rely on the enforcement of codes of conduct or rules'.[712] Discussing this possibility, Scott rightly concluded that '[t]here are few

[710] Commission, COM(2006) 824 final; Commission, COM(2006) 825 final; Commission, COM(2007) 785 final; Commission Recommendation C(2009) 7924 final of 19 October 2009 on withholding tax relief procedures.

[711] See, eg, Andrew Scott, 'Does Economic Union Require a Fiscal Union' in Niamh Nic Shuibhne and Laurence W Gormley (eds), *From Single Market to Economic Union* (OUP 2012) 33, 50-53.

[712] ibid 51. See also Clemens Fuest and Andreas Peichl, 'European Fiscal Union: What Is It? Does It Work? And Are There Really "No Alternatives"?' (2012) 39 IZA Policy Paper.

matters that challenge the principle of national sovereignty more deeply than those relating to the levels at which domestic taxes should be levied, and on whom'.[713] Actual changes in the status quo have been limited: they have been made through either non-binding or other flexible forms of instruments that bind only those Member States that agree upon coordination measures.

As mentioned earlier, in 2010 Member States agreed upon the closer coordination of budgetary and economic policies, and introduced a new model of governance, 'the European Semester'. Each semester is opened by the Annual Growth Survey, which is published by the Commission at the beginning of the calendar year. This sets the challenges that must be addressed by the EU in line with the Europe 2020 strategy. In March each year the European Council agrees upon economic policy priorities on the basis of the AGS. Then, in April, Member States submit to the Commission their national reform programmes (economic policy) and stability and convergence programmes (budget policy), which explain the steps they will take in light of the agreed targets. Following the assessment of these programmes, the Commission publishes 27 country-specific recommendations to coordinate the progress. In July the Council adopts recommendations for each Member State based on the recommendations of the Commission and the conclusions of the European Council, also taking into account the opinion of the Employment Committee and the Economic and Financial Committee. Finally, in the autumn, a thematic peer review and national follow-up assessment take place.

In its conclusions of 23-24 June 2011 the European Council assessed the first European Semester and emphasised the need for a 'pragmatic coordination of tax policies', in particular 'to ensure the exchange of best practices, avoidance of harmful practices, and proposals to fight fraud and tax evasion'.[714] The Council invited the Commission and Member States participating in the Euro Plus Pact to present a progress report on pursuing 'structured

[713] ibid 52.

[714] European Council Conclusions of 23–24 June 2011, point 6.

discussions on tax policy issues'.[715] Then, in November 2011, the Commission published the AGS 2012, which, unlike the first survey published in 2011, devoted substantial attention to tax matters. It included an annex on Growth-Friendly Tax Policies in Member States and Better Tax Coordination in the European Union, which represents the Commission's follow-up to the European Council's request made in June 2011. It aims to 'further pave the way for tax cooperation to develop more efficient tax systems in order to emerge from the crisis in a better and faster way'.[716] The following three objectives were addressed through tax coordination measures: (i) the tackling of tax evasion, fraud and the exploitation of loopholes between Member States' tax regulations that results in double non-taxation; (ii) the creation of better business conditions by removing double taxation and other obstacles to the Internal Market; and (iii) the prevention of harmful tax competition from third countries. In 2012 the European Council confirmed that 'Member States participating in the Euro Plus Pact will continue their structured discussions on tax policy issues, notably to ensure the exchanges of best practices.'[717]

This coordination model carries two important developments for direct tax policymaking in the EU. First, it introduces the *ex ante* and integrated coordination of national tax policies.[718] In many instances the country-specific recommendations, which are adopted by the Council, include suggested directions for domestic tax policies. For instance, in 2011 Austria was advised to reduce its effective tax rate on income, in particular for earners with a low income; France was advised to introduce tax simplification measures; the United

[715] The Euro Plus Pact, concluded in March 2011, envisaged additional macro-economic, fiscal and structural reform commitments (signed by eurozone countries and Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania).

[716] Commission, 'Growth Friendly Tax Policies in Member States and Better Tax Coordination' (Annex IV to the Annual Growth Survey 2012) COM(2011) 815 final.

[717] European Council Conclusions of 28–29 June 2012.

[718] See also Article 11 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (2012), 'with a view to benchmarking best practices and working towards a more closely coordinated economic policy, the Contracting Parties ensure that all major economic policy reforms that they plan to undertake will be discussed ex-ante and, where appropriate, coordinated among themselves.'

Kingdom was advised to reform its taxation of property; and it was recommended to Italy and a number of other countries to address the problem of tax compliance.[719]

Second, the coordination model demonstrates the change from the 'autonomous' decision-making of the Commission to a closer cooperation with other actors, such as the Council and Member States.[720] This results in a blurring of the difference between the open method of coordination and 'traditional' soft law.[721] The direction of the Commission's actions are now coordinated within the framework of the European Semester, even though these links are still weak. The adoption of recommendations and communications, which was tested at previous stages of European integration as described earlier, remains at the core of this post-crisis coordination. Pursuing its first priority, the Commission launched a public consultation on double non-taxation,[722] and adopted a package against tax evasion and avoidance.[723] Under its second priority, the Commission adopted the Communication on Double Taxation in the Single Market (2011), and is currently investigating the possibility of introducing a binding dispute resolution scheme for removing double taxation.[724] Finally, the third priority involves the reinforcement of the Code of Conduct on Business Taxation.

[719] Based on Commission, 'Country-specific Recommendations 2012–2013' <http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm> accessed 28 December 2012.

[720] Some examples of 'coordinated' instruments had been adopted before, eg, Code of Conduct for Business Taxation.

[721] On this point see, eg, Susana Borrás and Kerstin Jacobsson, 'The Open Method of Co-ordination and New Governance Patterns in the EU' (2004) 11 Journal of European Public Policy 185, 188-189.

[722] DG TAXUD, 'Consultation on Factual Examples and Possible Ways to Tackle Double Non-Taxation Cases' (2012) <http://ec.europa.eu/taxation_customs/common/consultations/tax/2012_double_non_taxation_en.htm> accessed 28 December 2012.

[723] Commission, 'Concrete Ways to Reinforce the Fight against Tax Fraud and Tax Evasion including in Relation to Third Countries' (Communication) COM(2012) 351 final; Commission, 'An Action Plan to Strengthen the Fight against Tax Fraud and Tax Evasion' (Communication) COM(2012) 722 final; Commission Recommendation C(2012) 8805 final of 6 December 2012 regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters; Commission Recommendation C(2012) 8806 final of 6 December 2012 on aggressive tax planning.

[724] Commission, 'Roadmap: Initiative to Address Double Taxation within the EU, including an Arbitration Mechanism for Double Taxation Disputes' (Impact Assessment Report) <http://ec.europa.eu/governance/impact/planned_ia/docs/2013_taxud_001_arbitration_for_double_taxation_disputes_en.pdf> accessed 28 December 2012 (expected date of adoption: 2013).

This stage also has some other characteristics that substantially differentiate it from what was seen before 2009. The Commission now employs more sophisticated drafting techniques and procedures: most notably, public consultations have become essential at the preparatory stage. This is true not only for the acts mentioned earlier, but also for the package on inheritance taxes adopted in 2011 as a continuation of the 2006 tax coordination initiative.[725] Unlike other communications adopted in 2006–2007 as a follow-up to tax litigation, attention has mainly been focused on targets that lie beyond the reach of the Court, such as double taxation and double non-taxation.[726]

2.3. Interim Conclusion

Section 2 defined 'soft law' as an act that has not been adopted under a rule-making procedure that can generate a legally binding force, but is nevertheless intended to have a regulatory impact. Preparatory and informative instruments have been excluded from the definition of soft law, as they are not intended to produce a regulatory effect on their own. Since EU legislative and policy acts do not provide a comprehensive account of soft law instruments, a basic distinction was made between three categories, namely (i) institutional instruments, (ii) self-regulation and (iii) co-regulation.

The retrospective overview demonstrated that the central role in the field of direct taxation was played by institutional soft law instruments, in particular those adopted by the Commission. These measures were either *autonomous*, or in other words, elaborated and adopted by a single institution (e.g. Communication on the Tax Treatment of Losses in Cross-Border Situations), or *coordinated* between two and more institutions (e.g. the Code of

[725] Commission, 'Tackling Cross-Border Inheritance Tax Obstacles within the EU' (Communication) COM(2011) 864 final; Commission Recommendation 2011/856/EU of 15 December 2011 regarding relief for double taxation of inheritances [2011] OJ L336/81; Commission, 'Non-Discriminatory Inheritance Tax Systems: Principles Drawn from EU Case-Law' (Staff Working Paper) SEC(2011) 1488 final.

[726] Part II demonstrated that double taxation and non-taxation issues lie beyond the reach of the Court of Justice and can be considered as a clearer example of the limits of negative harmonisation.

Conduct for Business Taxation). This study will focus on the autonomous measures adopted by the Commission, as this has so far been the dominant type in the field of direct taxes. It will also demonstrate the importance of a newly emerging and strengthening trend towards *coordinated* soft regulation, and will analyse situations where the possibility of adopting coordinated instruments should be more fully exploited.

3. Key Procedural Problems

As discussed in Part II, the soft law approach could potentially become a reasonable solution in the following situations: (i) to supplement the case law of the Court, contributing to its more consistent application of EU law and bringing greater legal certainty for taxpayers and tax administration; (ii) to fulfil a preventive function by giving advance warning to Member States of potential infringements, thus also avoiding extensive spending on enforcement actions; (iii) to offer coordinated policy solutions where it is not possible to eliminate the restriction coherently (or in the most reasonable way) by unilateral measures; and (iv) to stimulate tax harmonisation within the Internal Market, leaving greater flexibility for Member States and respecting the principle of subsidiarity.

However, these potential advantages are counterbalanced by strong criticism. Part IV Section 3 will consider key constitutional and legal problems raised by EU law scholars. First, Section 3.1 discusses the application of the general principles of EU law in the context of institutional soft law, asking whether soft law measures allow the broadening of limits set by the principle of attributed competences, and whether it disregards other traditional constitutional and legal safeguards applicable to EU legislation. Next, Section 3.2 evaluates the impact of soft regulation on the institutional balance established by the EU Treaties, addressing the arguments that the soft law approach undermines the role of the Parliament, that it clashes with the exclusive competence of the Court, and that it allocates a

decisive role to bureaucrats. Then, Section 3.3 examines whether soft law lowers the standards of good governance that are normally required in the framework of the legislative procedure, such as effectiveness, participation, openness, accountability and coherence. Finally, in response to the argument that non-binding instruments 'can be very resource-intensive and also they are not directly enforceable in legal terms',[727] Section 3.4 analyses the (indirect) legal and practical effects of non-binding instruments.

3.1. The Constitutional and Legal Limits of EU Competence

Under Article 288 TFEU, to exercise the Union's competences, EU institutions shall adopt 'regulations, directives, decisions, recommendations and opinions'. The article stipulates that the latter two instruments have no binding force. Article 292 TFEU introduces two legal safeguards in relation to recommendations adopted by the Council. First, it ensures that the prerogatives of the Commission are respected, stating that the Council 'shall act on a proposal from the Commission in all cases where the Treaties provide that it shall adopt acts on a proposal from the Commission'. Second, it balances the interests of EU institutions and Member States by ruling that the Council 'shall act unanimously in those areas in which unanimity is required for the adoption of a Union act'. In relation to the recommendations of the Commission, the article is less specific, stating that 'the Commission, and the European Central Bank in the specific cases provided for in the Treaties, shall adopt recommendations'. Thus, the Commission exercises general competence, is not limited to 'the specific cases provided for in the Treaties' and has no restrictions in relation to tax matters. The Treaties contain no further references to procedural conditions and is interpreted as simply requiring a decision by the Commission, with no approval by the Council or the Parliament.

[727] Commission, COM(2001) 260 final, section 4.3.

In view of this limited acknowledgement of soft regulatory instruments by the EU Treaties, de Búrca and Scott conclude,

> it would certainly be difficult (…) even to detect the existence of the many European new governance initiatives from a reading of the EU constitutional texts (…). The formal constitutional framework of the EU (such as it is) unlike the policy documents of the Commission and Council, seems largely blind to the spreading practices of new governance.[728]

These academics describe this situation with 'the gap thesis', which emphasises the vacuum between two phenomena.[729] The legal framework (i) has not 'caught up with' the emergence of new regulatory instruments;[730] (ii) demonstrates a resistance to recognising 'developments which do not conform to its presuppositions, structures and requirements';[731] and even (iii) shows the lack of capacity 'to steer (...) and to secure accountability in new governance'.[732] Consequently, '[f]ar from providing a legitimate framework for the development of experimental governance forms, the EU's current framework appears to exclude the latter, which seem instead to operate free of its constraints and normative underpinnings.'[733]

This submission raises a number of questions: Does tax coordination lie beyond the scope of the constitutional and legal limits imposed by the EU Treaties on the ordinary legislative process? Should the Commission take into account the principles of subsidiarity and proportionality, as well as other general principles of EU law, when drafting soft law

[728] Gráinne de Búrca and Joanne Scott, 'Introduction: New Governance, Law and Constitutionalism' in Gráinne de Búrca and Joanne Scott (eds), *Law and New Governance in the EU and the US* (Hart Publishing 2006) 1, 11.

[729] Ibid. For a discussion on the relationship between hard and soft law, see Joanne Scott and David M Trubek, 'Mind the Gap: Law and New Approaches to Governance in the European Union' (2002) 8 European Law Journal 1; Gráinne de Búrca and Joanne Scott (eds), *Law and New Governance in the EU and the US* (Hart Publishing 2006); special issue of Wisconsin Law Review, in particular Gráinne de Búrca, 'New Governance and Experimentalism: An Introduction' (2010) Wisconsin Law Review 227; Michael Wilkinson, 'Three Conceptions of Law: Towards a Jurisprudence of Democratic Experimentalism' (2010) Wisconsin Law Review 673; Mark Dawson, 'Three Waves of New Governance in the European Union' (2011) 36 European Law Review 208.

[730] Gráinne de Búrca and Joanne Scott, 'Introduction: New Governance, Law and Constitutionalism' in Gráinne de Búrca and Joanne Scott (eds), *Law and New Governance in the EU and the US* (Hart Publishing 2006) 1, 4.

[731] ibid.

[732] ibid 5.

[733] ibid 11.

acts? If traditional legal safeguards can be disregarded, is the weakness of 'soft' coordination a sufficient excuse for it? Can one argue that this facilitates further 'competence creep', as the Commission promotes the convergence of national direct tax policies without recourse to the legislative procedure that requires unanimous voting? Armstrong, Begg and Zeitlin (2008) broadly agrees with de Búrca and Scott that the new governance occupies 'unsettled constitutional space',[734] but as he has rightly concluded, 'notwithstanding the intellectual difficulties in seeking to reconcile constitutionalism and new forms of governance, the task is unavoidable.'[735]

3.1.1. The Principle of Conferral

Under the principle of conferral, EU institutions have only the power that has been attributed to them by Member States through the EU Treaties (Article 5 TEU). The 'competence requirement' also implies that the EU's legislative actions are limited to specific areas: when the Commission exercises its right of legislative initiative, it shall refer to a substantive legal basis provided for by the Treaties. The extent to which the acts of EU institutions with no legally binding power have to comply with the principle of attributed powers 'has not yet been completely clarified'.[736]

Article 292 TFEU provides the Commission with broad discretion. Its predecessors were more specific, stipulating that recommendations and opinions can be adopted 'on matters dealt with in this Treaty, if it expressly so provides *or* if the Commission considers it necessary'.[737] This can be interpreted as giving the Commission 'the power to issue

[734] Kenneth Armstrong and others, 'JCMS Symposium: EU Governance after Lisbon' (2008) 46 Journal of Common Market Studies 413, 416.

[735] ibid 425.

[736] Armin von Bogdandy and Jürgen Bast, 'The European Union's Vertical Order of Competences: The Current Law and Proposals for its Reform' (2002) 39 Common Market Law Review 227, 232.

[737] See Article 155 of the EC Treaty (pre-Amsterdam Treaty numbering), Article 211 of the EC Treaty (post-Amsterdam Treaty numbering) (emphasis added).

recommendations on virtually any subject it pleases'.[738] The Commission would not necessarily mention a specific legal basis for its soft regulatory measures, as it would for proposals for legislative actions. In Case C-325/91 *France v Commission,* the Court explains that the legal basis needs to be 'expressly' indicated in any instrument that intends to have legal effects on its own and creates a new obligation.[739] The Court defines recommendations as measures adopted by EU institutions 'when they do not have powers under the Treaty to adopt binding measures or when they consider that it is not appropriate to adopt more mandatory rules'.[740] When adopting 'recommendations' in the field of direct taxation, the Commission refers to a procedural legal basis of a general nature provided by Article 292 TFEU. Other types of soft law used by the Commission, such as interpretative and steering communications, traditionally include an introduction that puts the acts in a broader policy context, stating its aim and goals: this can hardly substitute a reference to substantive competence grounds, as is required for the Commission's legislative proposals.

Since there is no direct link between legislative competence and soft law, 'European institutions have frequently regulated in a soft manner areas in which the EU lacked legal authority vis-à-vis the member states, or where the division of competences between the EU or former EC and the member states was unclear.'[741] Non-binding instruments have been used to fill the loopholes in EU legislative competence, fulfilling a so-called 'path-breaking function' by laying the foundation for its future broadening.[742] This has happened to cultural, public health and environmental issues, which have all been added to the EU Treaties as

[738] Anthony Arnull, 'The Legal Status of Recommendations' (1990) 15 European Law Review 318, 320.

[739] Case C-325/91 *France v Commission* [1993] ECR I-3283, para 26. To that effect see also Case C-57/95 *France v Commission* [1997] ECR I-1627, paras 23-26.

[740] Case C-322/88 *Grimaldi* [1989] ECR 4407, para 13.

[741] Anne Peters, 'Soft Law as a New Mode of Governance' in Udo Diedrichs and others (eds), *The Dynamics of Change in EU Governance* (Edward Elgar Publishing 2011) 21, 32.

[742] Armin von Bogdandy and others, 'Legal Instruments in European Union Law and their Reform: A Systematic Approach on an Empirical Basis' (2004) 23:1 Yearbook of European Law 91, 113.

integration has progressed.[743] Considering the 'para-law' function of 'steering' measures, Peters raised the question: Should the competence to adopt soft law 'be linked to the power to enact hard law or is it independent? (...) Under what conditions is member state sovereignty potentially infringed by reliance of soft law?'[744] The establishment of substantive limits for soft law by linking hard and soft law competences would be difficult, especially in relation to those policy areas where 'flexible' articles such as Article 115 TFEU are used. It would be virtually impossible to find a soft tax measure that does not follow under the wide interpretation of the legal ground provided for direct taxation under Article 115 TFEU, which allows the approximation of laws, regulations or administrative provisions of the Member States that directly affect 'the establishment or functioning of the internal market'.[745]

The power to adopt non-binding acts is, however, limited by the scope of the competence of the EU institution in question. Where a communication is considered as 'intended to have legal effects of its own' (which would be most relevant for steering acts), the Court may access the validity of soft law and satisfy the claim for annulment under Article 263 TFEU.[746] For instance, in Case C-57/95 *France v Commission*, the Court's decision states that 'the Communication constitutes an act adopted by an authority lacking the necessary competence'.[747] In a more recent case law, the Court further explained that the adoption of soft law measures should be assessed against the competence requirement, especially if it has an impact on the division of powers and the institutional balance established by the Treaties. In Case C-233/02 *France v Commission*, the Court states:

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[743] Anne Peters, 'Soft Law as a New Mode of Governance' in Udo Diedrichs and others (eds), *The Dynamics of Change in EU Governance* (Edward Elgar Publishing 2011) 21, 32.

[744] ibid 40.

[745] For instance, in 2012 the European Commission opened a public consultation on double non-taxation, considering a range of hard and soft follow-up measures. According to the Commission, double non-taxation 'has potential harmful effects in terms of fairness of the tax systems and potential distortion of the Internal Market'. The EU measures that address these 'distortions' thus contribute to 'the establishment and functioning of the internal market'. See Commission, 'The Internal Market: Factual Examples of Double Non-Taxation Cases (Consultation Document)' (Staff Working Paper) TAXUD D1 D(2012), section 3.

[746] Article 173 of the EC Treaty (pre-Amsterdam Treaty numbering) and Article 230 of the EC Treaty (post-Amsterdam Treaty numbering). See Case C-57/95 *France v Commission* [1997] ECR I-1627, paras 23-26.

[747] ibid, para 25.

> [T]his judgment cannot be construed as upholding the Commission's argument that the fact that a measure such as the Guidelines is not binding is sufficient to confer on that institution the competence to adopt it. Determining the conditions under which such a measure may be adopted requires that the division of powers and the institutional balance established by the Treaty in the field of the common commercial policy be duly taken into account, since in this case the measure seeks to reduce the risk of conflict related to the existence of technical barriers to trade in goods.[748]

Even though this move can only be welcomed, its practical significance is minor. The doctrine of implied powers provides a competence that derives from the tasks envisaged by the EU Treaties and may justify the adoption of soft measures in those cases where an explicit reference cannot be found in the Treaties. The range of EU objectives indicated in Articles 2 and 3 TEU provides for broad interpretation: the EU is based on the principles of non-discrimination and solidarity (Article 2), and it 'shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress (...). It shall promote economic, social and territorial cohesion, and solidarity among Member States' (Article 3(3)).

Besides, the Commission, as guardian of the EU Treaties, may exercise its broad discretion by publishing 'interpretative acts', which aim at ensuring the proper application of EU law. The Court has also admitted the competence of the Commission to adopt guidelines in areas where it can take individual decisions. This is considered to be the exercise of the implementing power, which benefits potential parties by ensuring equality of treatment and by bringing more legal certainty into the application of law in specific circumstances.[749]

To sum up, the principle of conferred powers can, in some circumstances, be used to challenge non-binding acts adopted by an EU institution (in particular, if it infringes the division of powers and the institutional balance established by the Treaties). As rightly put forward by von Bogdandy and Bast, '[t]he need for legitimacy for any act by a public

[748] Case C-233/02 *France v Commission* [2004] ECR I-2759, para 40; see also Case T-240/04 *France v Commission* [2007] ECR II-04035, para 31.

[749] Linda Senden, 'Soft Law and Its Implications for Institutional Balance in the EC' [2005] 1 Utrecht Law Review 79, 89-91.

authority suggests that a competence requirement is also necessary for such acts.'[750] However, there is no explicit procedural requirement to justify the adoption of soft acts with reference to an appropriate legal basis analogous to the legislative process, unless the act intends to have a legal effect on its own. Although the requirement to provide a specific legal basis and/or further justification of actions in the light of the competence attributed to an EU institution would be desirable, it would be unlikely to have considerable practical importance in the field of direct taxation due to the ambiguity of the legal basis and the broad interpretation of institutional competences.

3.1.2. The Principle of Subsidiarity

Article 5 TEU defines the basic principles that govern the division of competence between the EU and Member States. Under the principle of subsidiarity, in areas other than those defined as the 'exclusive competence', the EU 'shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States (…), but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level'. The principle of subsidiarity could have particular relevance in the context of the Commission's soft law, where no decisive voting with the Member States' participation takes place. Unlike with legislative acts, which represent the cooperative efforts of EU institutions, sanctioned by Member States through either unanimous or qualified majority voting in the Council,[751] there is no guarantee that EU Member States believe that the soft law act does not infringe the principle of subsidiarity. Hence, there is no reason for the basic subsidiarity question ('should the EU act?') not to be asked in each case.

[750] Armin von Bogdandy and Jürgen Bast, 'The European Union's Vertical Order of Competences: The Current Law and Proposals for its Reform' (2002) 39 Common Market Law Review 227, 233.

[751] See Paul Craig, 'Subsidiarity, a Political and Legal Analysis' (2012) 50:s1 Journal of Common Market Studies 72, 81.

According to the Protocol (No 2) on subsidiarity, compliance with this principle is guaranteed through a number of legal safeguards, the most important of which are the following: (i) justification: each draft legislative act should include a detailed statement that justifies compliance with the principle of subsidiarity (Article 5); (ii) political control: any national parliament (chamber) can raise objections if it alleges that the principle of subsidiarity is infringed – the so-called 'orange' and 'yellow' card procedures (Article 6); and (iii) judicial control: the Court has jurisdiction to assess the compliance of binding instruments with the principle of subsidiarity under Articles 263 and 267 TFEU (Article 8).[752] To date, the application of these safeguards in the context of legislative acts has been strongly criticised by scholars for their inefficiency.[753] The statement that justifies subsidiarity compliance is often drafted in a very general form, being far from the detailed assessment required by Protocol No 2.[754] The thresholds for the 'yellow' and 'orange' cards, which could enforce changes in the Commission's legislative proposals, with rare exceptions, have been far from reached.[755] Finally, as Craig points out, in the period of nearly 20 years after this principle was introduced into the Treaty, in only around 10 cases has the measure been expressly challenged on the ground of subsidiarity (this can be compared with proportionality concerns, which are raised in over 10 cases each month).[756]

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[752] Protocol (No 2) on the application of the principles of subsidiarity and proportionality of 13 December 2007 [2012] OJ C326/206 (Lisbon Treaty).

[753] See, eg, Nicholas W Barber, 'The Limited Modesty of Subsidiarity' (2005) 11 European Law Journal 308; Gareth Davies, 'Subsidiarity: The Wrong Idea, in the Wrong Place, at the Wrong Time' (2006) 43 Common Market Law Review 63; Paul Craig, 'Subsidiarity, a Political and Legal Analysis' (2012) 50:s1 Journal of Common Market Studies 72.

[754] Stephen Weatherill, 'Competence Creep and Competence Control' (2004) 23 Yearbook of European Law 1, 11.

[755] For more see Anzhela Yevgenyeva, 'EU Legislative Process and the National Parliaments: Symbolic Importance and Practical Implications of the Treaty of Lisbon' in Peter M Huber and Katja Ziegler (eds), *The EU and National Constitutional Law* (Richard Boorberg Verlag 2012). So far, the threshold of a 'yellow card' has been reached only once, in relation to Commission, 'Proposal for a Council Regulation on the exercise of the right to take collective action within the context of the freedom of establishment and the freedom to provide services' COM(2012) 130 final [2012] OJ C171/ 4, withdrawn on 11 September 2012).

[756] Paul Craig, 'Subsidiarity, a Political and Legal Analysis' (2012) 50:s1 Journal of Common Market Studies 72, 80-81.

Having said this, one should remember that these legal safeguards may play an important preventive role, facilitating compliance by the mere fact of their articulation in the EU Treaties. Since the Court's role in ensuring subsidiarity compliance has so far not been fully utilised, attention should be focused on the justification requirement and the political monitoring mechanism.

The first guarantee is provided by the requirement to justify compliance with the principle of subsidiarity. In relation to the Commission's soft acts, although an introductory section often explains the need for EU intervention, an explicit reference to the principle of subsidiarity is not required. Subsidiarity checks, however, are conducted as part of the preparatory impact assessment exercise.[757] In some cases, the Commission concludes that a proposed legislative measure can be introduced in a non-binding form, as a deeper intervention is unjustified. In other examples, even a measure that has initially been designed as non-binding can undergo an impact assessment. However, this is not a prerequisite: the tax coordination communications published in 2006–2007, for instance, have not undergone the impact assessment exercise.

The second guarantee is set by the subsidiarity checks conducted by EU national parliaments (chambers). The Protocol (No 1) on the role of National Parliaments in the EU requires the Commission to send all consultation documents to national parliaments,[758] but it does not mention other types of soft acts that may not be regarded as preparatory. In practice, however, the Commission makes no distinction, and all new documents are sent to national parliaments.

Since under the pre-Lisbon 'Barroso initiative' (2006) national parliaments were invited to submit their opinions on any type of act, they continue to exercise this right, expressing

[757] Commission, 'Impact Assessment Guidelines' (Guidelines) SEC(2009) 92 final, section 3.3.2 (the evaluation matrix applicable to the non-legislative initiatives/communications/recommendations/strategy papers).

[758] Article 1 of the Protocol refers to green papers, white papers and communications. See Protocol (No 1) on the role of National Parliaments in the European Union of 13 December 2007 [2012] OJ C326/203 (Lisbon Treaty).

political disagreement whenever they deem necessary.[759] The Commission considers all feedback sent in 'the framework of the political dialogue'.[760] For instance, the European Scrutiny Committee of the House of Commons of the UK Parliament scrutinised the Commission Recommendation regarding relief for double taxation of inheritances.[761] In practice, therefore, the treatment of legislative and non-binding initiatives is similar. Obviously, the mechanism of reasoned opinions, which is stipulated under the Protocol (No 2) on subsidiarity, by the nature of its consequences, is strictly limited to legislative acts.[762] It should also not be forgotten that national parliaments monitor legislative proposals at the preparatory stage of the lawmaking process; since institutional soft law is sent to them in its final form, it eliminates the participatory element.

This discussion shows that the non-binding nature of soft law instruments should not mean that they satisfy the criteria laid down in Article 5 TEU a priori. The call made by the Parliament to ensure 'due regard' to the principle of subsidiarity should be supported,[763] involving the adjustment of legal, political and judicial safeguards to ensure their proper application in relation to non-binding instruments. These steps, however, should not raise unrealistic expectations: all in all, the concept of subsidiarity is somewhat 'a legal mystery', which provides a convenient setting for political dialogue.[764] The readiness of Member States to get involved in a dialogue on the limits of EU competence in relation to non-binding

[759] Commission, 'A Citizens' Agenda – Delivering Results for Europe' (Communication) COM(2006) 211 final.

[760] See, eg, Paul Craig, 'Subsidiarity, a Political and Legal Analysis' (2012) 50:s1 Journal of Common Market Studies 72, 79.

[761] For examples of the parliamentary screening of non-legislative proposals, see, inter alia, UK Parliament – House of Commons, '54th Report of the Select Committee on European Scrutiny: HMT (33583) (33591) Taxation' (2012) concerning Commission, 'Tackling Cross-Border Inheritance Tax Obstacles within the EU' (Communication) COM(11) 864 final and Commission Recommendation C(11) 8819 of 15 December 2011 regarding relief for double taxation of inheritances.

[762] Protocol (No 2) on the application of the principles of subsidiarity and proportionality of 13 December 2007 [2012] OJ C326/206 (Lisbon Treaty).

[763] European Parliament Resolution 2007/2028(INI) of 4 September 2007 on institutional and legal implications of the use of 'soft law' instruments, point L and para 5.

[764] See, eg, Gareth Davies, 'Subsidiarity: The Wrong Idea, in the Wrong Place, at the Wrong Time' (2006) 43 Common Market Law Review 63; Paul Craig, 'Subsidiarity, a Political and Legal Analysis' (2012) 50:s1 Journal of Common Market Studies 72.

measures – even if it may potentially cause further 'executive-driven creeping competence' – should not be overestimated.[765] As Peters rightly noticed, quite often 'the production of soft law by organs and institutions, even if it is outside the competence of the organization, appears to be tolerated by member states and is normally not criticized (as would happen in the event of hard law-making) as being *ultra vires*'.[766]

3.1.3. The Principle of Proportionality

According to the principle of proportionality, 'the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties'. If the subsidiarity question ('should the EU act?') has been answered affirmatively, the choice of a non-binding instrument becomes an explicit expression of the principle of proportionality. The non-binding *form* is proportionate per se: in defining the proportionate level of regulatory actions, the 2009 Commission Impact Assessment Guidelines start with non-legislative initiatives, communications, recommendations and strategy papers that identify 'commitments for future legislative action' as the weakest type of regulatory response.[767]

However, in some cases, the principle of proportionality can be applied to the *content* of the measure.[768] In *Dow Chemical Company v Commission* (2012), the Court examined the compliance of point 24 of the Commission's guidelines with the principle of proportionality.[769] The Court analysed whether the multiplier with respect to the duration of the infringement should be strictly proportionate to the exact duration of the infringement

[765] Stephen Weatherill, 'Competence Creep and Competence Control' (2004) 23 Yearbook of European Law 1, 55.

[766] Anne Peters, 'Soft Law as a New Mode of Governance' in Udo Diedrichs and others (eds), *The Dynamics of Change in EU Governance* (Edward Elgar Publishing 2011) 21, 34.

[767] Commission, 'Impact Assessment Guidelines' (Guidelines) SEC(2009) 92 final, sections 3.3 and 7.

[768] ibid, section 7.2.

[769] Case T-77/08 *The Dow Chemical Company v Commission* [2012] ECR II-0000, concerns the Guidelines on the Method of Setting Fines Imposed Pursuant to Article 23(2)(a) of Regulation (EC) No 1/2003 OJ [2006] C210/2 (see paras 142-145).

committed by the undertaking. It concluded that 'in the light of the generally long duration of infringements, in particular of the most serious infringements, to which Article 81 EC is applied, the setting of progressive thresholds of six months is coherent, objectively justified and not disproportionate.'[770]

Two reservations, however, must be made clear in relation to this judgment. First, the Court applies the principle of proportionality to the administrative practice of the Commission in light of the discretion attributed to it by the Treaties, rather than to a soft law instrument as such: 'the Commission's *choice* to treat periods of less than 6 months as half a year, and therefore to treat a period of 1 month and 13 days as if it was half a year, and to treat periods of 6 months, but of less than 1 year, as a full year *does not exceed the limits of the discretion* which it has in that regard and does not infringe the principles of proportionality and of equal treatment.'[771] Second, the case leaves uncertainty, as the Court did not consider whether the claim was admissible at first place. In paragraph 145 the Court rules that 'the argument put forward by the applicant at the hearing by which it sought a declaration that point 24 of the 2006 Guidelines is contrary to the principles of proportionality and of equal treatment must be rejected as unfounded, and it is not necessary to rule on its admissibility'.[772]

The principle of proportionality, therefore, plays a much less important role. The choice of a non-binding *form* could hardly be found to be disproportionate. In cases, however, where the Court can establish (indirect) legal effects in the form of self-imposing obligations, the proportionality of *content* would be assessed just as for any other exercise of discretion provided to EU institutions under the Treaties.

[770] ibid, para 143.

[771] ibid, para 144 (emphasises added).

[772] ibid, para 145.

3.1.4. Other General Principles of EU Law

The general principles of EU law are used as a mediator to establish the (indirect) legal effects of soft law. In *Dansk Rørindustri and Others v Commission* (2005), the Court relies upon the principle of equal treatment and the protection of legitimate expectations to conclude that soft law commitments constrain the discretion of the Commission:

> In adopting such rules of conduct and announcing by publishing them that they will henceforth apply to the cases to which they relate, the institution in question imposes a limit on the exercise of its discretion and cannot depart from those rules under pain of being found, where appropriate, to be in breach of the general principles of law, such as equal treatment or the protection of legitimate expectations. It cannot therefore be precluded that, on certain conditions and depending on their content, such rules of conduct, which are of general application, may produce legal effects.[773]

Once the legal effect has been admitted, the rules of conduct adopted by the Commission should comply with the general principles of EU law, such as, for example, the principle of non-retroactivity:

> [A] change in an enforcement policy, in this instance the Commission's general competition policy in the matter of fines, especially where it comes about as a result of the adoption of rules of conduct such as the Guidelines, may have an impact from the aspect of the principle of non-retroactivity. Having particular regard to their legal effects and to their general application (…) such rules of conduct come, in principle, within the principle of 'law' for the purposes of Article 7(1) of the ECHR.[774]

If the legal effects cannot be found, the Court is most likely to be reluctant to consider the validity of non-binding measures under Article 263 TFEU. However, the argument that soft law should be consistent with superior legal norms, including the general principles of EU law, can still be raised under Article 267 TFEU. For instance, in *Wagner*, the French Administrative Tribunal asked for a ruling on the validity of Note 2 to Annex I of the Commission's notice of 11 March 1981 on import and export licences and advance-fixing

[773] Joined Cases C-189/02 P, C-202/02 P, C-205/02 P to C-208/02 P and C-213/02 P *Dansk Rørindustri and Others v Commission* [2005] ECR I-5425, para 211.

[774] ibid, paras 222-223.

certificates for agricultural products.[775] In view of the explanatory nature of the note, the Court considered that there was no need to examine its validity but that it was necessary to ascertain whether it complied with the provisions of EU law applicable at the material time.[776]

An analysis of case law shows that there is little room to argue that non-binding acts lie entirely beyond the constitutional and legal limits imposed by the EU Treaties.[777] Despite the lack of relevant procedural provisions, the Court has demonstrated its readiness to apply the general traditional constitutional and legal safeguards in situations where (indirect) legal effects of soft law can be established. The most 'comfortable' way for the Court to treat soft law is to find (indirect) legal effects attributable to it; this allows the disregard of a specific nature of soft law and the application of traditional legal reasoning. If such (indirect) legal effects cannot be found, the Court enters shaky ground: it prefers to restrain its jurisdiction with respect to assessing such instruments under Article 263 TFEU, leaving them subject to *political* control instead. Under Article 267 TFEU, the Court provides an interpretation for any type of institutional soft law, including conducting an assessment against the hard provisions of EU law. The limited scope of protection provided by the judicial means discussed in this section, however, has neither been reflected in positive obligations, such as to justify the compliance of a non-binding instrument with Article 5 TEU, nor been fully compensated by elements of political control over the principles established by this article that are applicable in the context of legislative procedure.

3.2. Institutional Balance

[775] Case C-94/91 *Wagner* [1992] ECR I-2765.

[776] ibid, para 17.

[777] Gráinne de Búrca and Joanne Scott, 'Introduction: New Governance, Law and Constitutionalism' in Gráinne de Búrca and Joanne Scott (eds), *Law and New Governance in the EU and the US* (Hart Publishing 2006) 1, 6-9 (see 'the hybridity thesis').

The EU is based on the principle of the separation of power: although a clear division between the legislative, executive and judicial competence inherent to national legal systems is lacking, the essence of this principle – ensuring that power is not concentrated in a single public body – remains the same. Soft law is often condemned for distorting the institutional balance enshrined by the EU Treaties.[778] The next section will address this criticism in two steps. First, it looks at the cooperation between EU legislators: the Commission on the one hand, and the Parliament and the Council on the other. Then, it asks whether the exercise of soft regulatory powers by the Commission clashes with the competence of the Court.

3.2.1. Cooperation between EU Legislators

As mentioned earlier in Part IV, the Interinstitutional Agreement on Better Lawmaking between the European Commission, the Parliament and the Council (2003, hereafter 'the Agreement') regulates the adoption of two forms of soft law: 'co-regulation' and 'self-regulation'.[779] The Agreement demonstrates a compromise reached by all three institutions and thus could potentially be used for designing a procedural framework for institutional soft law.

Under the Agreement, co-regulation and self-regulation cannot be employed instead of hard law 'where fundamental rights or important political options are at stake or in situations where the rules must be applied in a uniform fashion in all Member States'.[780] It should meet the criteria of transparency and representativeness, and respect EU law.

[778] Linda Senden, 'Soft Law and Its Implications for Institutional Balance in the EC' [2005] 1 Utrecht Law Review 79.

[779] European Parliament, Council and Commission, 'Interinstitutional Agreement on Better Law-Making' [2003] OJ C321/01, paras 16-23.

[780] ibid, para 17.

In relation to the co-regulation mechanism, the Agreement introduces four key safeguards.[781] First, it explains that voluntary agreements must respect the conditions provided in the basic legislative act and comply with EU law, in particular Articles 154 and 155 TFEU (ex Articles 138 and 139 of the EC Treaty);[782] the screening of this compliance is conducted by the Commission. Second, each draft is sent to the Parliament and the Council; this should be accompanied by an explanatory memorandum in which the Commission justifies the selection of this tool.[783] Third, the Parliament and the Council can request a special provision, which provides for 'a two-month period of grace following notification of a draft agreement', to be included in the basic legislative text.[784] This period of time can be used at the discretion of these two institutions so that they can 'either suggest amendments, if it is considered that the draft agreement does not meet the objectives laid down by the legislative authority, or object to the entry into force of that agreement and, possibly, ask the Commission to submit a proposal for a legislative act'.[785] Finally, the legislative authority will design follow-up measures, such as regular reports from the Commission, or a revision clause.[786]

Self-regulation is less extensively regulated.[787] The Commission will examine whether self-regulation practices contribute to the attainment of the EU Treaties objectives, comply with EU law, meet the criteria of representativeness, and bring 'added value'; and, if these conditions are met, the Commission will notify the Parliament and the Council.[788] The Commission will also 'consider the possibility of putting forward a proposal for a legislative

[781] ibid, paras 18-21.

[782] ibid, para 19.

[783] ibid.

[784] ibid, para 20.

[785] ibid.

[786] ibid, para 21.

[787] ibid, paras 22-23.

[788] ibid, para 23.

act, in particular at the request of the competent legislative authority or in the event of a failure to observe the above practices'.[789]

The Agreement remains silent regarding institutional soft law. This gap created a conflict between the Commission and the Parliament. In 2007 the Parliament adopted a resolution where it declared that soft law 'too often constitutes an ambiguous and ineffective instrument which is liable to have a detrimental effect on Community legislation and institutional balance and should be used with caution, even where it is provided for in the Treaty'.[790] The Parliament criticised particularly strongly the use of 'institutional soft law' adopted by the Commission, as this allows the circumvention of due regard to the principles of subsidiarity and proportionality; undermines the principle of legal certainty, the rule of law, justiciability and enforceability; and disregards the institutional balance and transparency standards envisaged by the EU Treaties.[791] The Parliament argued that the application of soft law instruments is inherent to international public law situations and has historically been justified by the lack of legislative competence.[792] Since EU institutions have been attributed legislative powers, soft law instruments must be precluded with three exceptions: (i) where the Treaties expressly provide for soft law instruments; (ii) if soft law is used as an interpretative or preparatory tool for binding legislative acts without any 'norm-setting effectiveness'; and (iii) when the Commission publishes notices and guidelines explaining the application of competition and state-aid policy rules.[793]

The Commission disagreed with this evaluation of soft law. It replied that the critical attitude that was expressed by the Parliament was unjustified, because non-binding

[789] ibid.

[790] European Parliament Resolution 2007/2028(INI) of 4 September 2007 on institutional and legal implications of the use of 'soft law' instruments, para 1.

[791] ibid, point J.

[792] ibid, point H.

[793] ibid, points L and M.

instruments have become a common and well-established practice in many policy areas.[794] This regulatory approach allows 'for more flexibility and a better adaptation to the circumstances of those that it governs and it also fits in well with the shared objective of the Commission, the Council and the Parliament to reduce as much as possible the regulatory and administrative burdens'.[795] Furthermore, considering certain legal and practical limitations of this instrument, the Commission 'takes a restrictive approach already', especially in the Internal Market area.[796]

The Parliament's proposal to conclude an interinstitutional agreement that would introduce a procedure of compulsory consultations with MEPs before the 'soft-law instruments, such as Commission recommendations (…), interpretative communications and other documents of a similar nature' could be adopted, was not accepted.[797] The Commission explained that the competence to adopt soft law instruments, such as recommendation, has been attributed by the Treaties and thus it 'cannot be restricted legally or politically by introducing a formal mandatory consultation of the Parliament'.[798] Rejecting the 'horizontal solution', as the problems concern 'a very small number of isolated issues', the Commission agreed, however, that the Parliament would be involved 'whenever relevant'.[799] The Commission's Communication on Tax Policy Priorities used even stronger language, stating that the Parliament should be involved 'to the largest extent possible'.[800]

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[794] 'Operators and citizens have generally recognised and appreciated the benefits in terms of speed and flexibility that such instruments may have' (Commission Response SP(2007) 5402 of 24 October 2007 to European Parliament Resolution 2007/2028(INI) of 4 September 2007 on Institutional and Legal Implications of the Use of 'Soft Law' Instruments').

[795] ibid.

[796] ibid.

[797] ibid.

[798] ibid.

[799] ibid.

[800] This concerns recommendations, guidelines and interpretative notices. See Commission, 'Towards an Internal Market without Tax Obstacles: A Strategy for Providing Companies with a Consolidated Corporate Tax Base for their EU-wide Activities' (Communication) COM(2001)582 final, section 4.

Following the adoption of the Treaty of Lisbon, the Parliament changed its strong antagonistic attitude towards soft law, and now takes a more constructive approach to ensure that the basic principles of good governance, such as transparency and accountability, are duly observed. In November 2009 the Conference of Presidents appointed a working party to prepare a new version of the Framework Agreement between the Parliament and the Commission, which aimed at establishing a 'special partnership' between these two institutions, reflecting developments in the Parliament's role introduced by the Treaty of Lisbon. The key priorities included the improvement of the level of political accountability and the legitimacy of the Commission, building better communication and reinforcing cooperation.

The new Framework Agreement was concluded in November 2010.[801] This revision brought important developments: for the first time, the Agreement referred to 'soft law'.[802] The amendments that were made in the draft between February and November 2010, which are highlighted below in italics, make evident the Parliament's attempt to impose stricter limits on the Commission's competence to adopt non-legislative instruments.[803] The Commission and the Parliament have agreed upon the following:

1) Participation: 'in areas where Parliament is usually involved in the legislative process, the Commission shall use soft law, where appropriate and on a duly justified basis after having given Parliament the opportunity to express its views. *The*

[801] European Parliament and European Commission, 'Framework Agreement on Relations between the European Parliament and the European Commission' (Interinstitutional Agreement) [2010] OJ L304/47.

[802] Cf European Parliament Decision of 26 May 2005 on the revision of the framework agreement on relations between the European Parliament and the Commission' (Interinstitutional agreement) [2005] OJ C117E/123. The European Parliament proposed to define the term broadly as covering 'recommendations, interpretative communications, voluntary agreements and optional instruments', but this definition does not appear in the final text. See European Parliament Decision 2010/2118(ACI) of 20 October 2010 on the revision of the framework agreement on relations between the European Parliament and the European Commission [2012] OJ C70E/98.

[803] Cf European Parliament Resolution of 9 February 2010 on a revised Framework Agreement between the European Parliament and the Commission for the next legislative term [2010] OJ C341E/1 and European Parliament and European Commission, 'Framework Agreement on Relations between the European Parliament and the European Commission' (Interinstitutional Agreement) [2010] OJ L304/47.

Commission shall provide a detailed explanation to Parliament on how its views have been taken into account when it adopts its proposal [addition]' (para 43).

2) Transparency: 'the Commission Work Programme shall be accompanied by a list of legislative and non-legislative proposals for the following years. (…) The Commission Work Programme shall also include planned initiatives on *[deletion of 'major']* soft law, withdrawals and simplification' (Annex IV).

3) Openness: 'the Commission will provide full information and documentation on its meetings with national experts within the framework of its work on the preparation and implementation of Union legislation, including soft law and delegated acts. *If so requested by Parliament [addition]*, the Commission may also invite Parliament's experts to attend those meetings' (para 15).[804]

In addition to these changes, in January 2012, the Parliament for the first time presented an Annual Tax Report, which scrutinises the Commission's initiatives undertaken in 2011 and examines the key areas where tax coordination may be desirable. In the report, the Parliament pursues an ambitious goal to set the priorities for the Commission Work Programme 2012 and asks for the Commission to report on the fiscal implications of the European Semester. These developments have created more possibilities for political control over the institutional soft law adopted by the Commission and have allocated limited participatory rights to the Parliament.

The dual functionality of the Commission's soft law explains the conflicting vision for a procedural framework, as disputed between the Commission and the Parliament: the Commission treats soft law as an expression of its executive competence, whereas the

[804] European Parliament and European Commission, 'Framework Agreement on Relations between the European Parliament and the European Commission' (Interinstitutional Agreement) [2010] OJ L304/47.

Parliament believes that non-binding instruments (at least in some circumstances) include lawmaking elements, which undermine its prerogatives as an EU legislator. The Commission's position is justifiable in relation to interpretative and decisional acts, which reflect the exercise of its executive competence; and the Parliament's demands are plausible when it comes to steering acts, which may intervene in its lawmaking competence. The basic principles of democratic decision-making dictate that soft law measures of an executive nature should be *controlled* by the Parliament, while the presence of norm-setting elements entitle it to claim *participatory rights*.

In order to ensure that the Commission's soft law does not undermine the role of its co-legislator, the Commission commits to justifying the use of these instruments 'in areas where Parliament is usually involved in the legislative process' and to providing an opportunity for the Parliament to express its views.[805] Technically, the procedural treatment of institutional soft law that can 'define future policies' becomes similar to that of legally binding instruments: these acts are included to the Commission Working Programme, and the Commission conducts their impact assessment, setting the scene for parliamentary involvement.[806] On the practical side, however, parliamentary *input* in steering instruments still needs to be enhanced, and the scope of parliamentary *scrutiny* over institutional soft law must be enhanced across all types of non-binding instruments. Besides, the role of the Council, which remains undefined, needs to be strengthened.

3.2.2. The Commission and the Judicial Power of Interpretation

Under Article 17 TEU, the Commission should 'ensure the application of the Treaties'. It allows the Commission to adopt soft law instruments with an interpretative purpose in order to explain how EU law should be applied in particular circumstances. As discussed in Part II,

[805] ibid, point 43.

[806] Commission, 'Impact Assessment Guidelines' (Guidelines) SEC(2009) 92 final, section 1.4.

the Commission may use these tools to influence the actions of Member States: by acknowledging a potential infringement, it may force Member States to amend their national laws without the involvement of Article 258 TFEU. This could be an effective way of saving resources allocated for enforcement actions and ensuring a more homogeneous application of EU law.

This interpretation provided by the Commission is criticised by some commentators as clashing with the competence of the Court, since the latter has exclusive jurisdiction over the interpretation of EU law (Article 19 TEU).[807] To preserve the institutional balance set by the Treaties, the Commission declares that its interpretative communications represent 'exclusively the Commission's opinion' and that the final word belongs to the Court.[808] However, Part IV Section 4 will demonstrate that: (i) the line between the Commission's opinion and authoritative statements is not always clearly drawn; (ii) in some cases, the Commission attempts to influence the position of the Court in relation to emerging issues; and (iii) the Commission's view can be (and sometimes is) overturned by the Court. This practice, in particular disagreements, substantially undermines the impact of soft law and makes the problem of legal certainty even more apparent.

The analysis provided in this section has demonstrated that the Commission and the Parliament have recently agreed upon the basic principles of parliamentary scrutiny over non-binding instruments. This should be considered as an important development following a period of strong criticism towards soft law instruments expressed by the Parliament in 2007. This regulation, however, remains limited – especially when compared to two other forms of soft law: 'co-regulation' and 'self-regulation'. Unlike the Parliament, which was struggling with a lack of political involvement in the decision-making process and a lack of control over

[807] See, eg, Mario Tenore, 'The Scope for "Consistent Interpretation" in the Area of Dividend Taxation' in Pasquale Pistone (ed), *Legal Remedies in European Tax Law* (IBFD 2009) 27, 43; citing also Pasquale Pistone, 'Expected and Unexpected Developments of European Integration in the Field of Direct Taxes' (2007) 35 Intertax 70, 71.

[808] Commission Response SP(2007) 5402 of 24 October 2007 to European Parliament Resolution 2007/2028(INI) of 4 September 2007 on Institutional and Legal Implications of the Use of 'Soft Law' Instruments'.

the implementation of soft law recommendations, the Court and the Council have not confronted the Commission's actions in the same open manner; yet the support of these two institutions is crucial for enhancing the effectiveness of soft law. Part IV Section 4 will examine this problem from an empirical angle, suggesting different ways of addressing it.

3.3. Good Governance and Procedural Standards for Non-Binding Instruments

The White Paper on European Governance (2001) formulates five principles of good governance: openness, participation, accountability, effectiveness and coherence.[809] These values are equally important for legislative and non-legislative regulatory instruments,[810] but soft law is often considered to circumvent them.[811] The question discussed in the following sections is whether non-binding instruments are subject to lower democratic standards than those with legally binding force.

3.3.1. Openness

Greater transparency and accessibility is one of the key factors contributing to increased confidence in complex bureaucratic institutions at the EU level. EU institutions should operate in an open manner, widely communicating their activities to Member States and citizens.[812] Following the White Paper on European Governance, the Commission started publishing annual reports on its activities in the tax field. These reports, prepared by DG TAXUD, explain the Commission's actions in simple terms, covering both binding and non-

[809] Commission, COM(2001) 428 final, section 2.

[810] ibid, section 3.2.

[811] See, eg, Sandra Eden, 'Corporate Tax Harmonisation in the European Community' [2000] 6 British Tax Review 624, 651.

[812] Commission, COM(2001) 428 final, section 2.

binding initiatives. The Commission also publishes informative and preparatory reports on specific policy matters, which concern different types of regulatory measures. The number of these documents in the field of direct taxation has increased in the last decade: the Commission published an average of one act annually between 1991 and 2001, and three acts annually between 2001 and 2012.

Despite these positive developments, some aspects of the preparatory stage can still be improved. The Commission has created several expert forums to deal with tax matters, which are frequently relied upon at the drafting stage. In some cases, the results of these meetings are considered confidential or have limited coverage in the Commission's communications.[813] This concern applies, for instance, to the Tax Policy Group: relaunched in October 2010, the group provides a platform for regular meetings of the representatives of Member States' Ministers of Finance to discuss 'the scope and priorities for tax policy coordination within Europe'.[814] Information about the Tax Policy Group's activities is limited to brief press releases, and could be more comprehensive.

3.3.2. Participation

Since a transparent and effective consultation process lies 'at the heart of EU policy-shaping' and the legitimacy of the Commission's actions depends upon it,[815] the adoption of the general principles and minimum standards for consultation of interested parties followed shortly after the White Paper on European Governance.[816] Despite the strong policy messages

[813] Hans Gribnau, 'The Code of Conduct for Business Taxation: An Evaluation of an EU Soft-Law Instrument' in Dennis Weber (ed), *Traditional and Alternative Routes to European Tax Integration* (IBFD 2010) 67, 93.

[814] The group was initially created in 1996 and contributed to the success of the 'Monti Package'. See Commission, IP/10/1312.

[815] Commission, COM(2001) 428 final, section 3.1.

[816] Commission, 'Towards a Reinforced Culture of Consultation and Dialogue – General Principles and Minimum Standards for Consultation of Interested Parties by the Commission' (Communication) COM(2002) 704 final. See also Commission, 'Review of the Commission Consultation Policy' (Staff Working Document) SWD(2012) 422 final accompanying 'EU Regulatory Fitness' (Communication) COM(2012) 746 final.

contained in both documents towards greater public involvement, the practice of consultation in the field of direct taxation was infrequent until 2010; the 2006 tax coordination initiative, for example, was not a subject for consultation (see Table 6). The Commission tended to rely more on expert groups, which have played an important role in the elaboration and adoption of non-binding instruments, such as the Code of Conduct for Business Taxation and the Code of Conduct for the Effective Implementation of the Arbitration Convention.[817]

In 2010–2012 the level of public participation increased: all major policy initiatives were offered for consultation with interested parties, including individual citizens; businesses; Member States; tax administrations; intergovernmental, non-governmental and business organisations; tax practitioners; and academia. The list of planned, open and closed tax consultations, including all consultation papers and reports that summarise the outcomes, are available online. Following the Commission's declaration to move 'from better to smart regulation', the duration of public consultations has been increased to 12 weeks (as from January 2012). More regular meetings with national tax experts, who represent the Member States' Ministries of Finance, help to lay the groundwork for acceptable policy solutions.

Table 6. Public Consultation in the Field of Direct Tax Policies (2001–2012)[818]

2012
Consultation on factual examples and possible ways to tackle double non-taxation cases
Consultation on tax problems linked to cross-border venture capital investment
2011
Consultation on withholding taxes on cross-border dividends: problems and possible solutions

[817] ECOFIN Council Meeting Conclusions of 1 December 1997 concerning taxation policy (Annex 1: Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997 on a code of conduct for business taxation) [1998] OJ C2/1; Council, 'Revised Code of Conduct for the Effective Implementation of the Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises' [2009] OJ C 322/1.

[818] DG TAXUD, 'Tax Consultations' <http://ec.europa.eu/taxation_customs/common/consultations/tax/index_en.htm> accessed 28 December 2012.

Consultation on financial sector taxation (Financial Transaction Tax and Financial Activity Tax)
2010
Consultation on taxation of cross-border interest and royalty payments between associated companies
Consultation on possible approaches to tackling cross-border inheritance tax obstacles within the EU
Consultation on double tax conventions and the Internal Market: factual examples of double taxation cases
2007
Green paper on market-based instruments for environment and related policy purposes
2004
Home State Taxation for SMEs
2003
The experimental application of 'Home State Taxation' to SMEs in the EU
The application of International Accounting Standards (IAS) in 2005 and the implications for the introduction of a consolidated tax base for companies' EU-wide activities

3.3.3. Accountability

Mörth rightly warns that '[i]nherent in soft law (…) is a vagueness, both in form (who is accountable) and in substance (the political commitments) that could impair accountability, transparency and a public debate.'[819] The adoption of institutional soft law is often perceived as 'a "superbureaucracy" without democratic legitimacy'.[820] The narrow scope of parliamentary control, as well as the lack of Member States' input, makes the Commission's

[819] Ulrika Mörth, 'Soft Law and New Modes of EU Governance: A Democratic Problem?' Conference Paper (Darmstadt, November 2005) <http://www.mzes.uni-mannheim.de/projekte/typo3/site/fileadmin/research%20groups/6/Papers_Soft%20Mode/Moerth.pdf> accessed 28 December 2012, 14; see also Mark Dawson, 'Transforming Into What? New Governance in the EU and the "Managerial Sensibility" in Modern Law' (2010) Wisconsin Law Review 390.

[820] European Parliament Resolution 2007/2028(INI) of 4 September 2007 on institutional and legal implications of the use of 'soft law' instruments, point Y.

soft law 'a bad fit' in the modern vision of democratic decision-making.[821] Central to this criticism are the limited possibilities for judicial review.

The Treaty stipulates that the Commission should fulfil its overseeing function under the Court's control (Article 17 TEU), but the possibilities for judicial control over soft law are more limited than those applicable to binding instruments. According to the Court, in the framework of the preliminary reference procedure it can judge upon the validity and interpretation of *all* acts of the institutions of the Union 'without exception'.[822] Under Article 263 TFEU, the Court examines 'the legality of legislative acts, of acts of the Council, of the Commission and of the European Central Bank, *other than recommendations and opinions*, and of acts of the Parliament and of the Council intended to produce legal effects vis-à-vis third parties'.[823]

Case law confirms that the legality of non-binding acts cannot be reviewed under Article 263 TFEU: instruments that do not 'have the force of law and can bind neither the competent authorities of the Member States nor, *a fortiori*, individuals' are not considered to be 'a legal decision by the Commission', and thereby they cannot be subject for annulment actions.[824] This, however, does not stop the Court from applying the 'substance over form' argument. In Case C-325/91 *France v Commission*, the Court held that 'an action for annulment is available in the case of all measures adopted by the institutions, whatever their

[821] See, eg, Adrienne Héritier and Dirk Lehmkuhl, 'New Modes of Governance and Democratic Accountability' (2011) 46 Government and Opposition 126.

[822] Case C-322/88 *Grimaldi* [1989] ECR 4407, paras 8-9: 'it is sufficient to state in that respect that, unlike Article 173 of the EEC Treaty, which excludes review by the Court of acts in the nature of recommendations, Article 177 confers on the Court jurisdiction to give a preliminary ruling on the validity and interpretation of all acts of the institutions of the Community without exception (…). Moreover, in proceedings under Article 177 the Court has already ruled on several occasions on the interpretation of recommendations adopted on the basis of the EEC Treaty'. See also Case 113/75 *Frecassetti* [1976] ECR 983, para 8; Case C-137/08 *VB Pénzügyi Lízing Zrt. v Ferenc Schneider* [2010] ECR I-10847, para 38 (for examples of earlier and recent case law confirming this line of interpretation).

[823] Emphasis added.

[824] Case C-146/91 *KYDEP v Council* [1994] ECR I-4199, para 25.

nature or form, which are intended to have legal effects'.[825] The Commission's communication, which was published in the C Series of the Official Journal, notified to all Member States and required them to report to the Commission on an annual and systematic basis; this was considered to be an act intended to have legal effects of its own and to add new obligations to those provided for by the relevant legislation.[826] Referring to the principle of legal certainty, the Court ruled that any act intended to have legal effects must meet the procedural and substantive requirements set by the Treaties for binding instruments.[827] However, the limits of this obligation are not clear: in *KYDEP v Council*, the Court assessed a telex that 'had no binding force' but 'was likely to prompt' Member State authorities to buy certain agricultural products.[828]

The Parliament found a contradiction between the Court's jurisprudence, which obliges national courts to take due account of recommendations, and Article 263 TFEU, which puts non-binding instruments outside the Court's control.[829] This model limits, foremost, the possibility for Member States to initiate a judicial review of soft law, unless its legal effect can be established. This restriction on judicial intervention creates an additional argument for the enhancement of political control over soft law measures, which is still nominal.

3.3.4. Effectiveness

This principle is interpreted by the White Paper on European Governance as a requirement to deliver effective and timely policies that have clear goals, are based on impact assessment and

[825] Case C-325/91 *France v Commission* [1993] ECR I-3283, para 9. To that effect see also Case C-57/95 *France v Commission* [1997] ECR I-1627, para 23; and earlier case law, such as Case 22/70 *Commission v Council* [1971] ECR 263, para 42; Case 60/81 *IBM v Commission* [1981] ECR 2639, para 9.

[826] Case C-325/91 *France v Commission* [1993] ECR I-3283, paras 10-23.

[827] ibid, para 26; Case C-57/95 *France v Commission* [1997] ECR I-1627, para 24; Case C-370/07 *Commission v Council* [2009] ECR I-8917, para 42.

[828] Case C-146/91 *KYDEP v Council* [1994] ECR I-4199, paras 26-27.

[829] European Parliament Resolution 2007/2028(INI) of 4 September 2007 on institutional and legal implications of the use of 'soft law' instruments, para 17.

provide a proportionate policy response at the appropriate level. The integrated procedure of impact assessment for major legislative and policy proposals was introduced in 2002, following shortly after the White Paper.[830] The Commission's internal guidelines explain that the proposals selected for impact assessment must demonstrate an economic, social or environmental impact, and can include 'white papers, expenditure programmes, communications on policy orientations and negotiating guidelines for international agreements'.[831] Certain types of act are explicitly exempt, such as 'Green Papers where the policy formulation is still in process, periodic Commission decisions and reports, proposals relating to international obligations and executive decisions for example, implementing decisions, statutory decisions and technical updates, including adaptations to technical progress'.[832] The impact assessment analysis of non-legislative instruments includes a set of standardised questions.[833] It contains a description of the problem, general and specific objectives, and an analysis of subsidiarity and proportionality that justifies the need for policy intervention. It also considers alternative options for action and their potential impact. Finally, it identifies follow-up measures and evaluation arrangements.

Since 2006, impact assessments have been conducted for the majority of non-binding direct tax initiatives published by the Commission, covering: good governance in relation to tax havens; arbitration in cross-border tax disputes; the elimination of double taxation on cross-border dividend payments to portfolio investors (ongoing);[834] cross-border inheritance taxes (adopted as a recommendation on 15 December 2011);[835] withholding tax relief

[830] Commission, 'Impact Assessment' (Communication) COM(2002) 276 final.

[831] Commission, 'New Impact Assessment Procedure Developed for the Commission Services' (Internal Guidelines) <http://ec.europa.eu/governance/docs/comm_impact_en.pdf> accessed 28 December 2012, section 2.

[832] ibid.

[833] Commission, 'Impact Assessment Guidelines' (Guidelines) SEC(2009) 92 final, section 3.3.

[834] Commission, '2012 Roadmaps: Taxation and Customs Union' <http://ec.europa.eu/governance/impact/planned_ia/roadmaps_2012_en.htm#TAXUD> accessed 28 December 2012.

[835] Commission, '2011 Roadmaps: Taxation and Customs Union' <http://ec.europa.eu/governance/impact/planned_ia/roadmaps_2011_en.htm#TAXUD>.

procedures (adopted as a recommendation on 19 October 2009);[836] and the fight against tax fraud (adopted as a communication on 31 May 2006).[837] This practice, however, is not entirely consistent: some communications do not appear in the Commission's annual work programme and their assessment has not been made, despite the 'regulatory' messages contained in their texts.[838]

3.3.5. Coherence

The White Paper on European Governance states that 'policies can no longer be effective unless they are prepared, implemented and enforced in a more inclusive way'.[839] This principle should be interpreted as including three different aspects. First, at the most basic level, it requires the Commission to ensure the internal coherence of soft law measures. Second, the principle highlights the importance of coordinating various regulatory and enforcement tools that are available to the Commission. Finally, it requires inter-institutional cooperation and, in particular, the coherence of messages sent by various EU institutions.

The effectiveness of EU law is undermined by differences that can be found in, for instance, (i) the interpretation of EU law by the Court and the Commission on the tax treatment of losses,[840] and (ii) the Commission's Communication and the Council's resolution

[836] Commission, '2009 Impact Assessment Reports: Taxation and Customs Union' <http://ec.europa.eu/governance/impact/ia_carried_out/cia_2009_en.htm> accessed 28 December 2012.

[837] Commission, '2006 Impact Assessment Reports: Taxation and Customs Union' <http://ec.europa.eu/governance/impact/ia_carried_out/cia_2006_en.htm> accessed 28 December 2012.

[838] See Commission, 'On the Work of the EU Joint Transfer Pricing Forum in the Period April 2009 to June 2010 and Related Proposals 1. Guidelines on Low Value Adding Intra-group Services and 2. Potential Approaches to Non-EU Triangular Cases' (Communication) COM(2011) 16 final; Commission, 'On the Work of the EU Joint Transfer Pricing Forum in the Period March 2007 to March 2009 and a Related Proposal for a Revised Code of Conduct for the Effective Implementation of the Arbitration Convention (90/436/EEC of 23 July 1990)' (Communication) COM(2009) 472 final; Communication, 'The Application of Anti-Abuse Measures in the Area of Direct Taxation – within the EU and in relation to Third Countries' (Communication) COM(2007) 785.

[839] Commission, COM(2001) 428 final, section 2.

[840] See Part IV Section 4.3 for details.

on exit taxes.[841] The critical comments expressed by the Parliament in relation to soft law,[842] as well as the inability of the Commission and the Parliament to agree upon the procedural framework, increase public mistrust in EU bureaucracy. Messages sent from EU decision-making centres must be coherent: synergy can be generated only if various instruments and institutions move towards a common objective. Part IV Section 4 will discuss the 2006 tax coordination initiative at two levels: (i) the coherence of soft law instruments and the subsequent enforcement actions of the Commission, and (ii) the consistency of messages sent by various EU institutions.

This section has considered hard and soft law as being at opposite ends of a regulatory scale. Despite the many differences between these instruments, they share a common goal by aiming to set certain standards of behaviour.[843] Applying the basic principles of good governance to both instruments, Mather concluded that '[h]ard law is now constrained by heavy requirements of consultation, impact assessment, judicial challenge as well as the rigours of the democratic law making process.'[844] This section has also acknowledged some positive developments that have brought institutional soft law into the field of direct taxation, under the umbrella of requirements that are similar to those essential for traditional lawmaking.

Since 2001, a step forwards has been made in the field of direct taxation to increase openness, public participation in the preparatory process, and the effectiveness of non-binding measures. Thus far, however, there is no coherent procedure for the adoption of soft law instruments by the Commission, and accounts of the basic principles of good governance can vary significantly. At the preparatory stage, the Commission may rely upon expert groups that are involved in a wide range of work: from identifying priority areas for tax coordination to

[841] See Part IV Section 4.4 for details.

[842] See Part IV Section 3.2 for details.

[843] For more on this see Dinah Shelton, *Commitment and Compliance: The Role of Non-Binding Norms in the International Legal System* (OUP 2003).

[844] Graham Mather, 'Is Soft Law Taking Over?' (20 October 2010) European Policy Forum Working Paper, 12.

defining substantive provisions. The transparency of their operation depends on the willingness of public officials to disclose information. In its most recent practice, the Commission has become more consistent in opening the preparatory process to wider public consultation. More and more often, non-binding measures in the field of direct taxation undergo the impact assessment procedure. However, the lack of formalised procedural rules raises concerns that these welcome developments may be reversed if they ever become inconvenient to the Commission.

3.4. The Indirect Legal and Practical Effects of EU Soft Law

Soft law has become an integral part of the EU regulatory order and its 'non-binding operating mode cannot be equated with legal irrelevance'.[845] There is no single answer to the question about the normative weight of soft law, since various instruments 'exhibit varying degrees of normativity', which can be described as 'a sliding scale of softness and hardness'.[846] This section aims at exploring this scale of effects and at explaining how these instruments, which have not been attributed a legally binding force, may impose standards of conduct. Two types of effects, which are traditionally distinguished by EU scholarship, will be discussed: (indirect) legal and practical effects.[847]

3.4.1. Soft Law and (Indirect) Legal Effects

[845] Armin von Bogdandy and others, 'Legal Instruments in European Union Law and their Reform: A Systematic Approach on an Empirical Basis' (2004) 23:1 Yearbook of European Law 91, 111.

[846] Gabrielle Kaufmann-Kohler, 'Soft Law in International Arbitration: Codification and Normativity' [2010] 1 Journal of International Dispute Settlement 283, 285.

[847] See Linda Senden, *Soft Law in European Community Law* (Hart Publishing 2004) 111-112.

Senden defines 'indirect legal effects' as the influence on interpretation recognised in *Grimaldi*,[848] and as resulting from the application of the general principles of EU law, in particular the principle of legal certainty and legitimate expectations.[849] These effects are to be distinguished from the 'inherent legally binding force' attributed to regulations, directives and decisions, and the 'incidental legally binding force', which is explained through the 'substance over form' decisions of the Court.[850] Since the general category of '(indirect) legal effects' provides little explanation for various consequences produced by soft norms and their relative 'hardness', a more detailed examination will be undertaken.

3.4.1.1. The Interpretative Effect of Soft Law

In the seminal *Grimaldi* case, the Court ruled that 'recommendations' cannot 'be regarded as having no legal effect' and thus '[t]he national courts are bound to take recommendations into consideration in order to decide disputes submitted to them, in particular where they cast light on the interpretation of national measures adopted in order to implement them or where they are designed to supplement binding Community provisions.'[851] This decision became a logical continuation of earlier cases on the interpretation of recommendations, delivered in the mid-1970s,[852] and it has consistently been reconfirmed ever since. The lack of proper consideration for recommendations may be considered as a breach of the principle of sincere cooperation, which envisages that 'the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties' (Article 4 TEU).

The *Grimaldi* judgment leaves two questions open. First, the ambiguity of the obligation to 'take recommendations into account' is open for interpretation. Second, and

[848] Case C-322/88 *Grimaldi* [1989] ECR 4407.

[849] Linda Senden, *Soft Law in European Community Law* (Hart Publishing 2004) 240.

[850] ibid.

[851] Case C-322/88 *Grimaldi* [1989] ECR 4407, para 18; see also Case C-188/91 *Deutsche Shell v Hauptzollamt Hamburg-Harburg* [1993] ECR I-363, para 18; Case C-207/01 *Altair Chimica* [2003] ECR I-8875, para 41.

[852] Case 113/75 *Frecassetti* [1976] ECR 983; Case 90/76 *Van Ameyde* [1977] ECR 1091.

even more importantly, it is unclear whether this obligation concerns all types of soft law, or only those adopted in the form provided for by the Treaties. As Sarmiento notes, '[t]he very absence of a precise definition of EU soft law applicable to a specific case, could put national courts in undesirable situations of uncertainty.'[853] To date, eight recommendations have been adopted by the Commission in the field of direct taxation: anti-avoidance measures (2012),[854] inheritance taxes (2011),[855] withholding tax relief procedures (2009),[856] the accession of Bulgaria and Romania to the EU Arbitration Convention (2007),[857] the taxation of SMEs (1992 and 1994),[858] and the taxation of non-residents (1993).[859] Does this mean that interpretative and steering communications are to be treated differently from 'recommendations' by the national courts?

There are three different ways of interpreting this case. The 'interpretative effect' can either be: (i) limited only to 'recommendations'; (ii) attributed to all types of acts defined in this study as 'soft law' (narrow definition of soft law); or (iii) relevant for all types of soft law, including informative and preparatory instruments (broad definition of soft law).

The argument in defence of the first position would be that *Grimaldi* has been consistently upheld in more recent cases, but the term 'recommendation' has not been altered into a broader notion of 'soft law'.[860] However, in light of the Commission's practice where

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[853] Daniel Sarmiento, 'The Function of EU Soft Law' in Dennis Weber (ed), *Traditional and Alternative Routes to European Tax Integration* (IBFD 2010) 53, 59-60.

[854] Commission Recommendation C(2012) 8805 final of 6 December 2012 regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters; Commission Recommendation C(2012) 8806 final of 6 December 2012 on aggressive tax planning.

[855] Commission Recommendation 2011/856/EU of 15 December 2011 regarding relief for double taxation of inheritances [2011] OJ L336/81.

[856] Commission Recommendation C(2009) 7924 final of 19 October 2009 on withholding tax relief procedures.

[857] Commission Recommendation COM(2007) 839-1 final of 20 December 2007 for a Council Decision concerning the Accession of Bulgaria and Romania to the Convention of 23 July 1990 on the Elimination of Double Taxation in connection with the Adjustment of Profits of Associated Enterprises.

[858] Commission Recommendation 94/390/EC of 25 May 1994 on taxation of small and medium-sized enterprises.

[859] Commission Recommendation 94/79/EC of 21 December 1993 on the taxation of certain items of income received by non-residents in a Member State other than that in which they are residents.

[860] Case C-207/01 *Altair Chimica* [2003] ECR I-8875, para 41; Case C-55/06 *Arcor* [2008] ECR I-2931, para 94; Joined cases C-317/08 to C-320/08 *Alassini and Others* [2010] ECR I-2213, para 40. This position is supported

the difference between recommendations, guidelines and communications is blurred, the second interpretation, where *Grimaldi* attributes the 'interpretative effect' to all types of non-binding acts with a regulatory purpose, is more plausible. The Court has repeatedly held that while 'the choice of form cannot alter the nature of a measure, it must nevertheless be ascertained whether the content of a measure is wholly consistent with the form attributed to it'.[861] In Case C-415/07 *Lodato & C*, AG Colomer argued that 'national courts must "take into consideration" *soft law provisions* when deciding cases before them'.[862] Although the Court does not restate this explicitly, it has provided the interpretation of Regulation No 2204/2002 on the basis of the Commission's guidelines.[863]

But how far can the interpretative effect given to non-binding instruments be extended? Is it possible that it covers all types of soft law, including informative and preparatory instruments, as claimed by some scholars? Considering the very careful position taken by the Court when it comes to the use of preparatory documents for the purpose of the interpretation of EU law, such a wide interpretation of *Grimaldi* is ungrounded.[864]

In Case C-375/98 *Epson Europe*, the Court had difficulties with the interpretation of Article 5(4) of the Parent–Subsidiary Directive.[865] The Portuguese government made reference to a declaration recorded in the minutes of the Council. Following its settled case law, the Court stated that 'declarations recorded in Council minutes in the course of

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by, for instance, Anne Peters, 'Soft Law as a New Mode of Governance' in Udo Diedrichs and others (eds), *The Dynamics of Change in EU Governance* (Edward Elgar Publishing 2011) 21, 36.

[861] Case C-322/88 *Grimaldi* [1989] ECR 4407, para 14. See also Case 147/83 *Binderer v Commission* [1985] ECR 257, para 11.

[862] Case C-415/07 *Lodato & C* [2009] ECR I-2599, Opinion of AG Colomer, para 34. In footnote 11, AG Colomer noted that 'there is no serious impediment to extending this case-law to other forms of soft law such as guidelines'. Also AG Tizzano, in Case C-144/04 *Mangold v Helm* [2005] ECR I-9981, argued that the duty of consistent interpretation 'applies with respect to all sources of Community law, whether constituted by primary or secondary legislation, and whether embodied in acts whose legal effects are binding or not' (para 117, citations omitted).

[863] Case C-415/07 *Lodato & C* [2009] ECR I-2599; in the 'golden shares' cases, the Court also relied upon the Communication in its reasoning (see Case C-367/98 *Commission v Portugal* [2002] ECR I-4731, para 47; Case C-483/99 *Commission v France* [2002] ECR I-4781, para 43; Case C-503/99 *Commission v Belgium* [2002] ECR I-4809, para 43).

[864] See, eg, Giulio Itzcovich, 'The Interpretation of Community Law by the European Court of Justice' (2009) 10 German Law Journal 537, 554-555.

[865] Case C-375/98 *Epson Europe* [2000] ECR I-4243.

preparatory work leading to the adoption of a directive cannot be used for the purpose of interpreting that directive where no reference is made to the content of the declaration in the wording of the provision in question.'[866] In *Gebr. Stolle and Doux Geflügel*, the Court further explained that 'neither individual statements of position nor joint declarations of the Member States may be used for the purpose of interpreting a Community provision where, as in the present case, their content is not reflected in its wording and therefore has no legal significance'; rather, for the purposes of interpretation, 'account should be taken (…) of the overall scheme and objectives of the system of export refunds of which it forms part'.[867] Thus, case law sets a clear difference between 'recommendations', which have interpretative significance per se, and preparatory documents.

One of the recent cases, however, has reopened the question of the interpretative effect of preparatory instruments, which was deemed settled. In Case T-18/10 *Inuit Tapiriit Kanatami and Others v Parliament and Council*, the Court considered whether Council Regulation (EC) No 1007/2009 of 16 September 2009 on trade in seal products should be annulled.[868] Since the conditions of admissibility were regulated by Article 263 TFEU, the Court had to consider the meaning of 'regulatory act' in the context of paragraph 4. In drawing its conclusion, the Court relied heavily on the history of the adoption:

> It is apparent, inter alia from the cover note of the Praesidium of the Convention (Secretariat of the European Convention, CONV 734/03) of 12 May 2003, that, in spite of the proposal for an amendment to the fourth paragraph of Article 230 EC mentioning 'an act of general application', the Praesidium adopted another option, that mentioning 'a regulatory act'. As is apparent from the cover note referred to above, that wording enabled 'a distinction to be made between legislative acts and regulatory acts,

[866] ibid, para 26. To that effect see also Case C-292/89 *Antonissen* [1991] ECR I-745, para 18; Case C-329/95 *VÄG Sverige* [1997] ECR I-2675, para 23; but note Case C-368/96 *The Queen v The Licensing Authority* [1998] ECR I-7967, paras 26-28.

[867] Joined Cases C-323/10 to C-326/10 *Gebr. Stolle and Doux Geflügel* [2011] ECR I-0000, paras 66-67. Also, 'expressions of intent on the part of Member States in the Council (…) have no legal status if they are not actually expressed in the legislation' (Joined Cases C-283/94, C-291/94 and C-292/94 *Denkavit* [1996] ECR I-5063, para 29), see also Case 143/83 *Commission v Denmark* [1985] ECR 427, para 13; Joined Cases C-197/94 and C-252/94 *Bautiaa and Société Française Maritime* [1996] ECR I-505, para 51; Case C-329/95 *VÄG Sverige* [1997] ECR I-2675, para 23; Case C-402/03 *Skov v Bilka* [2006] ECR I-199, para 42; Case C-404/06 *Quelle* [2008] ECR I-2685, para 32.

[868] Order of the General Court of 6 September 2011; Council Regulation (EC) No 1007/2009 of 16 September 2009 on trade in seal products [2009] OJ L286/36.

> maintaining a restrictive approach in relation to actions by individuals against legislative acts (for which the "of direct and individual concern" condition remains applicable)'.[869]

It is unclear how the deliberations of the Praesidium of the Convention in 2003 differ from declarations and reservations made in the Council, which for a long time have been considered to have 'no legal significance'.[870] The Court does not make any reference to this line of case law. This is particularly striking in light of the fact that the Court used the Convention's preparatory documents concerning paragraph 4 of Article III-365 of the draft Treaty establishing a Constitution for Europe for the purpose of interpreting *the Treaty of Lisbon.*

A similarly uncertain move was seen earlier in Case C-368/96 *The Queen v The Licensing Authority*.[871] In this case, the Court exceptionally concluded that for the purpose of clarifying a general concept, Council minutes '*may* be taken into consideration' for interpretation.[872] As a supporting argument for this decision, the Court stated that 'the definition of that concept adopted in the minutes of the Council is, moreover, used in the guidelines published by the Commission'.[873] Since no additional explanation has been given, this has left the question regarding the interpretation effect of preparatory instruments open.

Thus, several conclusions can be made. National courts are bound to take recommendations into consideration when deciding a case, but it remains unclear whether the 'interpretative effect' admitted in relation to 'recommendations' can be attributed to other types of soft law. This contribution supports the view that it can, as long as soft law is narrowly defined and thus excludes preparatory and informative instruments. This position is

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[869] ibid, para 49.

[870] See, inter alia, Case C-292/89 *Antonissen* [1991] ECR I-745, para 18; Case C-375/98 *Epson Europe* [2000] ECR I-4243, para 26.

[871] Case C-368/96 *The Queen v The Licensing Authority* [1998] ECR I-7967.

[872] ibid, para 27 (emphasis added). A similarly vague reference, where non-binding instruments are used as an additional confirmation, can be found in Case C-310/90 *Nationale Raad van de Orde der Architecten v Egle* [1992] ECR I-177, para 12.

[873] ibid, para 28.

based on the settled case law that preparatory acts, as a rule, cannot be used for the purpose of interpretation if EU legislation does not contain reference to the content of such an act. The Court has demonstrated its readiness to change this strict formula of 'cannot be used' into 'may be used in certain cases', but these examples are infrequent and should be treated as exceptional. Interpretative and steering instruments are adopted with a regulatory purpose that makes their legal position similar, in substance, to 'recommendations'.

3.4.1.2. Self-Imposing Obligations Created by the Application of the General Principles of EU Law

The Court admits that non-binding rules of general application, under certain conditions and depending on their content, may produce (indirect) legal effects. This type of legal effect is created through the application of the general principles of EU law. As Meyer precisely captured it, soft law frequently 'piggybacks on binding law'.[874]

Applying the principles of legal certainty and equal treatment, the Court concludes that soft law may create self-imposing restrictions that determine the way in which EU institutions exercise their discretion. Hence, if the Commission adopts guidelines and other types of non-binding instruments that are consistent with the Treaties and designed to specify the criteria that the Commission intends to apply in the exercise of its discretion, the Commission itself limits this discretion and must comply with the guidelines that it has imposed upon itself.[875] The Commission may not depart from its guidelines in an individual case without giving reasons that are compatible with the principle of equal treatment.[876] The departure from guidelines that have been announced to the public can be found to be in breach of the general

[874] Timothy Meyer, 'Soft Law as Delegation' (2009) 32 Fordham International Law Journal 888, 907.

[875] See, inter alia, Case T-73/04 *Carbone-Lorraine v Commission* [2008] ECR II-2661, para 192; Case C-413/08 P *Lafarge v Commission* [2010] ECR I-5361, paras 93 and 95; Case T-77/08 *The Dow Chemical Company v Commission* [2012] ECR II-0000, para 139 (and the case-law cited).

[876] Joined Cases C-189/02 P, C-202/02 P, C-205/02 P to C-208/02 P and C-213/02 P *Dansk Rørindustri and Others v Commission* [2005] ECR I-5425, paras 209-210.

principles of law, such as legitimate expectations.[877] The Commission retains, however, the competence to annul or amend any guidelines if needed.[878] This self-imposing effect extends to all institutional bodies under vertical (subordinate) relations. As the Commission confirms, 'it goes without saying that, when the Commission decides to apply the principles and guidelines [of a non-legally binding nature], its departments have to act accordingly.'[879] This type of legal effect is particularly common in fields that are under the wide discretion of the Commission.[880]

In Case C-39/10 *Commission v Estonia*, however, the Court demonstrated that self-imposing obligations cannot be interpreted too widely.[881] In this case, the Commission submitted that Estonia was infringing the freedom of movement for workers by excluding non-resident pensioners who receive less than 75 per cent of their income in Estonia from the benefit of the allowances provided for domestic income tax.[882] In its defence, Estonia referred to Article 2 of Commission Recommendation 94/079/EC,[883] which envisaged that the non-discriminatory tax treatment of residents and non-residents is mandatory in situations where non-residents receive at least 75 per cent of their annual income in that Member State.[884] The Court rejected this argument by stating that the recommendations are non-binding under Article 288 TFEU and that the principle of legitimate expectations cannot be relied upon to restrict the Commission's power to declare a failure to fulfil obligations under EU law.[885]

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[877] ibid, para 211.

[878] Case T-214/95 *Vlaams Gewest v Commission* [2003] ECR II-717, para 89.

[879] Commission, 'Towards a Reinforced Culture of Consultation and Dialogue – General Principles and Minimum Standards for Consultation of Interested Parties by the Commission' (Communication) COM(2002) 704 final, section 2.

[880] The Commission's guidelines ensure that it acts in a transparent, foreseeable and consistent manner, respecting the principle of legal certainty, but they do not bind the Court. See Case C-109/08 *Commission v Greece* [2009] ECR I-4657, para 27 (and the case law cited).

[881] Case C-39/10 *Commission v Estonia* [2012] ECR I-0000.

[882] ibid, para 35.

[883] Commission Recommendation 94/079/EC of 21 December 1993 on the taxation of certain items of income received by non-residents in a Member State other than that in which they are resident [1994] OJ L39/22.

[884] Case C-39/10 *Commission v Estonia* [2012] ECR I-0000, para 41.

[885] ibid, para 63.

Besides, the preamble to Recommendation 94/79 explicitly states that 'it does not affect the Commission's conduct of policy in the field of infringement procedures'.[886]

The Court has consistently held that non-binding instruments 'are not capable of creating rights that individuals can rely on before a national court'.[887] In some cases, however, such rights are created de facto and protected through other means. For instance, in its communication on relations with the complainant in respect of infringements of EU law, the Commission undertook certain obligations, in particular: (i) to inform applicants about all the main steps taken in relation to an infringement case, and (ii) to respect a one-year time limit for the initial stage of an investigation that may result in the opening of an infringement case.[888] Despite its soft nature, this Communication has created rights for individuals, which should be respected. EU citizens may find protection by submitting a maladministration complaint to the European Ombudsman.[889]

3.4.1.3. Hybridity Created by Authoritative Recognition

The legal effect of soft law can be created though the integration of binding and non-binding instruments. The authoritative recognition of EU institutions such as the Court or the Commission creates legal hybrids, which enhance the impact of soft law.

First, this hybridity can be created by EU legislative instruments. A non-binding act would be considered to be an important tool for the interpretation of hard provisions if the latter included a reference to such an instrument of interpretation.[890] This lawmaking technique was adopted by the creators of the Charter of Fundamental Rights of the European

[886] ibid, para 64.

[887] Joined cases C-317/08 to C-320/08 *Alassini and Others* [2010] ECR I-2213, para 40.

[888] Commission, 'Relations with the Complainant in Respect of Infringements of Community Law' (Communication) COM(2002) 141 final, replaced by Commission, 'Updating the Handling of Relations with the Complainant in respect of the Application of Union Law' (Communication) COM(2012) 154 final, paras 8-9.

[889] See also Commission Decision 2000/633/EC of 17 October 2000 amending its Rules of Procedure and containing 'Code of Good Administrative Behaviour for Staff of the European Commission in Their Relations with the Public' (Annex) [2000] OJ L267/63, para 6.

[890] Case 149/73 *Witt/Hauptzollant Hamburg Ericus* [1973] ECR 1587, para 3.

Union. Article 52 of the Charter ('Scope and Interpretation of Rights and Principles') stipulates that '*the explanations* drawn up as a way of providing guidance in the interpretation of this Charter shall be given due regard by the courts of the Union and of the Member States'.[891]

Second, the Commission can combine its competence to publish a non-binding interpretation of EU law – explaining the application of EU law in specific legal circumstances – with the pressure of general and special enforcement procedures that can be initiated on the basis of the EU Treaties. Even if the Court may disagree with the Commission, the fact that in the area of direct taxation only 5 per cent of infringement cases are referred to the Court (and those referred are usually decided in favour of the Commission) allows us to attribute a certain (indirect) legal effect to this model. This combination can be found in the Code of Conduct for Business Taxation, where 'the failure of progress under the Code of Conduct is being used in the context of threat of action under the state aid rules'.[892]

Finally, the authoritative recognition of soft regulatory rules can be given by the Court. This type of hybridity demonstrates the transposition of soft law into hard law through litigation. For instance, the Court accepts that, in some cases, Member States may rely upon the rules of international legal practice, in particular on the soft law of the Organisation for Economic Cooperation and Development (OECD).[893] In contrast, the Communication on the Tax Treatment of Losses, COM(2006)824, and the Communication on Exit Taxation, COM(2006)825, have not obtained explicit judicial recognition. Both communications have been mentioned only once: the Communication on Losses in the Opinion of AG Sharpston in

[891] Charter of Fundamental Rights of the European Union [2012] OJ C326/389 (emphasis added).

[892] Sandra Eden, 'Corporate Tax Harmonisation in the European Community' [2000] 6 British Tax Review 624, 652.

[893] See, inter alia, Case C-336/96 *Gilly* [1998] ECR I-2793, para 31; Case C-513/03 *Van Hilten-van der Heijden* [2006] ECR I-1957, para 48; Case C-414/06 *Lidl Belgium* [2008] ECR I-3601, para 22.

Case C-414/06 *Lidl Belgium*[894] and the Communication on Exit Taxation by AG Kokott in her opinion in Case C-371/10 *National Grid Indus BV*.[895]

To summarise, the legal effects of soft law have two dimensions. The '*internal applicability*' can either originate from the Court's jurisprudence on self-constraining statements or hierarchical institutional structures with subordinate relations. The '*external applicability*' is reflected in the interpretative effect of soft regulatory instruments, as well as in various types of integration of hard and soft law. This overview of (indirect) legal effects, however, cannot effectively explain *why* the impact of the Code of Conduct for Business Taxation (1997) differs from that of the Communication on Losses (2006). The difference between these instruments will be conceptualised through an analysis of practical effects produced by soft law measures.

3.4.2. Soft Law and Practical Effects

Voluntary compliance reflects another side of the law: its behaviour-changing characteristics are not always related to the pressure of sanctions, but rather reflect an agreement with standards of conduct. The phenomenon of voluntary compliance with non-binding instruments has been widely discussed by socio-legal scholarship. The literature in this field discusses the factors that can contribute to better compliance.

Weiss and Shelton consider academic commentaries on compliance with non-binding norms in a domestic context and adapts them for the purpose of international law.[896] Six 'postulates', established in this way, can also be applied to EU soft law.[897] Some of these are

[894] Case C-414/06 *Lidl Belgium* [2008] ECR I-3601, Opinion of AG Sharpston, footnote 28.

[895] Case C-371/10 *National Grid Indus BV* [2011] ECR I-0000, Opinion of AG Kokott, footnote 2.

[896] Brown Edith Weiss and Dinah Shelton, 'Conclusions: Understanding Compliance with Soft Law' in Dinah Shelton, *Commitment and Compliance: The Role of Non-Binding Norms in the International Legal System* (OUP 2003) 536, 540.

[897] ibid.

strongly present in the tax coordination measures adopted by the Commission, whereas others should be considered as possibilities to be employed for enhancing the efficacy of soft law.

To start with, a continuing paradigm of the relationship between the parties is one of the most important factors of compliance.[898] This first condition is partly satisfied for EU soft law through the nature of the relationships between Member States and their long-lasting commitment to the Internal Market. This effect can be further enhanced by linking 'states and other actors together in a process that requires them to interact continuously over time.'[899] Close interaction between actors may facilitate changes through such channels as 'shaming, diffusion through mimesis or discourse, deliberation, learning, and networks'.[900]

The second important factor is reputation.[901] Some ideas promoted by non-binding instruments are supported by 'the moral factor attached to the norm'.[902] For instance, political risks related to not entering and/or non-compliance with the Code of Conduct for Business Taxation are high: 'states may not enter into binding agreements because of the risk of noncompliance, since noncompliance could adversely affect their reputation. Compliance with non-binding instruments would enhance a state's reputation, since a state would be known to comply even if it had not assumed a binding obligation.'[903] This effect is further enhanced in the context of the EU by the principle of sincere cooperation:

> The Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties. The Member States shall take any appropriate measure, general or particular, to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union. The Member States shall facilitate the achievement of the Union's tasks and refrain from any measure which could jeopardise the attainment of the Union's objectives (Article 4 TEU).

[898] ibid 540-542.

[899] ibid 541.

[900] David M Trubek and Louise G Trubek, 'Hard and Soft Law in the Construction of Social Europe: the Role of the Open Method of Co-ordination' (2005) 11 European Law Journal 343, 356 (citation omitted).

[901] Brown Edith Weiss and Dinah Shelton, 'Conclusions: Understanding Compliance with Soft Law' in Dinah Shelton, *Commitment and Compliance: The Role of Non-Binding Norms in the International Legal System* (OUP 2003) 536, 542-543.

[902] ibid.

[903] ibid 543.

The importance of the third factor cannot be overestimated. In order to be effective, soft law has to develop a consensus on the underlying norm.[904] This consensus can be built *ex ante*, reflecting mutual interests matched at the preparatory stage (gentlemen's agreements). Another route would be to rely upon the acceptance of soft law and *ex post* consensus (persuasive solutions). The 2006 Commission tax coordination initiative relies on the second approach: it attempts to convince Member States to follow specific policy solutions designed for them, based on guidance received from the Court.

The fourth factor uses the argument of an efficient solution: the party may find it 'more efficient to agree upon informal social norms and develop their own cost-effective approach to maintaining compliance with them.'[905] The fifth element may induce compliance through the common thread of legal enforcement,[906] which is referred to by EU scholarship as a 'default hybridity'.[907] Finally, compliance with non-binding norms can be enhanced through the creation of appropriate institutional settings.[908] The institutional mechanism is required for monitoring and follow-up purposes, and would encourage changes.

This overview has demonstrated a limited range of (indirect) legal effects that can be produced by non-binding measures. In the context of tax coordination, the Commission has two primary addressees: national courts and lawmakers. The interpretative effect is the most important mediator between the Commission and national courts. In relation to the communication between the Commission and national governments, hardly any use can be made of (indirect) legal effects to increase compliance with non-binding instruments. In fact,

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[904] ibid 543-544.

[905] ibid 544-545.

[906] ibid 545.

[907] See, eg, Gráinne de Búrca and Joanne Scott, 'Introduction: New Governance, Law and Constitutionalism' in Gráinne de Búrca and Joanne Scott (eds), *Law and New Governance in the EU and the US* (Hart Publishing 2006) 1, 9.

[908] Brown Edith Weiss and Dinah Shelton, 'Conclusions: Understanding Compliance with Soft Law' in Dinah Shelton, *Commitment and Compliance: The Role of Non-Binding Norms in the International Legal System* (OUP 2003) 536, 546-547.

the involvement of hybrid instruments is the most effective of these, first and foremost by supporting the Commission's soft measures with the threat of enforcement mechanisms. At the same time, an overview of practical effects has proved that a large potential reserve for better tax coordination can be found in stimulating voluntary compliance. The scope for improvement will be further discussed in the next section with the due consideration of empirical evidence.

3.5. Interim Conclusion

Part IV Section 3 has explored the major areas of criticism related to the use of institutional soft law instruments by the Commission. The analysis has demonstrated that soft law, with its uncertain constitutional and legal footing in the system of European governance, is gradually building up the foundations of its legitimacy. Although non-binding instruments have largely been ignored by the EU Treaties, the procedural framework is slowly being constructed by the case law of the Court and the soft inter-institutional and/or unilateral commitments of EU institutions.

This procedural framework is still evolving: although this section has identified some positive developments, many doctrinal questions remain unanswered. Member States can make the process of reconciling hard and soft regulatory frameworks smoother, bringing greater legal certainty for EU citizens; but, as a result of the so far uncoordinated evolution, Member States are increasingly losing the opportunity to shape the concept of soft law in European governance by means of a democratic decision-making process. Non-binding acts require a coherent procedural framework that takes into account the interests of all parties.

The formalisation of the procedural framework will ensure that the principles of good governance are respected in each case. It will introduce certainty into the preparatory process, ensuring that compliance with the democratic standards of openness, transparency, respect for

the participatory rights of interested parties, effectiveness and coherence is duly observed. Furthermore, it may help to create more rigorous mechanisms of political control over non-binding measures, which would compensate the limits of judicial review. The accountability problem, as well as the issue of effectiveness and coherence, will be further discussed in Part IV Section 4.

4. Assessing the Use of Non-Binding Coordination in the Field of Direct Taxation (2006–2012)

This section takes a closer look at the Commission's initiative of coordinating Member States' direct tax systems, which was launched in 2006.[909] Several subsequent communications have been published under its umbrella, namely the tax treatment of losses in cross-border situations, exit taxes, anti-abuse measures in the area of direct taxation[910] and, more recently, inheritance taxes.[911] These non-binding instruments have combined interpretative and steering elements. First, the Commission provided 'guidance on the principles flowing from the case law and how these apply to the main areas of direct taxation' in order to ensure 'greater legal certainty' and to contribute to the coherence of national responses.[912] Two types of interpretations should be distinguished in this context. When legal norms and principles are codified, this constitutes *passive* interpretation: the main benefit of

[909] Commission, COM(2006) 823 final.

[910] Commission, COM(2006) 824 final; Commission, COM(2006) 825 final; Commission, COM(2007) 785 final.

[911] Commission, 'Tackling Cross-Border Inheritance Tax Obstacles within the EU' (Communication) COM(2011) 864 final; Commission Recommendation 2011/856/EU of 15 December 2011 regarding relief for double taxation of inheritances [2011] OJ L336/81; Commission, 'Non-Discriminatory Inheritance Tax Systems: Principles Drawn from EU Case-Law' (Staff Working Paper) SEC(2011) 1488 final. For the commentary on the inheritance tax package see, eg, Bruno Peeters, 'Tackling Cross-Border Inheritance Tax Obstacles within the EU' (2012) 21 EC Tax Review 54; Inge JFA van Vijfeijken and Hedwig F van der Weerd-van Joolingen, 'Double Taxation of Inheritances and the Recommendations of the European Commission' (2012) 21 EC Tax Review 309.

[912] Commission, COM(2006) 823 final, section 2.2.

such acts is linking various legal sources and explaining the relations between them. *Active* interpretation goes further: the Commission clarifies the meaning of EU law, extrapolating the principles established by case law to similar situations, and making conclusions that were not obvious from the original source. Second, the Commission explored coordinated policy solutions where there was no option 'to implement the non-discrimination obligation coherently or in an optimal way by unilateral measures'.[913] The steering component may be either adopted by the Commission as an *autonomous* non-binding solution or *coordinated* with other EU institutions.

Part IV Section 4 examines the Commission's practice of tax coordination. Section 4.1 explains the benchmarks for evaluating the impact of non-binding instruments. The substantive analysis covers two case studies: the Communication on the Tax Treatment of Losses in Cross-border Situations, COM(2006)824, and the Communication on Exit Taxation, COM(2006)825, discussed in Sections 4.2 and 4.3 respectively. Section 4.4 proposes a normative framework for improving the procedural framework of tax coordination.

4.1. Research Design

The use of non-binding instruments in the field of direct taxation could be considered from two theoretical standpoints, both of which produce very different assessments regarding its effectiveness.

Under the first approach, soft law is accepted as 'a pragmatic second-best choice', used instead of hard law when the Commission fails to sustain the unanimous support of Member States for legislative proposals.[914] As discussed in Part II, the Court cannot fill the gaps left by EU legislators: it brings slow progress towards a homogeneous direct tax environment and

[913] ibid.

[914] See, for instance, Hans Gribnau, 'Improving the Legitimacy of Soft Law in EU Tax Law' (2007) 35 Intertax 30, 32.

can sometimes multiply disparities between national tax systems. The Commission's initiative to move to qualified majority voting in at least certain tax areas – which had been proposed during negotiations on the Constitutional Treaty – was not supported by Member States. This makes soft law one of the very few available regulatory alternatives able to 'achieve progress in removing tax obstacles and distortions to the Internal Market, which taxpayers have a right to expect.'[915]

The second approach considers soft law as a conscious regulatory choice. The arguments used in favour of non-binding instruments are different. The classic Community method may not be the only, or indeed, preferable solution for dealing with some regulatory tasks, especially in a sensitive policy area such as taxes. For those who advocate new governance approaches, 'traditional forms of command and control governance are viewed as exclusive, incapable of addressing societal complexity, static and unable to adapt well to changing circumstances, and limited in their production of the knowledge needed to solve problems.'[916] The flexibility and learning offered by soft law may be preferable to 'rigid and uniform rules'.[917] For instance, in relation to the soft form of the Code of Conduct for Business Taxation, Gribnau concludes that its 'non-binding nature (…) may be considered a strength rather than a weakness'.[918] Not only does due respect for the principles of subsidiarity and proportionality require the least intrusive instruments to be used where appropriate, but it also requires a policy rationale: in some cases, 'the gap between the aspired norm and existing reality is so large that hard regulatory provisions will be meaningless.'[919]

[915] Commission, COM(2001) 260 final, section 4.1.

[916] David M Trubek and others, '"Soft law", "Hard Law", and EU Integration' in Gráinne de Búrca and Joanne Scott (eds), *Law and New Governance in the EU and the US* (Hart Publishing 2006) 65, 76.

[917] ibid.

[918] Hans Gribnau, 'The Code of Conduct for Business Taxation: An Evaluation of an EU Soft-Law Instrument' in Dennis Weber (ed), *Traditional and Alternative Routes to European Tax Integration* (IBFD 2010) 67, 70.

[919] David M Trubek and others, '"Soft law", "Hard Law", and EU Integration' in Gráinne de Búrca and Joanne Scott (eds), *Law and New Governance in the EU and the US* (Hart Publishing 2006) 65, 78.

These two standpoints, which are often said to reflect rationalist v. constructivist approaches, define the evaluation of the outcome brought about by soft law instruments.[920] Under the 'second-best choice' argument the most valuable part of soft law is the one that makes it *similar* to hard law, while those who refer to soft law as a better regulatory choice would often find many valuable characteristics of soft law in what makes it *different* from hard law.

When soft law is considered as a *substitute* for hard law, its value is mainly measured by its similarities to hard law; and its lack of certain characteristics that are inherent to hard law such as obligation, enforceability and justifiability are automatically regarded as problems. For example, since compliance is an essential component of hard law, followers of the 'second-best choice' approach would assess the effectiveness of soft law according to the level of compliance. This approach does not have much to offer in the way of evaluating soft law as a regulatory tool with its own distinct features.

While the effectiveness of soft law as a 'second-best' alternative to hard law is doubtful, this tool 'may receive a more favourable evaluation in circumstances where there is a shift in the underlying theoretical framework from a rationalist/realist account, to a constructivist account'.[921] The choice of soft law as a more appropriate regulatory tool dictates other indications of success. Under the constructivist approach, 'soft law is presented and understood less as a tool for directly constraining behaviour than as a transformative tool capable of changing behaviour.'[922] The change of legislation, policies and practices, the mere identification of the gradual 'change-inducing process' would be sufficient.[923] The

[920] For an explanation of the rationalist v. constructivist arguments see, eg, David M Trubek and others, '"Soft law", "Hard Law", and EU Integration' in Gráinne de Búrca and Joanne Scott (eds), *Law and New Governance in the EU and the US* (Hart Publishing 2006) 65.

[921] Gráinne de Búrca and Joanne Scott, 'Introduction: New Governance, Law and Constitutionalism' in Gráinne de Búrca and Joanne Scott (eds), *Law and New Governance in the EU and the US* (Hart Publishing 2006) 1, 6.

[922] ibid.

[923] David M Trubek and others, '"Soft law", "Hard Law", and EU Integration' in Gráinne de Búrca and Joanne Scott (eds), *Law and New Governance in the EU and the US* (Hart Publishing 2006) 65, 81.

construction of indicators to measure the transformations that occur over time is challenging, since

> policy changes result from transformative processes such [*sic*] norm diffusion, social learning and persuasion, which are all time dependent and gradual. In this sense, it is understandable that the effects of soft forms of governance are not discernible in the short or even medium term because it takes a considerable amount of time for constitutive effects or a 'norms cascade' to take place.[924]

The assessment of soft law thus cannot be limited to compliance and requires a more complex approach to identify changes that occur over time. To keep this research within manageable borders, the evaluation of the tax coordination initiative will be limited to three specific aspects that can be assessed in a short-term perspective. First, the study discusses whether and to what extent the content of two selected communications – the Communication on Losses, COM(2006)824, and the Communication on Exit Taxation, COM(2006)825 – reflect their declared objectives (substantive legitimacy). Second, it draws attention to the inter-institutional coordination (if any) between the Commission and other EU institutions in the process of adoption (procedural legitimacy). Finally, the study asks whether requests by the Commission for legislative and policy changes have been followed by corresponding changes in Member States in the period between 2006 and 2012 (effectiveness). Later developments are also linked with an analysis of the coherence between the Commission's non-binding measures and its enforcement actions.

4.2. The Tax Treatment of Losses in Cross-Border Situations, COM(2006) 824 final

The tax treatment of losses in cross-border situations became one of the first targets addressed by the Commission under the 2006 tax coordination initiative. The Communication on Losses

[924] ibid.

acknowledged the obstacles that are faced by taxpayers due to the lack of coordination among national governments.[925] Two legal situations were considered by the Commission: Member States (i) were encouraged 'to introduce and maintain domestic tax systems for loss relief within a group of companies that offer treatment equivalent to that provided for loss relief within a single company' (group of companies); and (ii) were called to review their policy in all cases 'where Member States do not allow losses incurred by permanent establishments in other Member State to be taken into account' (single company).[926] The Communication proposed solutions that can be adopted in the short to medium term, since a strategic answer for the problem of losses was offered through the legislative proposal for a CCCTB.[927]

4.2.1. Interpretation of the Principles Flowing from Case Law

The first aim pursued through the Communication on Losses was to provide guidance on the application of principles that can be deduced from the case law of the Court. The decision of the Court in the *Marks & Spencer* case was a central judgment discussed in the Communication, and furthermore, one of the main causes for its adoption.[928] In the Opinion delivered on 19 July 2012, AG Kokott referred to this case as the synonym of 'chaos and despair' created by 'a single sentence of approximately 100 words'.[929] In the light of this evaluation, the intervention of the Commission, which should protect the proper application of EU law, was reasonable.

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[925] Communication, COM(2006) 824 final.

[926] Communication, COM(2006) 824 final, section 4.

[927] Commission, 'Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)' (Communication) COM(2011) 121 final. For an analysis see Eric CCM Kemmeren, 'CCCTB: Enhanced Speed Ahead for Improvement' (2011) 20 EC Tax Review 208 (political and academic support for the proposal); Luca Cerioni, 'Postponement of the Commission's Proposal for a CCCTB Directive: Possible Ways Forward' [2010] 2 Bulletin for International Taxation 98 (potential prospects); Wolfgang Schön, 'Group Taxation and the CCCTB' (2007) 48 Tax Notes International 1063 (substantive analysis).

[928] Case C-446/03 *Marks & Spencer* [2005] ECR I-10837.

[929] Case C-123/11 *A Oy* (pending), Opinion of AG Kokott, paras 1 and 2.

Following a brief introduction to the various group tax regimes used by Member States, the Commission discussed the *Marks & Spencer* judgment. Surprisingly enough, the 'lessons' of the case were narrowed to two basic statements. First, Member States have to provide for '*permanent* loss relief in the case of *terminal* losses'.[930] Second, the subsidiary should exhaust 'the *immediate* possibilities for loss relief available in its Member State of residence'.[931] This laconic summary is far from the explanation that could be expected from the Commission in the light of its declared objective to provide guidance to national governments, courts and taxpayers on the application of case law. In addition to the *Marks & Spencer* case,[932] the Commission briefly acknowledged two other related judgments that had been delivered by the Court before 2006, namely *Futura*[933] and *AMID*.[934]

Developments in this line of case law have been dynamic.[935] The Communication, however, was not brought up to date to accommodate clarifications provided by the Court. The case law that remains unmentioned includes the judgments on the tax treatment of losses attributed to PEs (*Deutsche Shell*,[936] *Lidl Belgium*[937] and *Krankenheim*[938]) and subsidiaries (*Oy AA*,[939] *Rewe Zentralfinanz eG*,[940] *Papillion*,[941] *X Holding*[942] and *Philips Electronics UK*[943]).

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[930] Commission, COM(2006)824 final, section 3.3.

[931] ibid.

[932] Case C-446/03 *Marks & Spencer* [2005] ECR I-10837.

[933] Case C-250/95 *Futura* [1997] ECR I-2471. The case concerned the state of residence: the legislation that makes the carrying forward of losses incurred by a non-resident taxpayer subject to the existence of an economic link between those losses and the income earned in that Member State is precluded by EU law.

[934] Case C-141/99 *AMID* [1999] ECR I-11619. The case concerned a home state: the national legislation limiting the possibility of deducting losses incurred in that Member State for companies that have a permanent establishment in another Member State was found to be in breach of EU law.

[935] See Dennis Weber and Bruno da Silva (eds), *From Marks & Spencer to X Holding: The Future of Cross-Border Group Taxation* (Kluwer law International 2011).

[936] Case C-293/06 *Deutsche Shell* [2008] ECR I-1129.

[937] Case C-414/06 *Lidl Belgium* [2008] ECR I-3601.

[938] Case C-157/07 *Krankenheim* [2008] ECR I-8061.

[939] Case C-231/05 *Oy AA* [2007] ECR I-6373.

[940] Case C-347/04 *Rewe Zentralfinanz eG* [2007] I-2647.

[941] Case C-418/07 *Papillion* [2008] ECR I-8947.

This raises the delicate problem of legal certainty. In Case C-39/10 *Commission v Estonia*, when the government was seeking to rely upon the recommendation of the Commission to justify its interpretation of EU law, the Commission argued that 'since the recommendation was adopted before the judgment in *Schumacker* was delivered, it has in fact lost its *raison d'être*'.[944] If this is so, the Communication should be read in the light of recent developments in case law, which completely eradicates its purpose of providing more certainty.

Since 2006 the notion of 'terminal losses' has been tested in several distinct circumstances. For instance, the Commission's guidelines say nothing about losses that cannot be used in a home state but which nevertheless do not qualify as 'terminal' in the *Marks & Spencer* meaning. This possibility was established in *Krankenheim* (2008), where the Court narrowed the definition by interpreting that the 'finality' of losses cannot derive from the restrictive 'carry-forward' provisions of a Member State where a permanent establishment is situated.[945] According to the interpretation provided by the Court, the disadvantages faced by the German company arose from a disparity of national tax rules and could not be considered as discriminatory treatment attributable to the tax provisions of one Member State.[946] In *Deutsche Shell* (2008), the notion of 'terminal losses' was broadened by including losses that by their objective nature cannot be taken into account in the Member State where that establishment is situated.[947] Although the *Marks & Spencer* case was not explicitly mentioned, the case was decided along the same lines.

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[942] Case C-337/08 *X Holding* [2010] ECR I-1215.

[943] Case C-18/11 *Philips Electronics UK* [2012] ECR I-0000.

[944] Case C-39/10 *Commission v Estonia* [2012] ECR I-0000, para 46.

[945] Case C-157/07 *Krankenheim* [2008] ECR I-8061.

[946] 'The freedom of establishment cannot be understood as meaning that a Member State is required to draw up its tax rules on the basis of those in another Member State in order to ensure, in all circumstances, taxation which removes any disparities arising from national tax rules, given that the decisions made by a company as to the establishment of commercial structures abroad may be to the company's advantage or not, according to circumstances.' See ibid, para 50.

[947] Case C-293/06 *Deutsche Shell* [2008] ECR I-1129. The Court ruled that 'a Member State which has waived its tax powers by concluding a double taxation convention such as that applicable in the main proceedings cannot

In its attempt to facilitate the application of case law, the Commission did not address some of the key questions that remained unanswered after the *Marks & Spencer* rulings.[948] One of these key questions is whether the principle of 'terminal losses' applies to all types of group tax regimes and to what extent other group regimes can be considered to be subject to the same minimal requirements.[949] The transfer of losses within a group of companies involves a parent company and its subsidiary, where the latter has its legal personality, in particular, for tax purposes. From an economic perspective, however, it constitutes a single economic unit with its parent company. The conflict between a legal form and economic substance is resolved through special rules on group taxation. Since there is no standardised model, Member States have adopted different group tax regimes. Under the first model ('fiscal unity', adopted by the Netherlands), separate legal persons are disregarded for tax purposes and thus under certain conditions a subsidiary can be treated as a PE for tax purposes. According to the second model ('tax consolidation', adopted by Austria, Denmark, France, Germany, Italy, Luxembourg, Poland, Portugal and Spain), the individual results of each enterprise are 'pooled' at the level of the parent company. The third model ('group contribution', adopted by Finland and Sweden) allows the transfer of profits; while the fourth model ('group relief', adopted by Cyprus, Ireland, Latvia, Malta and the United Kingdom) provides the possibility of transferring losses between group members. Finally, in other cases (in Belgium, Bulgaria, the Czech Republic, Estonia, Greece, Hungary, Romania, Slovakia and Slovenia), Member States disregard groups as such for tax purposes.

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rely on the lack of tax powers with respect to the results of a permanent establishment which belongs to a company established in the territory of that State in order to justify the refusal to deduct expenditure incurred by that company which, by its nature, cannot be taken into account in the Member State where that establishment is situated' (para 51).

[948] For the questions that were topical following the case see, eg, Michael Lang, 'The *Marks & Spencer* Case – The Open Issues Following the ECJ's Final Word' (2006) 46 European Taxation 54.

[949] The problem was acknowledged by the European Parliament. See European Parliament Resolution 2007/2144(INI) of 15 January 2008 on Tax Treatment of Losses in Cross-Border Situations, para 15. Also refer to Sjoerd Douma and Caroline Naumburg, '*Marks & Spencer*: Are National Tax Systems *Éclairé*?' (2006) 46 European Taxation 431.

In *Marks & Spencer*, the Court examined the United Kingdom's group relief. The Commission's Communication remains silent on the crucial question of the horizontal application of the principles that followed from the *Marks & Spencer* case. Subsequent cases, such as *Oy AA*[950] and *X Holding*,[951] which were decided by the Court after 2006, have similarly not provided a clear-cut answer. In the meantime, the Supreme Administrative Courts in Finland and Sweden have delivered contradictory judgments in relation to the applicability of the *Marks & Spencer* principle in the context of their national group regimes, despite the fact that both countries apply similar rules.[952] The Finnish Supreme Administrative Court considered the group contribution model to be different from the group tax relief applied in the United Kingdom, and therefore the *Marks & Spencer* principle was not applicable (2007).[953] The Swedish Supreme Administrative Court rejected the request for a preliminary reference and restrictively applied the *Marks & Spencer* principle, allowing deduction for contributions sent to foreign subsidiaries in liquidation, but not to foreign parent or sister companies facing final losses (2009).[954] The number of Member States where the application of the *Marks & Spencer* principle remains uncertain is still significant.

Another issue that remains largely unaddressed concerns the definition of 'terminal losses'. Even today, it remains unclear. The possibility for the coordination of Member States' responses through non-binding instruments has not been fully exploited. In the *Marks &*

[950] Case C-231/05 *Oy AA* [2007] ECR I-6373. The Court of Justice considered the compliance of the 'group contributions' scheme with EU law. It held that Finnish tax law, which permits the deduction of taxes related to financial transfers within the same group provided that the both companies in question are established in Finland, constitutes a restriction on the freedom of establishment. This restriction, however, is justified and proportionate. The Court did not address the question as to whether the *M&S* principle of 'terminal losses' should apply in the case of Finland.

[951] Case C-337/08 *X Holding* [2010] ECR I-1215. The Court interpreted that a Dutch rule disallowing a resident parent company to form a 'single tax entity' with its non-Dutch subsidiary (outbound cross-border situation) breaches the freedom of establishment. However, such treatment is justified by the need to ensure a balanced allocation of tax power and is proportionate. Again, this case does not make it clear whether the 'terminal losses' should be taken into account. For more see, eg, Servaas van Thiel and Marius Vascega, '*X Holding*: Why Ulysses Should Stop Listening to the Siren' [2010] 8 European Taxation 334.

[952] Bruno da Silva, 'From *Marks & Spencer* to *X Holding*: A (Critical) Overview and Some Open Questions' in Dennis Weber and Bruno da Silva (eds), *From Marks & Spencer to X Holding: The Future of Cross-Border Group Taxation* (Kluwer law International 2011) 1, 12-13.

[953] Case KHO 2007/3378 (92) of 31 December 2007. See ibid 12.

[954] Case *Gambro AB* of 11 March 2009. See ibid 13.

Spencer case the foreign subsidiaries were either dismissed or sold, and therefore the exact scope of this term was not explored by the Court. According to the Commission, a non-resident subsidiary should use 'any relief currently available' and, as soon as all possible options have been exhausted, it qualifies for cross-border loss relief. This broad interpretation is being relied upon by the Commission in its infringement case against the United Kingdom, as discussed earlier in Part III. In the Opinion delivered in Case C-18/11 *Philips Electronics UK* and Case C-123/11 *A Oy*, AG Kokott demonstrated a narrow reading of 'the *Marks & Spencer* exception' in the light of the change in the grounds of justification that were accepted by the Court in *X Holding*.[955]

Since neither the Court nor the Commission have yet provided clear guidance, the interpretation of 'terminal losses' differs between Member States. Some national legislators (and/or courts) limited the term to the event of liquidation, such as in Sweden, where time-related restrictions or mergers will not be accepted.[956] In Germany the transformation of a PE abroad into a corporate entity and the transfer of residence qualify as 'terminal losses' in addition to liquidation.[957] In Lithuania any tax losses of a non-resident entity that cannot be carried forward to another tax year can be taken into account.[958] In Latvia a taxpayer needs to demonstrate that there is no possibility to carry forward and to transfer the losses to another taxpayer in the same state.[959]

A similar situation can be found in relation to the decision as to which rules – those of the state of residence or those of the home state – should be used to define and calculate the losses. In its 1990 proposal, the Commission suggested that such calculations should be made according to the rules of the resident state, but this approach was sceptically received by

[955] See Case C-123/11 *A Oy* (pending), Opinion of AG Kokott, paras 47-54; Case C-18/11 *Philips Electronics UK* [2012] ECR I-0000, Opinion of AG Kokott, paras 40-42.

[956] Ola Van Boeijen-Ostaszewska and Marnix Schellekens (eds), *European Tax Handbook* (IBFD 2012) 843.

[957] ibid. For more on the 'finality' of losses in Germany see, eg, Axel Cordewener, 'Cross-Border Loss Relief and the "Effet Utile" of EU Law: Are We Losing It?' (2011) 20 EC Tax Review 58, 59-60.

[958] Ola Van Boeijen-Ostaszewska and Marnix Schellekens (eds), *European Tax Handbook* (IBFD 2012) 541.

[959] ibid 512.

Member States.[960] In the Communication, the Commission avoided raising this sensitive issue. The interpretation of Member States – once again – varies significantly.

Having briefly considered the Court's jurisprudence, the Commission moved into the domain of 'active interpretation' and drew conclusions that went beyond pre-2006 case law, suggesting that Member States using the exemption method without loss deduction should review this system, as it 'constitutes an obstacle to the freedom of establishment'.[961]

In order to explain this position, the Commission started with a brief introduction of the legal relationship between a parent company and its permanent establishment. In a domestic context, a parent company and its PEs form a single entity for tax purposes, so an account of losses is automatic. When a permanent establishment is located aboard, a double tax treaty between two Member States determines the allocation of taxing rights. The elimination of double taxation is reached through one of two methods accepted by international tax practice: credit or exemption. The Communication on Losses discussed three possible ways of dealing with the treatment of losses under these methods and evaluates their compatibility with EU law. The Commission positively evaluated the credit method, since the consequences of its application are similar to the treatment of losses in a domestic context. The exemption method has two basic forms. It is based either on an asymmetric approach, allowing the (temporary) deduction of losses and their subsequent recapture, or a symmetric approach, disregarding both profits and losses for tax purposes.[962] The former method was considered by the Commission to be consistent with EU law, while the latter was criticised as needing to be eliminated due to the requirements of the Internal Market.[963]

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[960] Commission, 'Proposal for a Council Directive concerning Arrangements for the Taking into Account by Enterprises of the Losses of their Permanent Establishments and Subsidiaries Situated in other Member States' COM(90) 595 final [1991] OJ C53/30.

[961] Commission, COM(2006) 824 final, section 2.3.

[962] For an overview of EU practices see, eg, Tigran Mkrtchyan, 'In Search of Ariadne's Thread: Permanent Establishments and Losses in the European Union' (2009) 63 Bulletin for International Taxation 586.

[963] Commission, COM(2006) 824 final, section 2.3.

The Commission did not discuss the applicability of the *Marks & Spencer* principle in the context of PEs.[964] The legal status of permanent establishments under company law implies that situations where losses can be considered 'terminal' differ from those applicable to subsidiaries. For instance, the disposal or the dissolution of a permanent establishment does not necessarily mean that losses become 'final', as a parent company would not be prevented from using the losses when it set up another permanent establishment.[965] The Commission, however, did not address these legal questions and instead focused on the aspect that was not interpreted by the Court. The credit method and the asymmetric exemption were considered to allow taking losses into account, so the *Marks & Spencer* principle would not apply. In cases where a Member State disregards both profits and losses, the Commission takes the view that EU law is infringed and thus calls for an amendment to the *system*, rather than pushing for the 'terminal losses' to be taken into account.

The Court's subsequent case law clarified this matter and displayed a less critical position. The *Lidl Belgium* case was lodged before the Court shortly after the Communication had been published.[966] However, the Commission's attempt to set the route for the Court's reasoning was unsuccessful. In the course of the proceedings, the Commission had submitted its observations to the Court, where – in line with the Communication – it argued that the regime that was enforced in Germany prior to 1999, which provided for the deduction of losses and their subsequent recapture, could better preserve the balance of taxing rights and the freedom of movement.[967] The Opinion of AG Sharpston accepted this argumentation and concluded that the tax regime in question was disproportionate; it put forward a policy, rather than a legal argument, that a deduction rule with subsequent recapture would be much less

[964] See, inter alia, the decision of the German Federal Tax Court from 9 June 2010 in Case *I R 100/09* and the decision of the German Federal Tax Court from 9 June 2010 in Case *I R 107/09.*

[965] Werner Haslehner, 'Cross-Border Loss Relief for Permanent Establishments under EC Law' (2010) 64 Bulletin for International Taxation 33, 42.

[966] Case C-414/06 *Lidl Belgium* [2008] ECR I-3601.

[967] ibid, para 45.

restrictive in its effect on the taxpayer's freedom of establishment.[968] The Court, however, did not uphold this solution. It accepted that the symmetric approach, which disallows taxpayers to offset losses incurred in a foreign permanent establishment, can be justified and is proportionate.[969] Admitting that the symmetric approach may discourage companies from establishing themselves abroad, as well as the fact that a double tax treaty itself cannot justify the infringement of fundamental freedoms, the Court accepted two justifications for the German rules: the balanced allocation of taxing power and the possibility of using losses twice.[970] The Court decided to remain consistent with its previous rulings and applied the concept of 'terminal losses' to PEs. Referring to the conditions for the deduction of foreign losses by a home state set in paragraph 55 of the judgment in *Marks & Spencer*, the Court found that they had not been fulfilled, so Germany was not obliged to deduct foreign losses.[971]

Accordingly, while the Commission had explicitly called Germany and other Member States that were applying the exemption method without the deduction of losses (i.e. Denmark, Greece, France, Luxembourg, Hungary, Poland, Bulgaria and Romania) to change their approach due to its infringement of the freedom of establishment, the Court took the view that 'for the purposes of the allocation of fiscal competence, it is not unreasonable for the Member States to draw guidance from international practice and, particularly, the model conventions drawn up by the OECD'.[972] The allocation of taxing rights seems to develop in response to the policy needs of each country and – contrary to the Commission's requests – towards a mixed approach.[973] Countries that have traditionally preferred the exemption method (e.g. Germany and France) are starting to introduce the credit method in relation to

[968] Case C-414/06 *Lidl Belgium* [2008] ECR I-3601, Opinion of AG Sharpston, para 25.

[969] Case C-414/06 *Lidl Belgium* [2008] ECR I-3601, paras 42 and 53.

[970] ibid, para 42.

[971] ibid, para 51.

[972] ibid, para 22.

[973] Wolfgang Schön, 'Taxing Multinationals in Europe' (2012) 11 Working Paper of the Max Planck Institute for Tax Law and Public Finance 2.

jurisdictions with low tax rates to ensure that a fair amount is paid, while the 'credit' countries (e.g. the United Kingdom) are gradually adopting the possibility of exemption to increase the competitiveness and attractiveness of their domestic tax regime.[974]

To sum up, any changes made by Member States in group tax regimes after the *Marks & Spencer* case can hardly be attributed to the tax coordination measure. This analysis demonstrates that the Commission's 'passive interpretation' lacks a comprehensive account of the Court's jurisprudence, while the 'active interpretation' does not address some of the questions that play a crucial role for EU-wide coordination. The Commission's simplified interpretation of case law has provided very little or no explanation for the application of this judgment; the Commission has also failed to keep its Communication up to date following several important judgments delivered by the Court since 2006. Furthermore, the 'active interpretation' of EU law in relation to the discriminatory nature of the symmetric approach to the exemption of foreign losses was not supported by the Court, which made some of the Commission's points contradictory to subsequent case law.

4.2.2. Offering Coordinated Policy Solutions

Pursuing a second regulatory goal to offer coordinated policy solutions, the Commission focused on two messages. First, it called Member States that have no group tax regime at a domestic level to consider the possibility of its introduction. Clearly, a favourable tax treatment of groups should be extended to cross-border situations with due regard for the principles provided in the Communication. This recommendation was hardly heard by its addressees. In 2006 a group taxation regime was not available in nine Member States, namely Belgium, the Czech Republic, Greece, Lithuania, Hungary, Slovakia, Bulgaria, Romania and

[974] ibid. For France see Axel Cordewener, 'Cross-Border Loss Relief and the "Effet Utile" of EU Law: Are We Losing It?' (2011) 20 EC Tax Review 58, footnote 11. For the UK, see, eg, HM Revenue & Customs, 'Taxation of Foreign Branches' <http://www.hmrc.gov.uk/budget2011/tiin6420.pdf> accessed 28 December 2012.

Estonia.[975] Six years later, only a minor change has occurred: Lithuania introduced a group tax regime, whereas Slovenia abolished it (see Table 7).

Table 7. The Availability of a Group Tax Regime in the EU (2006 and 2012)[976]

No group tax regime (2006)	No group tax regime (2012)
Belgium	Belgium
Bulgaria	Bulgaria
Czech Republic	Czech Republic
Estonia	Estonia
Greece	Greece
Hungary	Hungary
Romania	Romania
Slovakia	Slovakia
–	Slovenia
Lithuania	–

Second, the Commission discussed the future treatment of losses incurred by a group and urged Member States to adopt one (or more) of the policy solutions proposed in the Communication. The possibility of extending domestic group tax provisions to cross-border situations was rejected, since the automatic recapture of losses that constitute an inherent part of domestic regimes becomes more complex and requires 'an explicit mechanism for recapture' applicable in cross-border circumstances. Mentioning the CCCTB as a strategic solution, the Commission concluded that some 'intermediate' measures could be introduced unilaterally.[977]

[975] Commission, 'Technical Annexes' SEC(2006) 1690 accompanying 'Tax Treatment of Losses in Cross-Border Situations' (Communication) COM(2006) 824 final.

[976] Based on IBFD Tax Research Platform 'Country Surveys' <http://online.ibfd.org/kbase> accessed 30 November 2012.

[977] Commission, COM(2006) 824 final, section 3.3.

Three alternative policy choices for the treatment of future profits were considered. The first option provides for definite loss transfer without any recapture mechanism (an 'intra-group loss transfer'). This policy requires 'a clearing system' to be agreed between the Member States involved, and thus it depends on their willingness to establish cooperation. The second option is the most simple, and for this reason was favoured by the Commission. It provides for a temporary loss relief (the 'deduction/reintegration method'). The losses are taken into account and subsequently recaptured from the future profits of a subsidiary. This approach was already proposed by the Commission in the 1990 draft directive on losses.[978] The third and final option is to introduce a 'system of consolidated profits', which means that profits and losses of all members of the group are consolidated at the level of the parent company. Under this scheme, subsidiaries are in fact treated as permanent establishments. The elimination of double taxation is reached through the credit method. The Commission went so far as to consider whether this tax regime could be available on a selective basis (i.e. leaving discretion to the taxpayer in relation to which subsidiaries should form a single tax entity) or whether it should cover all subsidiaries. Since the former approach was considered vulnerable to tax avoidance, the Commission supported a comprehensive approach with the compulsory involvement of all subsidiaries (reflected in the concept of CCCTB). The costs of this scheme were mentioned as a major drawback, since it involves the recalculation of profits under the rules of the parent company.

As Table 7 demonstrates, temporary relief is only available in a limited number of Member States. Countries that either do not allow for temporary loss relief or have not introduced a group tax regime at the domestic level, have much more frequently expressed political disagreement with the strategic solution of the tax treatment of losses problem proposed by the Commission in the draft CCCTB Directive.

[978] See Commission, 'Proposal for a Council Directive concerning Arrangements for the Taking into Account by Enterprises of the Losses of their Permanent Establishments and Subsidiaries Situated in other Member States' COM(90) 595 final [1991] OJ C53/30, withdrawn in 2001.

Table 8. The Cross-Border Transfer of Losses and Future Profits *(as of November 2012)*[979]

Member State	Type of Group Regime	Temporary Relief	Final Losses	No Loss Relief	Against CCCTB[980]
Netherlands	Fiscal unity	-	-	X	Subsidiarity
Finland	Group contributions	-	-	X	-
Sweden	Group contributions	-	+	-	Subsidiarity
Cyprus	Group relief	-	-	X	-
Ireland	Group relief	-	+	-	-
Latvia	Group relief	-	+	-	-
Lithuania	Group relief	-	+	-	-
Malta	Group relief	-	-	X	Subsidiarity
United Kingdom	Group relief	-	+		-
Austria	Tax consolidation	+ (special regime)[981]	-	-	-
Denmark	Tax consolidation	+ (special regime)	-	-	-
France	Tax consolidation	+ (special regime)	-	-	-
Germany	Tax consolidation	-	+	-	Substance
Italy	Tax consolidation	+ (special regime)[982]	-	-	-

[979] Based on IBFD Tax Research Platform 'Country Surveys' <http://online.ibfd.org/kbase> accessed 30 November 2012. For a brief overview see Ola Van Boeijen-Ostaszewska and Marnix Schellekens (eds), *European Tax Handbook* (IBFD 2012): Netherlands (652), Finland (260), Sweden (843), Cyprus (181), Ireland (434), Latvia (512), Lithuania (541), Malta (597), the United Kingdom (951), Austria (71), Denmark (221), France (284), Germany (327), Italy (473-474), Luxembourg (563), Poland (694), Portugal (716), Spain (820), Belgium (127), Bulgaria (152), Czech Republic (199), Estonia (241), Greece (364), Hungary (396), Romania (742), Slovakia (786), Slovenia (802).

[980] Based on the reasoned opinions sent by the national parliaments in the framework of the early warning procedure. See IPEX Database <http://www.ipex.eu/IPEXL-WEB/dossier/document/COM20110121FIN.do#dossier-COM20110121> accessed 28 December 2012.

[981] 'Gruppenbesteuerung', introduced in 2005 in anticipation of the *M&S* ruling. See Axel Cordewener, 'Cross-Border Loss Relief and the "Effet Utile" of EU Law: Are We Losing It?' (2011) 20 EC Tax Review 58, footnote 10.

[982] 'Consolidato mondiale' introduced in 2004 in anticipation of the *M&S* ruling. See ibid.

Luxembourg	Tax consolidation	-	-	X	Substance
Poland	Tax consolidation	-	-	X	Subsidiarity
Portugal	Tax consolidation	-	-	X	Substance
Spain	Tax consolidation	+ (special regime)	-	-	-
Belgium	No group tax regime	-	-	-	Substance
Bulgaria	No group tax regime	-	-	-	Subsidiarity
Czech Republic	No group tax regime	-	-	-	-
Estonia	No group tax regime	-	-	-	-
Greece	No group tax regime	-	-	-	-
Hungary	No group tax regime	-	-	-	-
Romania	No group tax regime	-	-	-	Subsidiarity
Slovakia	No group tax regime	-	-	-	Subsidiarity
Slovenia	No group tax regime	-	-	-	-

By adopting these policy recommendations while refraining from answering several important questions related to the desirable coordination between Member States following the *Marks & Spencer* ruling, the Commission sent a clear message. It confirms that rather than having overlooked these crucial aspects of the interpretation, the Commission has a preference for an alternative policy. This conclusion is consistent with the findings reported in Part III showing that the Commission has demonstrated inertness in enforcing the application of the *Marks & Spencer* judgment.

In the course of the Court proceedings, the taxpayers and the Commission both argued that 'measures less restrictive than a general exclusion from group relief might be envisaged', for instance, through 'the possibility that group relief might be made conditional on the subsequent profits of the non-resident subsidiary being incorporated in the taxable profits of the company which benefited from group relief up to an amount equal to the losses previously set off.'[983] According to the Commission, the principle of 'terminal losses' established in the

[983] Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, para 54.

Marks & Spencer case is not the best of the available solutions. The Parliament[984] and academic commentators[985] also supported this conclusion. The Court agreed that 'it may be possible to identify other, less restrictive measures', but it confronted the Commission by saying that the introduction of such measures would go beyond the competence of the judiciary and 'require harmonisation rules adopted by the EU legislature.'[986]

Following this problematic interpretation given by the Court, the Commission has tried to re-establish the balance of interests through soft coordination and weak enforcement. Consequently, its Communication on Losses appealed for complex policy changes rather than the introduction of loss relief in the narrowly defined circumstances as interpreted by the Court in *Marks & Spencer*. But in doing so, the Commission failed to secure the support of Member States for the proposed coordination measures. The lack of political agreement on the tax treatment of losses in cross-border situations has resulted in the limited responsiveness of national decision-makers to the solutions unilaterally designed by the Commission. For instance, the UK government critically concluded that the Communication (i) provides little evidence in support of its claims; (ii) offers complicated solutions that lack a comprehensive analysis of technical and administrative practicalities, as well as risks; and (iii) does not convince the UK government of the need for action in the directions proposed by the Commission due to the impact on tax revenue and other potential complications.[987] This comment demonstrates the importance of the comprehensive impact assessment of all steering instruments, and of building consensus on the underlying norm, as discussed earlier in Part IV Section 3.

[984] European Parliament Resolution 2007/2144(INI) of 15 January 2008 on Tax Treatment of Losses in Cross-Border Situations, para 19.

[985] See, eg, Jonathan Schwarz, 'The Need and Scope for Coordination of Tax Policies in the European Union' (2007) 61:7 Bulletin for International Taxation 272, 274-275.

[986] Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, para 58.

[987] UK Parliament – House of Commons, '9th Report of the Select Committee on European Scrutiny: HMT (28173) (28174) (28175) Taxation' (2007), para 2.17.

The Commission relies heavily on the CCCTB proposal as a key long-term solution for making cross-border loss relief more widely available. It should not be forgotten, however, that this initiative cannot be considered to be a universal solution. Tax consolidation provided under the CCCTB will be available only to those multinationals that opt for this regime.[988] Considering the drawbacks that this choice may carry, even under the most optimistic scenario, the problem of the cross-border transfer of losses will remain on the agenda of many business entities. The political uncertainty that surrounds the adoption of the CCCTB Directive enhances the demand for a more efficient use of alternative regulatory approaches.

4.3. Exit Taxes, COM(2006) 825 final

The Communication on Exit Taxation, COM(2006) 825 final, was the second one published under the tax coordination initiative. Once again, the Commission demonstrated the lack of a comprehensive account of the Court's jurisprudence and took the interpretation into unsettled territory. Along with some parallels between the Communication on Losses and the Communication on Exit Taxation, in many aspects they differ: the goals set in the latter have been much more actively pursued through political means and enforcement actions.

4.3.1. Interpretation of the Principles Flowing from Case Law

In the Communication on Exit Taxation, the Commission aimed at helping Member States with the interpretation of EU law provided by the Court. It explained the legal principles that

[988] The European Parliament, however, proposed some changes in this respect. See European Parliament Legislative Resolution 2011/0058(CNS) of 19 April 2012 on the proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB).

followed from the *De Lasteyrie* and the *N* judgments,[989] and discussed the possible consequences for exit taxes imposed on individuals and companies.

The central problem with this Communication is that the Commission went beyond the limits of a 'passive interpretation' of case law and touched upon issues that were not decided by the Court until 2011. Pistone critically noted that tax coordination 'should not justify using soft law as a surrogate for the interpretation of the existing EU law by the CJ.'[990] Strictly speaking, the Commission's communications cannot possibly be a 'surrogate' for case law because they have no binding effect. The Court is not bound by opinions that have been expressed by the Commission and may adopt a different point of view. However, the disagreement in the interpretation of EU law, which is given by two authoritative institutions, raises the problem of legal certainty and makes the critical evaluation given by Pistone very appealing.

Both cases, *De Lasteyrie* and *N*, were introduced earlier in Part III Section 3.4.1. In these cases, the Court explained the limits imposed by EU law on exit taxes for individuals; the application of these principles in the context of companies was unclear. The key issue is similar: the emigration state loses its taxing rights over the taxpayer's income, but under the principle of territoriality it has a right to tax capital gains that have been accumulated on its territory. Since the legal person is a fiction created by law, it gives more complexity to the migration of companies. Member States apply two doctrines: an incorporation system and a real seat system.[991] Under the incorporation system, a company may transfer the place of effective management to another country. It keeps the legal 'existence' but becomes subject to tax in another jurisdiction, which normally triggers exit charges. Under a real seat system, the

[989] Case C-9/02 *De Lasteyrie* [2004] ECR I-2409; Case C-470/04 *N v Inspecteur* [2006] ECR I-7409.

[990] Pasquale Pistone, 'Soft Tax Law: Steering Legal Pluralism towards International Tax Coordination' in Dennis Weber (ed), *Traditional and Alternative Routes to European Tax Integration* (IBFD 2010) 97, 112.

[991] For an analysis of potential consequences see, eg, Christiana HJI Panayi, 'Exit Taxation as an Obstacle to Corporate Emigration from the Spectre of EU Tax Law' (2011) 13 Cambridge Yearbook of European Legal Studies 245, 262. The complexity of interaction between corporate law and tax law is discussed by Mitchell Kane and Edward B Rock, 'Corporate Taxation and International Charter Competition' (2008) 106 Michigan Law Review 1229.

company is liquidated and its tax liabilities have to be satisfied. In both cases the company pays taxes, but the legal framework differs. The rights of Member States to define the conditions for transfer have been interpreted by the Court in a number of cases, from *Daily Mail* (1998) to *Cartesio* (2008), fuelling intense debate on the subject of exit taxes.[992] Two EU instruments have partially addressed the problem. The *Societas Europaea* eliminates the problem of cross-border movement for a new type of corporate entity created under its framework.[993] The Merge Directive provides a harmonised solution in regard to cross-border company merge, but it does not resolve the problem of capital gains taxation on the transfer of assets that are not connected to a PE in the emigration state.[994]

Against this background, the Commission did not gain much political support from Member States for its opinion on the general application of the principles established in the *De Lasteyrie* and *N* cases. National governments have shown a lack of responsiveness to the legal position that was expressed in the Communication but not directly addressed by the Court until 2011. The United Kingdom, for instance, simply declared that in its view corporate exit charge legislation is compatible with EU law.[995] The Commission had to rely upon the infringement procedure to pursue its position.

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[992] Case C-81/87 *Daily Mail* [1998] ECR 5483; Case C-210/06 *Cartesio* [2008] ECR I-9641. See also Case C-212/97 *Centros* [1999] ECR I-1459; Case C-208/00 *Überseering* [2002] ECR I-9919; Case C-167/01 *Inspire Art* [2003] ECR I-10155. For commentaries refer to, eg, Wolfgang Schön, 'Tax Issues and Constraints on Reorganizations and Reincorporations in the European Union' (2004) 34 Tax Notes International 197; Christiana HJI Panayi, 'Corporate Mobility in the European Union and Exit Taxes' (2009) 63 Bulletin for International Taxation 459; Ana Paula Dourado and Pasquale Pistone, 'Looking Beyond *Cartesio*: Reconciliatory Interpretation as a Tool to Remove Tax Obstacles on the Exercise of the Primary Right of Establishment by Companies and Other Legal Entities' (2009) 37 Intertax 342.

[993] Council Directive 2003/72/EC of 22 July 2003 supplementing the Statute for a European Cooperative Society with regard to the involvement of employees [2003] OJ L207/25; Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE) [2003] OJ L207/1.

[994] For more, see Wolfgang Schön, 'Tax Issues and Constraints on Reorganizations and Reincorporations in the European Union' (2004) 34 Tax Notes International 197.

[995] House of Commons, 'Ninth Report of the Select Committee on European Scrutiny' (2007) <http://www.publications.parliament.uk/pa/cm200607/cmselect/cmeuleg/41ix/41ix04.htm> accessed 28 December 2012.

In 2011 the Court delivered its decision in *National Grid Indus BV*, which concerned exit taxes for companies and their compliance with EU law.[996] The Commission's position was only *partly* upheld. Without explicit reference, the Court agreed with the Commission on two principle issues.[997] First, a Member State should give the taxpayer the option either to settle tax liabilities at the time of transfer or to defer until such time as the gains become realised. Second, a Member State 'may establish the amount of income on which it wishes to preserve its tax jurisdiction'.[998] However, some importance nuances are hidden in the details. The Commission notes that the deferral should be 'truly voluntary and even-handed', with 'no further conditions attached'.[999] Although some 'reasonable obligations' may be imposed on taxpayers (e.g. declaration), it emphasises that such obligations should not 'go beyond what is necessary to achieve their objective and do not prevent taxpayers from exercising their Treaty rights.'[1000] Furthermore, a Member State 'may not coerce its taxpayers into opting for immediate payment of the tax by imposing an undue burden on them in case of deferral of collection until the actual disposal of the assets.'[1001]

According to the interpretation provided by the Court, the freedom of establishment does not preclude a Member State from: (i) charging interests on a deferred payment of the amount of tax in accordance with the applicable national legislation; (ii) imposing an administrative burden for the company in connection with tracing the transferred assets; and (iii) introducing additional conditions to eliminate the risk of the non-recovery of the tax, such

[996] Case C-371/10 *National Grid Indus BV* [2011] ECR I-0000. See the commentary given by Christiana HJI Panayi, 'National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam: Exit Taxes in the European Union Revisited' [2012] 1 British Tax Review 41; Harm van den Broek and Gerard Meussen, '*National Grid Indus* Case: Re-Thinking Exit Taxation' (2012) 52 European Taxation 190.

[997] The lack of explicit reference should not be equated with a lack of influence on the Court's jurisprudence. See, eg, Stijn Smismans, 'From Harmonization to Co-ordination? EU Law in the Lisbon Governance Architecture' (2011) 18 Journal of European Public Policy 504, 517-519.

[998] Commission, COM(2006) 825 final, section 3.1.

[999] ibid.

[1000] ibid.

[1001] ibid.

as the provision of a bank guarantee.[1002] Besides, the Court makes it clear that a Member State may fix the amount of tax on unrealised capital gains relating to a company's assets *without* taking account of decreases or increases in value that may subsequently occur.[1003] This latter issue was not mentioned in the Communication, but was argued by the Commission before the Court.[1004] Some Member States have already amended their national laws, providing the possibility of deferral, which is subject to the conditions allowed by the Court.[1005]

The analysis of case law in the Communication has not been updated to accommodate the judgments delivered by the Court after 2006.[1006] It raises the problems of the clarity and reliability of 'passive interpretation', which are similar to those discussed earlier in relation to the Communication on Losses.

4.3.2. Offering Coordinated Policy Solutions

Unlike the Communication on Losses, the Commission's initiative on exit taxation was followed by a Resolution adopted by the Council. This became 'the first concrete result of the initiative on direct tax coordination which the Commission launched in December 2006' and one of the first examples of coordinated soft law measures.[1007] Commentators agree that it shows 'a constructive dialogue between the two institutions on the tax obstacles', which makes exit taxes 'a domain to test the new soft law approach for implementing positive

[1002] Case C-371/10 *National Grid Indus* [2011] ECR I-0000, paras 73-74.

[1003] ibid, para 64.

[1004] ibid, para 53.

[1005] Several examples can be found in Otmar Thömmes and Alexander Linn, 'Deferment of Exit Taxes after National Grid Indus: Is the Requirement to Provide a Bank Guarantee and the Charge of Interest Proportionate?' (2012) 40 Intertax 485, 488-489.

[1006] Case C-371/10 *National Grid Indus* [2011] ECR I-0000; Case C-38/10 *Commission v Portugal* [2012] ECR I-0000.

[1007] DG TAXUD, 'Letter to EU Member States Representatives (E3/BZ)' <http://ec.europa.eu/taxation_customs/resources/documents/common/infringements/commission_policy/letter_to_ambassadors_en.pdf> accessed 28 December 2012.

integration of direct taxes within the Internal Market.'[1008] This Communication has been regarded by some scholars as 'a model case to explain the co-ordinated approach'.[1009]

This positive evaluation, however, should be balanced by some critical concerns. It is indeed true that the two documents – the Commission's Communication and the Council's Resolution – had no major contradictions and displayed the willingness of both institutions to resolve the problem. But at the same time, the Council predominantly focused on the avoidance of double taxation with respect to the cross-border transfer of assets, and left the crucial question of timing unanswered. This reaction was welcomed in some commentaries, which concluded that the Council rightly rejected the concept of interpretative instruments and '[got] back on to the right track' of political coordination.[1010]

As explained earlier, the Commission took the view that a taxpayer should be provided with the option to defer the collection of exit taxes until the moment of disposal, while Member States disregarded this important aspect. It could be deduced from the Resolution that the Council was of the opinion that the elimination of immediate charges was *not* required.[1011] DG TAXUD, which at that time had already opened a number of infringement proceedings concerning immediate charges, sent an official letter to Member States' representatives in order to explain 'the interaction between the various ongoing coordination

[1008] Pasquale Pistone, 'Council Resolution on the Coordination of Taxation in Case of the Transfer of an Economic Activity' [2009] 1 Highlights & Insights on European Taxation 84.

[1009] Adam Zalasiński and Franco Roccatagliata, 'A Community Action to Facilitate the Co-ordination Member States' Tax Systems. The Communication of the Commission "Coordinating Member States' Direct tax systems in the Internal Market": A New Step on the Strategy of Co-operation between the European Commission and the Member States' [2007] 1 International Tax Law Review 193, 199.

[1010] Pasquale Pistone, 'Council Resolution on the Coordination of Taxation in Case of the Transfer of an Economic Activity' [2009] 1 Highlights & Insights on European Taxation 84.

[1011] See, eg, Sjaak JJM Jansen, 'Freedom of Establishment and Transfer of Corporate Seats' in Sjaak JJM Jansen (ed), *Fiscal Sovereignty of the Member States in an Internal Market: Past and Future* (Wolters Kluwer Law & Business 2011) 99, 117; Henk PAM van Arendonk, 'Citizens and Taxation in the EU: Fifty Years after the Neumark Report' [2012] 3 EC Tax Review 144, 150-151; Reinout Kok, 'Exit Taxes for Companies in the European Union after National Grid Indus' (2012) 21 EC Tax Review 200, 201-202.

initiatives and the Commission's infringement action',[1012] or in other words, the lack of self-explanatory coherent actions.

In view of this questionable *coordination*, the Court was left in a difficult position. On the one hand, there was an official Opinion from the Commission that immediate exit taxation infringes EU law. On the other hand, Member States *unanimously* voted for the Resolution that remained silent on this important issue and thus could be interpreted as implicitly allowing it. The tensions between the Commission and Member States under the infringement procedure only confirm this analytical conclusion. As Part III has demonstrated, due to the large number of referrals to the Court, exit charges can be regarded as one of the most conflicting issues raised under Article 258 TFEU since 2005. The Court's decision in *National Grid Indus BV*, where the position of the Commission regarding the immediate charge was upheld but Member States were allowed to attach some conditions in case of deferral, could be seen as a gradual process of finding a balance.

The example of cooperation in the domain of the avoidance of double taxation, where the coordination of actions between the Commission and the Council took place, should be evaluated in more positive terms.[1013] It demonstrates how the measures designed by the Commission can get political approval from the Council, giving the notion of 'tax coordination' real meaning. In practical terms, however, the problem of double taxation has not been resolved.[1014] Progress towards a common regulatory goal remains slow, and this raises the question of the effectiveness of coordination that is not linked to any kind of progress review and/or benchmarking system.[1015]

[1012] DG TAXUD, 'Letter to EU Member States Representatives (E3/BZ)' <http://ec.europa.eu/taxation_customs/resources/documents/common/infringements/commission_policy/letter_to_ambassadors_en.pdf> accessed 28 December 2012.

[1013] See, eg, Pasquale Pistone, 'Council Resolution on the Coordination of Taxation in Case of the Transfer of an Economic Activity' [2009] 1 Highlights & Insights on European Taxation 84.

[1014] Réka Világi, 'Exit Taxes on Various Types of Corporate Reorganizations in Light of EU Law' (2012) 52 European Taxation 346, 354.

[1015] The importance of the evaluation of Member States' reactions to the Council Resolution in answer to the question about the potential of tax cooperation has been highlighted in Pasquale Pistone, 'Council Resolution on

4.4. Interim Conclusion

This section has discussed the 2006 tax coordination initiative that aimed at co-ordinating Member States' direct tax systems through *communications*, which were used to provide guidance to Member States on the principles developed through case law and to offer coordinated policy solutions where unilateral measures could not resolve the problem.[1016] Two case studies were selected for examination: the Communication on the Tax Treatment of Losses in Cross-Border Situations, COM(2006) 824 final, and the Communication on Exit Taxation, COM(2006) 825 final. These examples have demonstrated that the efficacy of tax coordination has been low and the Commission's regulatory goals have not been achieved.

The case studies have revealed some common problems related to the use of non-binding instruments. First, the Commission does not draw a clear dividing line between the codification of authoritative statements and non-binding opinions on the application of EU law. The communications discussed here included some elements taken directly from case law, unsettled legal issues and soft policy coordination elements. By doing so, the Commission's *active* interpretation statements may give a raise to 'illusory expectations of compliance with which no one is obliged to comply'.[1017] This critically undermines the principle of legal certainty and enhances public mistrust in EU institutions. The 'active interpretation' has resulted in examples of conflicting opinions expressed by the Commission and the Court, which undermine the authority of the Commission's communications as a reliable source of interpretation. In its *passive* interpretation of case law, the Commission has not ensured a comprehensive account of the Court's jurisprudence, ignoring the need for

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the Coordination of Taxation in Case of the Transfer of an Economic Activity' [2009] 1 Highlights & Insights on European Taxation 84.

[1016] Commission, COM(2006) 823 final, section 2.2.

[1017] Jerzy Sztucki, 'Reflections on International "Soft Law"' in Lars Ramberg and others (eds), *Festskrift till Lars Hjerner* (Norstedts 1990) 549 citing Ulrika Mörth, 'Soft Law and New Modes of EU Governance: A Democratic Problem?' Conference Paper (Darmstadt, November 2005) <http://www.mzes.uni-mannheim.de/projekte/typo3/site/fileadmin/research%20groups/6/Papers_Soft%20Mode/Moerth.pdf> accessed 28 December 2012, 7.

regular updates. Second, in its steering actions, the Commission has not put enough effort into securing the political support of Member States for the coordination of tax policies. The lack of agreement, follow-up enforcement measures and progress reviews has made the non-binding instruments much less effective than could have been expected.

This evaluation is broadly in line with concerns expressed by other studies, which find that 'the efficacy of this approach [of using interpretative and decisional instruments] for the achievement of fundamental tax harmonisation is, however, inevitably limited'.[1018] Should non-binding coordination thus be rejected as a regulatory tool? This conclusion can be supported only if soft law is considered as a substitute of hard law and its efficacy is measured through compliance. However, if the outcomes of legislative harmonisation and soft coordination are compared over time and account is taken of wider criteria than compliance, the results of the evaluation could be less negative for soft law.

Many years of negotiation between the Commission and Member States have resulted in a very limited scope of agreement: human and financial resources have been exploited with no definite legislative result. For instance, the first legislative proposal on the transfer of losses within the EU was drafted by the Commission in the 1980s. Reworked several times, the proposal finally became part of the CCCTB proposal, which may or may not be adopted. Considering this, the slow path of changes stimulated through tax coordination should not be rejected as an ineffective policy tool. Its application, however, must be based on a transparent and effective procedural model that can address the procedural and substantive problems that were raised in Sections 3 and 4.

[1018] See, eg, Charles E McLure, 'Legislative, Judicial, Soft Law, and Cooperative Approaches to Harmonizing Corporate Income Taxes in the US and the EU' (2007) 14 Columbia Journal of European Law 377, 411.

5. Towards the Proceduralisation of EU Tax Coordination

This study submits that the dual functionality of soft law, which combines executive and norm-setting elements, dictates two different procedural solutions for its adoption. This is primarily a rational conclusion based on observations from the two case studies considered earlier. Both communications illustrated the common regulatory error of combining two different types of institutional soft law in one instrument: an interpretative communication, which should facilitate the application of case law and be supported by enforcement actions, and a steering instrument, which should be coordinated with the Council to gain political acceptance and credibility. This conclusion is also supported by a constitutional argument about the institutional balance in the EU, which will be explained in the next section.

5.1. The Dual Functionality of Institutional Soft law

The Commission exercises legislative and executive competences, being an uneasy fit into Montesquieu's classical *trias politica*.[1019] At the most basic level, the functional triangle of powers can be read as follows:

> [T]he *legislative* power relates to the function of enacting rules with a general and abstractly defined scope of application (…); the *executive* power relates to the function of applying the said legislative rules to individual cases or specific categories of cases; finally, the *judicial* power relates to the function of settling litigation that arises on the occasion of the application of the legislative rules to individual cases or specific categories of cases.[1020]

[1019] Koen Lenaerts, 'Some Reflections on the Separation of Powers in the European Community' (1991) 28 Common Market Law Review 11. Under various constitutional models of the European Union, the status of this institution differs: the regulatory model considers the Commission as an independent expert body, the federal model regards the Commission as a federal government, and the intergovernmental model explains the Commission's role as that of an administrative secretariat to the Council. See Koen Lenaerts and Amaryllis Verhoeven, 'Institutional Balance as a Guarantee for Democracy in EU Governance' in Christian Joerges and Renaud Dehousse, *Good Governance in Europe's Integrated Market* (OUP 2002) 35, 51-55.

[1020] Koen Lenaerts, 'Some Reflections on the Separation of Powers in the European Community' (1991) 28 Common Market Law Review 11, 13 (citations omitted).

The most important element of this model in the context of EU governance is not in the separation of these competences, but in the maintenance of an effective system of checks and balances between different institutions.[1021] In the exercise of its executive competence the Commission enjoys wide autonomy, which is subject to control by the Parliament and the Court; this ensures that the Commission remains within the political and legal realm of its discretion. The legislative power is divided between three institutions: the Parliament and the Council, which adopt the proposal, and the Commission, which holds the right of legislative initiative.

The dual function of EU soft law reflects the Commission's role in the executive and legislative processes. The creation of institutional soft law may be considered under both competences: it can either reflect the executive power (interpretative and decisional acts with a 'post-law' function) or the lawmaking power (steering acts with a 'para-law' function).[1022] The criticism of soft law is strongly correlated with the borderline between the executive application of EU law, which is an *autonomous* function of the Commission, and the norm-setting, which is a continuation of *shared* legislative competence. The enhancement of the legitimacy of institutional soft law broadly coincides with this division: first, the Commission should respect the limits of its executive discretion, and second, it should coordinate its actions with the Parliament and the Council when soft law instruments are used to substitute legislative actions.

In the Staff Working Document on 'Instruments for a Modernised Single Market Policy' (2007), the Commission admitted the need to distinguish between these two types of

[1021] Stijn Smismans, 'Institutional Balance as Interest Representation: Some Reflections on Lenaerts and Verhoeven' in Christian Joerges and Renaud Dehousse (eds), *Good Governance in Europe's Integrated Market* (OUP 2002) 89, 94.

[1022] The 'post-law' and 'para-law' functions of soft law are explained by Senden. See the recent work: Linda Senden, 'Soft Post-Legislative Rulemaking: A Time for More Stringent Control' (2013) 19 European Law Review 57, in particular page 63 where Senden refers to the category of interpretative and decisional acts as reflecting the executive competence of the Commission and its role as guardian of the Treaties.

soft law.[1023] The interpretative instruments should aim at 'clarifying the law and ensuring that EU rules are properly applied on the ground without changing the EU acquis (technical guidelines, technical handbooks, interpretative communications)', whereas the steering instruments were defined as '[m]easures that contain normative elements, such as Recommendations'.[1024] Since the first group 'should have no new normative content', the problem with ensuring an institutional balance 'should, in principle, not come into play'.[1025] The Commission also acknowledged that '[i]n practice however, the dividing line between clarifying rules and facilitating their implementation may sometimes be difficult to draw – hence the potential for litigation.'[1026] The following sections develop these arguments, explaining how the difference between these two types of institutional soft law should be reflected at the procedural level to enhance their legitimacy and effectiveness.

5.2. Interpretative Instruments

The interpretative instruments aim at stimulating negative integration in a more coordinated way. An examination of the progress of the 2006 tax coordination measures towards this goal demonstrates that the positive impact of interpretative measures has been low. This criticism has its supporters in academic circles: analysing the input of soft law, Pistone concludes that 'its function of catalyzing negative integration has been, must, and will be extremely limited: an experience that should not be repeated in the future.'[1027]

[1023] Commission, 'Instruments for a Modernised Single Market Policy' (Staff Working Document) SEC(2007) 1518 final accompanying 'A Single Market for 21st Century Europe' (Communication) COM(2007) 724 final, section 2.3.

[1024] ibid.

[1025] ibid.

[1026] ibid.

[1027] Pasquale Pistone, 'Council Resolution on the Coordination of Taxation in Case of the Transfer of an Economic Activity' [2009] 1 Highlights & Insights on European Taxation 84.

The most critical comment in relation to the interpretative soft law measures examined in Part IV concerns the Commission's practice of extending the application of the principles that follow from case law to unsettled questions. This conclusion does not come as a surprise. Already in 2007 the Parliament strongly opposed the Commission going beyond 'the legitimate purpose of providing legal certainty' by 'extrapolat[ing] the case-law of the Court of Justice into uncharted territory', which was considered to be 'an inadmissible extension of law-making by soft law'.[1028] The analysis provided here has demonstrated that when the Commission acts in this way, EU citizens are at risk of being exposed to conflicting messages from EU institutions. In the light of these problems, Tenore concluded that soft law is ineffective 'as a standard for consistent interpretation', going so far as to say that 'the recourse by national courts to soft law instruments in the area of direct taxation should be excluded'.[1029]

However, instead of taking the position that the Commission should 'strictly abstain from making this [interpretative] use of soft-law instruments',[1030] this study argues that the Commission can and should exercise its competence more accurately. Interpretative communications have an important role to play in facilitating the better application of EU law, especially in the field of direct taxation, where the effect of judgments of the Court is often complicated.

In order to respond to the critical comments discussed here, the Commission should strictly observe the difference between 'passive' and 'active' types of interpretation. The 'passive interpretation' should remain within the realm of firm legal coverage, based on the Treaties, EU legislation and the case law of the Court, which could ensure its effective

[1028] European Parliament Resolution 2007/2028(INI) of 4 September 2007 on institutional and legal implications of the use of 'soft law' instruments, paras 5 and 10.

[1029] Mario Tenore, 'The Scope for "Consistent Interpretation" in the Area of Dividend Taxation' in Pasquale Pistone (ed), *Legal Remedies in European Tax Law* (IBFD 2009) 27, 44.

[1030] Pasquale Pistone, 'Soft Tax Law: Steering Legal Pluralism towards International Tax Coordination' in Dennis Weber (ed), *Traditional and Alternative Routes to European Tax Integration* (IBFD 2010) 97, 113.

application. This would make it similar to a non-binding codification, which is used in the United States (so-called 'restatements'):

> [T]he notion of a Restatement of the Law has traditionally signified a consolidation of the principles of [judge-made] law governing a given field with a view to bringing a measurably greater degree of clarity, consistency and simplicity to the law than would otherwise exist – without, however, any pretense that such a consolidation amounts in itself to positive law.[1031]

The 'active interpretation', which lacks the status of an authoritative source, must be visibly indicated and should be considered as a declaration of the Commission's position as the guardian of the Treaties. This guidance should be clearly detached from the principles established by the Court and EU legislators, and should be considered as an advance warning: a logical reflection of the Commission's role in ensuring the proper application of EU law. Through institutional soft law, the Commission could undertake a political commitment to employ the enforcement powers specified in Article 258 TFEU if its subjective interpretation of EU law were not followed. The status of this interpretation should be clearly acknowledged to avoid the conflict of judicial and executive competences that may otherwise occur; this would eliminate the impression of its being a 'replacement' for the Court, while allowing the Commission to fulfil the role of guardian attributed to it by the Treaties. This is the only legitimate purpose of 'active interpretation', which fully respects the boundaries of the Commission's competence. If kept in this form it increases rather than undermines the principles of legal certainty.

The integration of enforcement powers and tax coordination in the same regulatory field creates a default hybridity instrument that can substantially enhance the impact of soft law. As Kemmeren submits, '[b]oth hard-law and soft-law instruments, especially when applied in combination, can be very effective and efficient legal instruments to promote European tax

[1031] Jacques Ziller, *Alternatives in Drafting an EU Administrative Procedure Law* (European Parliament 2011) 17 (citation omitted).

integration.'[1032] Furthermore, this combination provides an effective answer to problems related to the use of enforcement mechanisms, which were identified in Part III. It could optimise the spending of human and financial resources, contribute to a more horizontal approach to infringement cases, reflect the principle of equal treatment, and bring more transparency and predictability. Support for this argument can be found in EU scholarship. Criticising 'the lack of a convincing policy of selective enforcement', Rawlings strongly argues the need to apply the soft law approach in the context of the general infringement procedure, which is widely used in state aid cases: 'open and flexible guidelines furnish the means to an appropriate balance of regulatory choice for the Commission, proper procedural protections, and more rational forms of decision-making'.[1033]

Exercising its 'executive' competence through the adoption of soft law measures with a *post*-law function, the Commission has wide decision-making autonomy but should respect the principles of good administration, in particular the accountability of actions. This could be secured through new forms of accountability, such as regular explanations and justifications of actions, performance measurements and peer reviews.[1034]

Non-binding instruments can be seen as desirable in three other areas. First, through institutional types of soft law instruments, the Commission could indicate foreseeable legal problems and recommend potential solutions in order to avoid conflicts between national tax provisions and EU law to be passed on to judicial institutions. Second, the Commission could help Member States to design novel legislative solutions if the Court established that a specific type of national tax provision infringed EU law. Finally, it could also address the

[1032] Eric CCM Kemmeren, 'Sources of EU Law for European Tax Integration: Well-Known and Alternative Legal Instruments' in Dennis Weber (ed), *Traditional and Alternative Routes to European Tax Integration* (IBFD 2010) 29, 49. See also the effects of combining hard and soft law in relation to state aid matters, eg, Michelle Cini, 'The Soft Law Approach: Commission Rule-Making in the EU's State Aid Regime' (2001) 8 Journal of European Public Policy 192.

[1033] Richard Rawlings, 'Engaged Elites Citizen Action and Institutional Attitudes in Commission Enforcement' (2000) 6 European Law Journal 4, 27.

[1034] William H Simon, 'New Governance Anxieties: A Deweyan Response' (2010) Wisconsin Law Review 727, 736. See also Linda Senden, 'Soft Post-Legislative Rulemaking: A Time for More Stringent Control' (2013) 19 European Law Review 57.

application issues that have been left for the consideration of national courts, contributing to a more homogeneous application of EU law in various Member States. All these objectives constitute a legitimate purpose for soft coordination. However, these goals should be pursued through *steering* instruments rather than *interpretative* ones. The category of steering instruments is less autonomous and presumes different standards of decision-making and accountability; the Commission should coordinate these actions with other EU institutions and Member States.

5.3. Steering Instruments

Unlike soft law with an interpretative function, the use of steering instruments is generally perceived in more favourable terms. As Pistone submits, the Commission 'should mainly use it [soft law] in its steering function, thus by envisaging possible future perspectives in the evolution of European law, which affect the internal market and thus require action either at the national level, through coordination, or at the EU level, by the issuing of secondary law.'[1035]

The major criticism in this respect concerns procedural matters, as by using non-binding instruments with a 'para-law' function the Commission may seek to overcome the lack of political will for legislative harmonisation and bypass competent legislative bodies. The solution can be found by making these instruments subject to minimal standards similar to those applied to the ordinary lawmaking process. They should satisfy the basic criteria of the democratic decision-making process and respect the institutional balance established between EU legislators by the Treaties. Similar accountability standards should also apply, involving an impact assessment that would justify the choice of regulatory instrument in each case, compulsory consultation with the Parliament, and finally, coordination with the Council. In

[1035] Pasquale Pistone, 'Soft Tax Law: Steering Legal Pluralism towards International Tax Coordination' in Dennis Weber (ed), *Traditional and Alternative Routes to European Tax Integration* (IBFD 2010) 97, 113.

Bothe's terms, 'if the non-legal norm is hailed because it circumvents the obstacles involved in the creation of a legal norm, one must not forget that a number of these obstacles, unpleasant as they may appear to a particular decision maker, have a justification of their own.'[1036]

The current tendency can be interpreted as gradually following this path and introducing comparable standards for legislative proposals and non-legislative instruments of this type. The Commission includes major legislative and non-legislative initiatives in its annual Working Programme; and an impact assessment is conducted for legislative proposals that have 'significant economic, social and environmental impacts' and for non-legislative initiatives that 'define future policies'.[1037] In those areas where the Parliament is usually involved in the legislative process, the Commission is committed to explaining the preference given to soft law and to taking the view of the Parliament into account. Nevertheless, the cooperation between the Commission and the Council, which is required as a part of the legislative process, is not guaranteed.

Although the change in the Commission's approach is clear, a more radical move from 'bilateralism' (EU institutions steering Member States to implement certain policies) towards 'multilateralism' (a more 'open' and interactive learning process)[1038] must be seen as unavoidable. Article 296(1) TFEU envisaged that '[w]here the Treaties do not specify the type of act to be adopted, the institutions shall select it on a case-by-case basis, in compliance with the applicable procedures and with the principle of proportionality'. Non-binding measures have become an inherent part of regulatory choices. Even if the Treaties do not envisage any specific procedural conditions for the adoption of non-binding measures, the principle of good governance requires it to deliver effective policies; the coordination of

[1036] Michael Bothe, 'Legal and Non-Legal Norms – a Meaningful Distinction in International Relations' [1980] Netherlands Yearbook of International Law 65, 93 citing Sandra Eden, 'Corporate Tax Harmonisation in the European Community' [2000] 6 British Tax Review 624, 651.

[1037] Commission, 'Impact Assessment Guidelines' (Guidelines) SEC(2009) 92 final, section 1.4.

[1038] Kenneth Armstrong and others, 'JCMS Symposium: EU Governance after Lisbon' (2008) 46 Journal of Common Market Studies 413, 414.

national policies cannot be effective without close cooperation with Member States.[1039] As shown in Part IV Section 3, the greatest potential for enhancing the impact of soft law lies with voluntary compliance and thus depends on achieving consensus among Member States. Soft law should be used as a tool for initiating discussion and reaching an agreement shared by the majority of governments. Another important function of participatory mechanisms is their ability to compensate for the lack of justiciability.

The Commission has approbated two models of such coordination. First, a communication adopted by the Commission can be subsequently approved by the Council, either as a general expression of political support or as a separate act articulating certain aspects of the Commission's initiative (*ex post* coordination). The Commission has used this approach with, for instance, the Code of Conduct for Business Taxation and the Code of Conduct for the Effective Implementation of the Arbitration Convention: both instruments were developed by the Commission in cooperation with national experts and then approved by the Council.

Second, the Commission can seek a mandate from the Council to develop a specific initiative (*ex ante* coordination). A new opportunity has recently emerged with the introduction of the European Semester. This post-crisis practice has demonstrated how autonomous soft law measures adopted by the Commission can be steered by Member States, thereby enhancing their level of political control over the Commission's actions. As mentioned earlier in Part IV, in 2011 and 2012 the Council adopted a set of recommendations for budgetary measures and economic reforms to enhance financial stability, and to stimulate growth and employment across the EU. These recommendations were developed for each Member State with due regard for country-specific problems and needs. Along with other aspects, these recommendations covered taxation. A logical development of this practice

[1039] Support for a better account of Member States' interests in soft law measures can be found in many academic commentaries. See, inter alia, Henk PAM van Arendonk, 'Citizens and Taxation in the EU: Fifty Years after the Neumark Report' (2012) 21 EC Tax Review 144, 147.

would be a closer integration of the Commission's recommendations made through steering communications and the country-specific recommendations adopted by the Council (but drafted and proposed by the Commission). Notwithstanding the difficulties of creating a general framework and then adopting it for each Member State, this model carries the important advantages of Member States' participation in the preparatory process, the political approval of the Council and regular peer-review mechanisms; in other words, it addresses many critical aspects identified in this study.

5.4. Interim Conclusion

The analysis provided here explains the potential normative significance of distinguishing two major types of institutional soft law adopted by the Commission. In providing an interpretation of case law, the Commission should observe the line between the interpretation of EU law, which is the prerogative of the Court, and its own guidance on the application of the principles flowing from case law. Any policy solutions proposed through the means of soft law require the Commission to seek prior political consensus with Member States and to conduct a comprehensive impact assessment. Most importantly, however, soft law must be consistently backed up by the Commission's enforcement actions and followed up in regular progress reports.

The difference between the 'post-law' and 'para-law' types of functions dictates that these two functions should not be combined in a single document: the 'interpretative' elements should reflect the dynamic pace of case law in the field of direct taxation, while the 'steering' elements have a more strategic and forward-looking nature. However, both elements may, of course, contribute to the same regulatory purpose. In this case, the solution can be found with the adoption of two separate but complementary acts: one that explains existent case law and the Commission's enforcement strategy with respect to it, and another

that proposes coordinated policy solutions for Member States. The most recent practice of tax coordination – the package on inheritance taxes (2011) and tax avoidance (2012) – has already moved towards this approach.

However, it is not enough for effective tax coordination to be well balanced in terms of form and substance. To inject it with a regulatory impetus, soft law measures must be better monitored and regularly reviewed. The Commission has increasingly emphasised the importance of a post-legislative review to provide a regular assessment of whether policy instruments produce the intended outcomes, and soft law measures should also be subject to such evaluation.[1040] Timely updates, especially when important case law developments take place, would also ensure a greater consistency of measures delivered by the various EU institutions.

6. Conclusion to Part IV

The Commission declares that, due to the differences in Member States' tax systems, legislative harmonisation in the field of direct taxation is in many cases 'neither necessary nor desirable'.[1041] However, tax coordination, which is proposed instead, carries its own challenges. The key problem is not the lack of competence to adopt non-binding acts, but in the way in which this competence is exercised by the Commission. Although it cannot be said that the Commission is operating in a legal vacuum, there are many procedural and substantive gaps that need to be filled. In order to make the best use of soft law, the Commission must tackle procedural ambiguity, ensuring that the application of this instrument is based on a transparent procedural model.

[1040] Graham Mather, 'Is Soft Law Taking Over?' (20 October 2010) European Policy Forum Working Paper, 12-13.

[1041] Commission, COM(2001) 260 final, section 2.4.

The use of communications has been particularly frequent since 2001, when the Commission announced that a non-binding approach could effectively supplement tax harmonisation.[1042] This practice has proved that tax coordination measures are challenging in their drafting and implementation. As Farmer notes, compared to positive harmonisation, 'coordination is equally difficult technically, and it is a common mistake to assume that coordination is less challenging politically.'[1043] This study proposes several steps that could enhance the effectiveness of tax coordination, based on the need for a clear separation between interpretative and steering instruments, and for distinct regulatory frameworks for both. Furthermore, this study submits that recent developments are moving current practices towards this model. These procedural developments are important for EU law in general, but they have particular appeal in the field of direct taxation. First, this model can increase the efficacy of non-binding instruments, which is important because of the political blockage in the legislative process. Second, it respects the general sensitivity of this policy area and enhances the protection of national fiscal sovereignty.

Persuasive coordination can be considered as a credible supplement to deregulatory litigation in the field of direct taxation. It can play an important role as an alternative route for tax integration by complementing case law, ensuring its more homogeneous interpretation across the EU and balancing the differences in national procedural rules that influence the taxpayer's possibility of seeking protection in Luxembourg. Furthermore, this is the only available alternative to clustering tax harmonisation within the EU through an enhanced cooperation procedure and international agreements. The enhanced cooperation procedure is widely thought to be a way of introducing an FTT and a CCCTB, while international agreements can take the form of double tax conventions or a less formalised political commitment (e.g. the recent initiative on the progress towards a common corporate income

[1042] Commission, COM(2001) 260 final, sections 4.3 and 5.

[1043] Paul Farmer, 'Tax Law and Policy in an Adolescent European Union' (2007) 61:2 Bulletin for International Taxation 42, 45.

tax regime, which was agreed by Germany and France).[1044] Such closer cooperation between *some* Member States should be balanced with non-binding instruments, which promote convergence over time, with no sanctions attached, and serve as mediators for legislative solutions as integration proceeds.

[1044] A Green Book on the harmonisation of corporation tax was published by the French and German Ministries of Finance on 6 February 2012.

PART V. Concluding Remarks

The regulatory tools and enforcement strategies of the EU have evolved over time, creating an innovative regulatory model that provides a challenging but enjoyable intellectual puzzle for legal scholarship. This study has offered an in-depth analysis on the history of EU direct tax harmonisation in the light of changes in regulatory approaches that have been relied upon by the Commission for the establishment and smooth functioning of the Internal Market. Although substantive conclusions have been provided following each Part of this study, several key messages are worth recalling:

1. The Shift in Regulatory Approaches to the Elimination of Fiscal Obstacles in the EU

The process of EU harmonisation in the field of direct taxation has been presented in five distinct stages. During the *first stage* (the 1960s to the mid-1980s) the Commission departed from the vision of far-reaching positive harmonisation in relation to direct taxes, and focused instead on priority legislative measures. During the *second stage* (the mid-1980s to 1992) these measures – in a revised and less intrusive form – were adopted as part of the systemic revision of the Internal Market. During the *third stage* (the 1990s) the Commission made limited progress in positive harmonisation and handed a leading role to the Court. The *fourth stage* in the integration process was initiated in 2001, when the Commission announced that all available policy tools, such as the infringement procedure, non-binding measures and the enhanced cooperation procedure, should be used for making progress in the field of direct taxation. Finally, during the *fifth stage* (post-2009), Member States established a closer

coordination of fiscal policies in the differentiated framework of the European Semester, and made steps towards the practical use of the enhanced cooperation procedure. These developments have signified an important change in the integration pattern, which has allowed this study to identify a decisive shift from maximum legislative harmonisation towards a differentiated model of European direct tax integration.

2. The Strengthening of the Commission's Role in the Field of Direct Taxation through the Proactive Use of the Infringement Procedure and Non-Binding Coordination after 2001

Post-2001 developments have become the focal point of this contribution. An analysis of the Commission's practices has demonstrated that its declaration of proactive involvement with alternative regulatory instruments for pursuing tax policy objectives, which was made in the Communication 'Tax Policy in the European Union – Priorities for the Years Ahead', has been closely followed.[1045] The implications of this strategy have been found to be of great importance, resulting in an evident reinforcement of the role played by the Commission.

Indeed, the dominance of negative harmonisation in the field of direct taxation that emerged in the 1990s has continued throughout the last decade. Yet, the Commission's participation in shaping the agenda of the Court has increased through its more frequent recourse to Article 258 TFEU. An even wider range of changes in direct tax provisions across the EU has been triggered at the pre-infringement and administrative stages: approximately 200 infringement cases have been reported by the Commission since 2005 as having reached the second stage of the infringement procedure and beyond. An analysis of these cases leads to the conclusion that the Commission has been particularly active in relation to the tax treatment of dividends, income taxes, the taxation of operations with real estate, inherence taxes and charities. The horizontal approach to the infringement procedure, employed by the

[1045] Commission, COM(2001) 260 final, sections 2.4 and 5.

Commission on several occasions, has effectively supplemented Article 267 TFEU in eliminating the fiscal obstacles in the Internal Market.

Non-binding measures pursuing interpretative and steering goals have been published more frequently. Initially, the Commission's practice was dominated by stand-alone recommendations and communications, such as those on the taxation of non-resident workers (1993), SMEs (1994), pensions (2001) and dividends received by individuals (2003).[1046] In 2006 the Commission adopted a more complex approach that involved the coordination of Member States' direct tax systems through communications published in selected areas of strategic importance, namely the tax treatment of losses, exit taxes and anti-avoidance provisions (2006–2007).[1047] In recent years tax coordination has taken a more sophisticated form. The Commission's packages on inheritance taxes (2011)[1048] and on tax evasion and avoidance (2012)[1049] demonstrate the strengthening of a non-binding approach through a periodical evaluation of Member States' responses. The choice of priority targets is currently coordinated with Member States through the European Semester. This annual governance cycle has also integrated a policy dialogue on the strategic direction of national fiscal reforms.

[1046] Commission Recommendation of 21 December 1993 on the taxation of certain items of income received by non-residents in a Member State other than that in which they are resident [1994] OJ L39/22; Commission Recommendation 94/390/EC of 25 May 1994 on taxation of small and medium-sized enterprises [1994] OJ L177/1; Commission Recommendation of 7 December 1994 on the transfer of small and medium-sized enterprises [1994] OJ L385/14; Commission, 'The Elimination of Tax Obstacles to the Cross-Border Provision of Occupational Pensions' (Communication) COM(2001) 214 final; Commission, 'Dividend Taxation of Individuals in the Internal Market' (Communication) COM(2003) 810 final.

[1047] Commission, COM(2006) 823 final; Commission, COM(2006) 824 final; Commission, COM(2006) 825 final; Commission, 'The Application of Anti-Abuse Measures in the Area of Direct Taxation – within the EU and in Relation to Third Countries' (Communication) COM(2007) 785 final.

[1048] Commission, 'Tackling Cross-Border Inheritance Tax Obstacles within the EU' (Communication) COM(2011) 864 final; Commission Recommendation 2011/856/EU of 15 December 2011 regarding relief for double taxation of inheritances [2011] OJ L336/81; Commission, 'Non-Discriminatory Inheritance Tax Systems: Principles Drawn from EU Case-Law' (Staff Working Paper) SEC(2011) 1488 final.

[1049] Commission, 'Concrete Ways to Reinforce the Fight against Tax Fraud and Tax Evasion including in Relation to Third Countries' (Communication) COM(2012) 351 final; Commission, 'An Action Plan to Strengthen the Fight against Tax Fraud and Tax Evasion' (Communication) COM(2012) 722 final; Commission Recommendation C(2012) 8805 final of 6 December 2012 regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters; Commission Recommendation C(2012) 8806 final of 6 December 2012 on aggressive tax planning.

3. Remaining Challenges for Regulatory Pluralism in the Internal Market

The field of direct taxation offers a micro-projection of wider regulatory tendencies in the EU. The effective use of the full range of legal and policymaking instruments available to the Commission was a central issue for the 1999 Single Market strategy and two subsequent generations of programme documents, covering the period between 1999 and 2009.[1050] The Mandelkern Report on Better Regulation and the Commission's White Paper on European Governance (2001) laid the basic priorities for a comprehensive strategy of better (smart) regulation in the EU.[1051] A number of steps were taken to ensure more effective policies, regulation and delivery, including those involving the widening of the selection of policy implementation options and the improvement of the application of EU law.[1052] Notwithstanding these positive developments, the Commission's practices in the field of direct taxation have demonstrated a wide range of problems, which have not yet been resolved.

In two recent communications – the Communication on Better Governance for the Single Market and the Communication on EU Regulatory Fitness (2012) – the Commission has defined the prospective direction of the better (smart) regulation strategy.[1053] The measures that aim at strengthening the enforcement mechanism are focused on the implementation of EU legislation and therefore have almost no relevance for fields that are

[1050] Communication, 'The Strategy for Europe's Internal Market' (Communication) COM(1999) 624 final; Commission, 'Internal Market Strategy – Priorities 2003–2006' (Communication) COM(2003) 238 final; Commission, 'A Single Market for 21st Century Europe' (Communication) COM(2007) 724 final.

[1051] Mandelkern Group, 'Report on Better Regulation' (13 November 2001) (Mandelkern Report); Commission, 'White Paper on European Governance' (Communication) COM(2001) 428.

[1052] See European Parliament, Council and Commission, 'Interinstitutional Agreement on Better Law-Making' [2003] OJ C321/1; Commission, Strategic Reviews of Better Regulation in the European Union (2006–2009); Commission, 'European Governance: Better Lawmaking' (Communication) COM(2002) 275 final; Commission, 'Smart Regulation in the European Union' COM(2010) 543 final; Commission, 'EU Regulatory Fitness' COM(2012) 746 final and the accompanying staff working documents: 'Review of the Commission Consultation Policy' SWD(2012) 422 final and 'Action Programme for Reducing Administrative Burdens in the EU' SWD(2012) 423 final.

[1053] Commission, 'Better Governance for the Single Market' (Communication) COM(2012) 259 final; Commission, 'EU Regulatory Fitness' COM(2012) 746 final.

non-harmonised, or do not belong to the selected areas with the highest 'growth potential'.[1054] Even more appealing is the lack of attention given to institutional soft law in the framework of the better (smart) regulation strategy.[1055] The Commission gives particular attention to the *choice* of appropriate regulatory instruments, which involves: (i) ensuring that the principles of subsidiarity and proportionality are respected;[1056] (ii) proposing the most effective policy option through the improvement of impact assessments, the consultation process and evaluation exercises;[1057] and finally, (iii) reviewing the existing instruments to decrease the regulatory burden.[1058] This strategy implies the full use of non-binding instruments, which have become an integral feature of the EU regulatory environment, but the Commission makes no attempt to address some problematic issues related to their adoption and effect.

Considering the importance of both instruments, the procedural and substantive problems discussed in this study require more attention. The rethinking of regulatory strategies used by the Commission should involve three key aspects: (i) the further proceduralisation of enforcement and coordination actions; (ii) the strengthening of accountability mechanisms; and (iii) the enhancing of the effectiveness of their application.

With regard to (i), it should be noted that the procedural regulation of the infringement procedure and non-binding instruments has been improved during the last decade, but requires a more comprehensive framework that would be built upon a consistent conceptual

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[1054] Namely services (including retail and wholesale trade, business services, and construction), financial (intermediation) services, transport, digital economy and energy. See Commission, 'Better Governance for the Single Market' (Communication) COM(2012) 259 final (see 'Annex').

[1055] The Commission's acknowledgement of non-binding instruments in the context of its better (smart) regulation strategy has been limited. With a few exceptions, the term 'soft law' has been narrowed to self-regulation practices and co-regulation mechanisms (see, eg, Commission, 'Better Regulation for Growth and Jobs in the European Union' (Communication) COM(2005) 97 final, section 1).

[1056] See Commission, Annual Reports on Better Lawmaking (2001–2006) and Annual Reports on Subsidiarity and Proportionality (2007–2011).

[1057] For the most recent developments, see Commission, 'EU Regulatory Fitness' COM(2012) 746 final and the accompanying staff working documents: 'Review of the Commission Consultation Policy' SWD(2012) 422 final and 'Action Programme for Reducing Administrative Burdens in the EU' SWD(2012) 423 final.

[1058] Involves a number of policy documents, starting with Commission, 'Codification of the Acquis Communautaire' (Communication) COM(2001) 645 final and Commission, 'Action Plan "Simplifying and Improving the Regulatory Environment"' (Communication) COM(2002) 278 final to the Commission's progress reports on the strategy for simplifying the regulatory environment (2006–2008).

basis (see Part III Section 3 and Part IV Section 3). Since many procedural questions can only be answered by eliminating the theoretical ambiguity that surrounds both instruments, this study has proposed two theoretical approaches. Referred to as 'the multilayered nature' of the infringement procedure (described in Part III Section 5) and 'the dual functionality' of institutional soft law (described in Part IV Section 5), these approaches seek to balance the interests of EU institutions and stakeholders, and can be used as a starting point for designing procedural solutions. Based on this theoretical foundation and the conclusions drawn from an analysis of the Commission's practices in the field of direct taxation, this study has proposed specific recommendations on procedural matters (Section 5 in Parts III and IV).

With regard to (ii), the weakness of accountability mechanisms in the context of the Commission's use of enforcement powers and coordination measures should be addressed. EU scholars find a 'lack of empirical data on the impact of infringement procedures', which raises the question as to 'whether in exercising this task it [the Commission] should be subject to more control than it currently is'.[1059] Similar appeals about the need for 'more stringent control' over the Commission's actions are expressed in relation to the use of soft law.[1060] These critical comments have been found to hold true in relation to the field of direct taxation. Following a comprehensive evaluation of the Commission's enforcement actions and coordination measures (detailed in Part III Section 4 and Part IV Section 4), this study has proposed changes in the reporting standards, evaluation and scrutiny of the Commission's actions.

Finally, with regard to (iii), the Commission should ensure the effective and coherent application of its various regulatory tools. Regulatory pluralism is an attractive concept, especially in areas where the Commission faces the obstruction of unanimous voting in the legislative process but still has to 'ensure the application of the Treaties' (Article 17(1) TEU)

[1059] Editorial Comments, 'A Revival of the Commission's Role as Guardian of the Treaties' (2012) 49 Common Market Law Review 1553, 1553 and 1562.

[1060] Linda Senden, 'Soft Post-Legislative Rulemaking: A Time for More Stringent Control' (2013) 19 European Law Review 57.

(see Part II Section 3). This approach, however, increases the complexity of the interaction between national legal systems and EU law, and also creates a more challenging managerial task for the Commission to ensure an effective combination of the strengths of each regulatory instrument. The synergy of directly applicable Treaty provisions, enforcement actions and non-binding coordination, which has been illustrated here with a case study on exit taxes, should be more fully exploited (see Part III Section 4.3 and Part IV Section 4.3). At the same time, inconsistencies between enforcement actions and coordination messages, which were found in relation to the tax treatment of losses, demonstrate potential regulatory risks (see Part III Section 4.3 and Part IV Section 4.2).

The priority directions for change identified in this study should be integrated into the Commission's strategic plans for the improvement of the regulatory environment in the EU. These plans should involve an extension of the better (smart) regulation strategy and the subsequent elaboration in policy-specific communications, which has so far proved to be an effective way for changing the Commission's regulatory practices. Certain aspects, however, would require a hard law framework.[1061] Most notably, as the Parliament proposed, Article 298 TFEU should be used to set minimum procedural standards for the infringement procedure. A closer cooperation between the Commission, the Parliament and the Council in the context of the adoption of soft steering instruments would require a special inter-institutional agreement.

4. The Scope for Future Research: the Differentiated Nature of Direct Tax Integration

By making the choice to pursue direct tax policy targets through the proactive use of alternative regulatory tools, the Commission has confirmed that the integration of direct tax

[1061] Cf Linda Senden, 'Soft Post-Legislative Rulemaking: A Time for More Stringent Control' (2013) 19 European Law Review 57, where Senden points to similar legal and policy solutions in a narrower context of soft post-legislative rulemaking.

systems could take on various forms and progress at different speeds across the EU. The conceptual framework of uniformity has been substituted by flexibility. Today, EU tax integration is not limited to a slow path of legislative harmonisation and persistent attempts of the Court to ensure the uniform interpretation of EU law. Progress towards the integration of Member States' direct tax systems is made through (i) the enforcement mechanism, where certain infringements are prioritised in substance and progress; (ii) non-binding recommendations that may (or may not) be taken into consideration by national authorities; and, potentially, (iii) the enhanced cooperation procedure, which creates additional 'Europes' for tax purposes. Future prospects will involve some countries, such as the United Kingdom, testing the possibility for even more flexible arrangements: an *à la carte* approach to EU integration.

Certainly, from having been dominated by negative integration for such a long time, this field has historically shown a limited range of homogeneous developments in national tax laws.[1062] Yet, the proactive use of alternative regulatory instruments has taken this heterogeneity to a more explicit and legitimate level. A flexible model of integration is widely accepted as a way of respecting national fiscal sovereignty, but it also raises some concerns. This study has looked into procedural and substantive problems related to the use of the infringement procedure and non-binding coordination in the field of direct taxation, asking two basic questions: How have these instruments been applied and how can they be made more efficient? A third logical question would be: Will this route take us to a Single Market? Future studies in this area should more carefully examine the potential short- and long-term implications of regulatory plurality and differentiated integration.

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[1062] Cécile Brokelind (ed), *Towards a Homogeneous EC Direct Tax Law: An Assessment of the Member States' Responses to the ECJ's Case Law* (IBFD 2007); Koen Lenaerts, '"United in Diversity" – also *In Fiscalibus*?' in Luc Hinnekens and Philippe Hinnekens (eds), *A Vision of Taxes within and outside European Borders: Festschrift in Honor of Prof. dr. Frans Vanistendael* (Kluwer Law International 2008) 617.

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Infringement Cases

I. Breach of EU Law in a Non-Harmonised Tax Area

1. Income Tax

1.1. Discriminatory taxation of non-resident taxpayers

1.1.1. Withholding taxes for non-residents on a gross basis

1.	1999/4852	Germany	IP/07/413 IP/08/144
2.	2004/4314	Spain	IP/05/933 IP/06/43
3.	2006/2375	Belgium	IP/08/337
4.	2007/2364	Portugal	IP/10/300
5.	2007/4129	Spain	IP/08/1533
6.	2007/4881	Bulgaria	IP/09/427
7.	2008/2115	Finland	IP/09/292
8.	2008/2163	The Czech Republic	IP/09/291

1.1.2. Restriction of certain types of deductions to resident taxpayers only

9.	2005/4910	Sweden	IP/07/1163
10.	2007/4228	Finland	IP/09/171
11.	2007/4380	The United Kingdom	IP/10/792
12.	2009/4216	Greece	IP/10/85

1.1.3. Limitation of tax benefits

13.	2007/4780	Belgium	IP/10/1403
14.	2008/4458	France	IP/10/1405
15.	2009/4335	Belgium	IP/12/408
16.	2009/4334	Belgium	IP/12/281
17.	2008/4334	Belgium	IP/12/176

1.2. Less favourable treatment of foreign source income

1.2.1. Restriction of personal deductions ('De Groot' follow-up)

18.	2003/4102	Finland	IP/05/945
19.	2005/2414	Austria	IP/07/414
20.	2005/4576	Belgium	IP/06/1048 IP/07/13

1.2.2. Discriminatory taxation of foreign lottery winnings

21.	2005/2426	Poland	IP/06/1360
22.	2005/2431	Spain	IP/07/1030
23.	2007/2138	Portugal	IP/08/1355 IP/09/567

1.2.3. Tax benefits provided to some domestic financial instruments

24.	2007/2061	Ireland	IP/08/1356
25.	2008/2053	Bulgaria	IP/09/289

1.3. Discriminatory treatment of expenses incurred abroad

26.	2000/5229	Germany	IP/05/946
27.	2005/5063	Belgium	IP/08/337
28.	2009/4083	Greece	IP/10/300

1.4. Discriminatory treatment of property income from abroad

29.	2007/4332	Belgium	IP/12/282

2. Pensions

2.1. Discrimination of non-resident taxpayers

30.	2003/2067	Germany	IP/06/32 IP/06/919
31.	2005/5115	Italy	IP/07/19
32.	2006/4221	Estonia	IP/08/1532 IP/09/1636
33.	2008/4640	Estonia	IP/08/1532 IP/09/1636

2.2. Discriminatory treatment of contributions to foreign pension funds

34.	2000/4538	Sweden	IP/07/20
35.	2002/2293	Spain	IP/07/19
36.	2005/2320	The United Kingdom	IP/08/1816
37.	2005/5060	Belgium	IP/10/300 IP/10/1559
38.	2009/2130	The Czech Republic	IP/10/1406
39.	2009/4025	The Netherlands	MEMO/12/876

3. Interests

3.1. Discriminatory taxation of inbound interests

40.	2005/4950	Ireland	IP/07/445
41.	2006/4084	Luxembourg	IP/07/1020
42.	2006/4696	Portugal	IP/08/339
43.	2006/4726	Belgium	IP/09/1017

			IP/10/513
44.	2007/2003	The United Kingdom	IP/07/445
45.	2007/4786	Belgium	IP/10/1563

3.2. Discriminatory taxation of outbound interests

46.	1999/4073	Portugal	IP/06/42
			IP/06/971
47.	2008/4386	Belgium	IP/10/1403
48.	2008/4335	Belgium	IP/12/61

4. Dividends

4.1. Discriminatory treatment of cross-border dividends: companies

49.	2004/4346	Austria	IP/07/1152
50.	2004/4347	Belgium	IP/06/1060
			IP/07/66
51.	2004/4349	Germany	IP/07/1152
			IP/09/435
52.	2004/4350	Italy	IP/06/1060
			IP/07/66
53.	2004/4351	Luxembourg	IP/08/712
			IP/06/1060
54.	2004/4352	The Netherlands	IP/06/1060
			IP/07/66
55.	2004/4353	Portugal	IP/06/1060
			IP/07/66
			IP/10/662
56.	2004/4354	Spain	IP/06/1060
			IP/07/66
57.	2005/4752	The Czech Republic	IP/08/143
58.	2005/4753	Latvia	IP/07/66
59.	2007/4443	Bulgaria	IP/08/712
60.	2007/4883	Bulgaria	IP/08/712

61.	2008/2048	Romania	IP/08/712

4.2. Discriminatory treatment of cross-border dividends: pension funds

62.	2006/4093	Poland	IP/07/616
			IP/09/780
			IP/11/720
63.	2006/4095	Lithuania	IP/07/616
			IP/08/334
			IP/09/1769
64.	2006/4102	The Czech Republic	IP/07/616
			IP/08/1022
65.	2006/4103	Denmark	IP/07/616
			IP/09/1018
66.	2006/4104	Portugal	IP/07/616
			IP/08/712
			IP/08/1817
67.	2006/4105	Slovenia	IP/07/616
68.	2006/4106	Spain	IP/07/616
			IP/08/712
			IP/08/1817
69.	2006/4107	Sweden	IP/07/616
			IP/10/1406
70.	2006/4108	The Netherlands	IP/07/616
71.	2006/4094	Italy	IP/07/1152
			IP/08/1022
72.	2006/4096	Finland	IP/07/1152
			IP/09/1018
			IP/10/513
73.	2006/4098	Germany	IP/08/143
			IP/09/1640
			IP/10/662
74.	2006/4101	Estonia	IP/08/143
75.	2006/4097	France	IP/10/300
			IP/11/603

4.3. Discriminatory taxation of cross-border dividends: investment companies and dividends on shares

76.	2008/4084	Belgium	IP/09/1452
77.	2007/4791	Belgium	IP/10/94
78.	2008/4156	Belgium	IP/10/91
79.	2008/4624	Belgium	IP/10/663 IP/11/422
80.	2008/4802	Belgium	MEMO/12/794
81.	2008/4439	France	IP/10/300 IP/11/603

4.4. Discriminatory treatment of cross-border dividends: individuals

82.	2005/4504	Belgium	IP/06/1045 IP/07/67
83.	2006/4044	Greece	IP/06/1410 IP/07/1019 IP/10/93
84.	2008/4155	Belgium	IP/10/663
85.	2007/2458	Latvia	IP/08/334

5. Research and Development

5.1. Tax credit (allowance) for research costs limited to activities carried out domestically

86.	2003/2245	Spain	IP/05/933
87.	2005/2427	Ireland	IP/07/408
88.	2007/2017	Hungary	IP/08/512

5.2. Deductibility of donations to research and educational institutions

89.	2007/2079	Austria	IP/09/428 IP/09/1637

6. Charities

6.1. Favourable taxation of domestic charities

90.	2008/4577	The Netherland	IP/10/1252

6.2. Tax relief for donation to domestic charities

91.	2001/4881	Belgium	IP/05/936
92.	2005/2281	The United Kingdom	IP/06/964
93.	2005/2301	The Netherland	IP/10/300
			IP/11/429
94.	2005/2410	Poland	IP/06/1408
95.	2005/2430	Ireland	IP/06/1408
96.	2005/5062	Belgium	IP/06/1879
97.	2006/5003	France	IP/09/1764
98.	2007/2103	Estonia	IP/08/1818
99.	2007/4203	France	IP/09/1764
100.	2007/4823	France	IP/09/1764
101.	2009/2335	Austria	MEMO/12/708

7. Inheritance and Gifts

7.1. Additional requirements for non-resident heirs or recipients

102.	2006/2431	Belgium	IP/11/425
103.	2008/4884	Luxembourg	IP/10/794

7.2. Lower tax rates for residents or assets domestically located

104.	2004/4090	Spain	IP/10/513
			IP/11/162
			IP/11/1278
105.	2008/2139	The Netherland	IP/10/1252

106.	2008/4566	Belgium	IP/10/1253
107.	2008/4749	Belgium	IP/10/1253
108.	2008/4777	Belgium	MEMO/12/794
109.	2009/4019	Belgium	IP/12/408
110.	2009/4592	Belgium	IP/11/607
111.	2008/4958	Belgium	IP/11/607

7.3. Inheritance tax relief (full or limited)

112.	2007/2433	The United Kingdom	IP/09/170
113.	2008/2244	The United Kingdom	IP/09/170
114.	2008/4534	Germany	IP/11/294
115.	2010/2111	The United Kingdom	MEMO/12/794

8. Company Taxation, including Groups and Branches

8.1. Limitation of group taxation and transfer of losses in cross-border situations

116.	1998/4684	Germany	IP/07/1547
117.	2007/4026	The United Kingdom	IP/08/1365 IP/09/1461 IP/12/1017
118.	2008/4909	Germany	IP/10/1253 IP/12/283
119.	2008/4616	The Netherlands	IP/11/719

8.2. Heavier taxation of non-resident entities

120.	2005/4153	Portugal	IP/07/18 IP/08/1353
121.	2006/2241	Greece	IP/07/14 IP/07/1018

9. Exit Taxation

9.1. Restrictive exit tax provisions for companies

122.	2007/2365	Portugal	IP/08/1813 IP/09/1460
123.	2007/2372	Sweden	IP/08/1362 IP/10/299
124.	2007/2382	Spain	IP/08/1813 IP/09/1460 IP/10/299 IP/10/1565
125.	2008/2157	Denmark	IP/10/299 IP/10/1565
126.	2008/2207	The Netherlands	IP/10/299 IP/10/1565
127.	2008/4250	Belgium	IP/10/299
128.	2009/2117	Ireland	IP/11/78
129.	2008/4923	The United Kingdom	IP/12/285

9.2. Restrictive exit tax provisions for individuals

130.	2007/2373	Spain	IP/08/1531 IP/09/431
131.	2007/2381	Portugal	IP/09/1635

10. Capital Gains

132.	2000/4854	Spain	IP/06/1407
133.	2007/2002	Denmark	IP/08/1021
134.	2008/4242	Belgium	IP/10/1253 IP/11/423
135.	2008/4249	Belgium	IP/11/421

136.	2008/4336	Germany	IP/11/1127 IP/12/1019

11. Real Estate

11.1. Tax benefits for operations with real estate domestically located

137.	2003/4314	Sweden	IP/05/943 IP/05/1621 IP/07/1162
138.	2006/4667	Germany	IP/08/146 IP/09/433
139.	2008/4809	Belgium	IP/11/427
140.	2009/4185	France	IP/11/160

11.2. Tax exemption conditioned by the residency requirement

141.	2005/5061	Belgium	IP/07/12
142.	2007/4319	Greece	IP/08/1364 IP/09/287
143.	2008/4445	Belgium	IP/11/159
144.	2009/4345	The United Kingdom	IP/11/295
145.	2008/4447	Belgium	IP/12/178

11.3. Beneficial tax treatment of the purchase of residential property after the sale of another house in the same Member State

146.	2002/5084	Portugal	IP/05/36
147.	2005/2283	Belgium	IP/06/1044 IP/07/11
148.	2007/4016	Hungary	IP/08/1020 IP/09/290

149.	2011/4001	Spain	MEMO/12/708

11.4. Income from real estate abroad

150.	2008/4851	Estonia	IP/11/718

12. Anti-Abuse Measures

151.	2003/4610	Germany	IP/07/1151
152.	2005/4290	Spain	IP/08/342
153.	2007/4435	Germany	IP/10/298
154.	2009/4105	The United Kingdom	IP/11/606
155.	2009/4130	The United Kingdom	IP/11/158 IP/12/1147
156.	2009/4131	The United Kingdom	IP/11/158 IP/12/1146

13. National Procedural Arrangements

13.1. Compulsory requirement for non-resident taxpayers to appoint a fiscal representative

157.	2006/5036	Portugal	IP/08/1024 IP/09/288
158.	2007/2446	Spain	IP/10/84 IP/10/1569
159.	2008/4418	Belgium	IP/10/300
160.	2008/4638	Austria	IP/09/782 IP/10/662

13.2. National procedural autonomy and retrospective abolition of remedies

161.	2009/4462	The United Kingdom	IP/10/1251 IP/12/64

13.3. Tax amnesty

162.	2005/4932	Portugal	IP/07/681

			IP/08/147
163.	2010/4150	Greece	IP/11/161

II. Breach of EU Law in a Harmonised Tax Area

14. Non-Communication

164.	2004/0204	Greece	IP/05/39
165.	2004/0214	France	IP/05/39
166.	2004/0226	Italy	IP/05/39
167.	2004/0248	Portugal	IP/05/39
168.	2004/0268	The United Kingdom	IP/05/348
169.	2004/0788	Greece	IP/05/941
170.	2005/0293	The Czech Republic	IP/05/941
171.	2005/0318	Greece	IP/05/941
172.	2005/0321	Greece	IP/05/941
173.	2005/0350	Ireland	IP/05/941
174.	2005/0358	Italy	IP/05/941
			IP/06/934
175.	2005/0361	Italy	IP/05/941
176.	2005/0372	Luxembourg	IP/05/941
			IP/06/934
177.	2005/0374	Luxembourg	IP/05/941
178.	2007/0220	Belgium	IP/08/132
179.	2009/2058	France	IP/10/1575
			IP/10/295
180.	2004/0067	Italy	IP/05/40
181.	2004/0080	Luxembourg	IP/05/40
182.	2004/0093	The Netherland	IP/05/40
183.	2004/0127	Portugal	IP/05/40
184.	2012/0106	Poland	MEMO/12/794
185.	2012/0116	Portugal	MEMO/12/794

15. Application of EU Directives

15.1. Savings Directive

186.	2007/2178	Luxembourg	IP/08/1815 IP/09/1013
187.	2009/4507	Greece	IP/10/1253

15.2. Parent–Subsidiary Directive

188.	2005/2275	Spain	IP/06/933
189.	2007/4333	Belgium	IP/09/1770
190.	2005/4047	Italy	IP/07/21
191.	2007/4629	The Netherland	IP/10/1252

15.3. Interests and Royalties Directive

192.	2006/4136	Italy	IP/07/17

15.4. Merger Directive

193.	2008/4083	Spain	IP/09/1019

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