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Cohesion of the national tax system

An analysis from a legal certainty perspective

Master's thesis within EC Direct Tax Law

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Titel:	**Skattesystemets inre sammanhang – En analys utifrån ett rättssäkerhetsperspektiv**
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Sammanfattning

Direkt beskattning är ett område som fortfarande inte har blivit helt harmoniserat inom den Europeiska Unionen. EG-domstolen har dock i sin praxis stadgat att även om direkt beskattning ligger inom medlemsstaternas eget kompetensområde, så får de inte utöva denna kompetens på ett sådant sätt att en inskränkning av EG-rätten sker. Samtidigt tillhandahåller EG fördraget vissa undantag i form av rättfärdigandegrunder som kan rättfärdiga en nationell lagstiftning som bryter mot EG fördraget. Dessa rättfärdigandegrunder är dock begränsade och generella, vilket leder till att de inte är lämpade för att rättfärdiga diskriminerande skatteregler. Därför har ”rule of reason” spelat en avgörande roll inom det direkta beskattningsområdet. ”Rule of reason” gjorde det möjligt att åberopa rättfärdigandegrunder som inte uttryckligen var berörda i EG fördraget. Uppkomsten av ”rule of reason” ledde till att medlemsstater åberopande många olika sorters rättfärdigandegrunder som just var anpassade till att rättfärdiga skatteregler och en av dem som har används flitigast är skattesystemets inre sammanhang.

Första gången skattesystemets inre sammanhang åberopades för att rättfärdiga en restriktiv skatteregel var i Bachmann fallet. EG-domstolen godkände då den belgiska lagstiftningen genom att poängtera att med hänsyn till skattesystemets inre sammanhang kunde en mindre restriktiv lagstiftning inte uppnås. EG-domstolen har sedan Bachmann fallet förhållit sig väldigt återhållsamt i förhållande till skattesystemets inre sammanhang och aldrig igen godkänt en nationell lagregel med åberopande av principen. Vad EG-domstolen istället har gjort är att utveckla betydelsen av skattesystemets inre sammanhang och även lagt till nya kriterier som måste vara uppfyllda för att medlemsstaterna med framgång skall kunna åberopa principen. Under denna utveckling har EG-domstolen varit väldigt oklar och inkonsekvent vilket lett till att den rättsäkerhet som skattebetalarna förväntas få inte har uppnåtts. Även i doktrinen har författare ifrågasatt giltigheten av skattesystemets inre sammanhang som en rättfärdigandegrund på grund av EG-domstolens motvillighet att återigen godkänna den i sin praxis. I anslutning till den nya rättspraxis som uppstått och som behandlar beskattning av gränsöverskridande utdelningar har röster gjort sig hörda och krävt att EG-domstolen skall en gång för alla klargöra innebörden av skattesystemets inre sammanhang. De menar att detta måste ske för att skattebetalarna skall få klarhet i hur EG-domstolen tillämpar principen och att EG-domstolen måste undanröja den rättsosäkerhet som finns på området. Som en konsekvens av detta är vårt syfte att analysera tillämpningen av skattesystemets inre sammanhang inom rättspraxis som behandlar gränsöverskridande utdelningar utifrån ett rättsäkerhets perspektiv. Analysen av rättspraxis rörande beskattning av gränsöverskridande utdelningar visar tydligt att EG-domstolen verkar ha lämnat tidigare

etablerade krav och uppkomsten av ett nytt tankesätt verkar dirigera utvecklingen mot att nya krav ställs upp och används.

Avslutningsvis har vi kommit fram till att EG-domstolens tillämpning av skattesystemets inre sammanhang har varit mycket inkonsekvent, vilket har lett till en betydande grad av rättsosäkerhet, som i sin tur försvårar framtida måls förutsebarhet. Därav anser vi att EG-domstolen bör förtydliga skattesystemets inre sammanhang som rättfärdigandegrund och sätta klara definitioner för tillämpningen. Detta med tanke på möjligheten som har uppstått i samband med de senaste rättsfallen rörande beskattningen av gränsöverskridande utdelningar.

Master's Thesis in EC Direct Tax Law

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Subject terms:	**EC direct tax law, cohesion justification, legal certainty**

Abstract

Direct taxation is an area which has not been harmonized entirely within the European Community. Nevertheless, the ECJ has in its case law stated that even though direct taxation falls within the competence of the Member States, they may not exercise that competence by breaching EC law. At the same time the EC Treaty provides certain exceptions in the form of justifications for national measures resulting in such breach of EC Law. The justification grounds provided by the EC Treaty are, however, limited and general and not suitable for justifying tax measures. That is why the rule of reason has played such an important role within the area of direct taxation. The rule of reason made it possible to invoke justification grounds that were not expressly mentioned in the EC Treaty. Since the list of justifying grounds, not provided by the EC Treaty, is open-ended, Member States have been invoking several different justifying grounds which were suitable for tax measures. One of those justification grounds which has been used the most is the preservation of the cohesion of the national tax system.

The first time the cohesion of a national tax system was brought forward as a justifying reason for a restrictive measure was in the Bachmann case. There the ECJ held that the Belgian legislation could be justified on the ground of the cohesion of the national tax system. However, the ECJ has been applying the cohesion justification very restrictively and never accepted it as a valid justification ground after the Bachmann case. What the ECJ has done in subsequent cases is to develop the meaning of the principle and adding new criteria which must be fulfilled in order for the cohesion justification to be successfully invoked. However, during this course the ECJ has been very unclear and inconsistent, harming legal certainty, which taxpayers are supposed to expect. Even in the doctrine, authors have been questioning the validity of the cohesion justification due to the ECJ's reluctance to accept it again. In connection with recent case law concerning cross-border dividend taxation, voices have been heard, demanding the ECJ to address the cohesion justification once more in order to set out clear boundaries for its application and to disperse the current legal uncertainty regarding the matter. As a consequence the aim of this paper is to analyze the application of the cohesion justification to cross-border dividend situations from a legal certainty perspective. As becomes clear from analyzing recent cross-border dividend cases, the ECJ seems to have departed from earlier established criteria and a new line of thought seems to direct the development towards the introduction and application of new criteria.

Conclusively, we have found that the application of the cohesion justification by the ECJ has been very inconsistent and that this inconsistency has led to a considerable degree of legal uncertainty, making it difficult to predict the outcomes of future cases. Therefore, we

conclude that the ECJ should take the opportunity, which has presented itself in recent cases concerning cross-border dividend taxation, to clarify the cohesion justification and set out clear definitions for how to apply it.

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Abbreviation List

EC	European Community
ECJ	European Court of Justice
EEA	Agreement on the European Economic Area
EFTA	European Free Trade Area
ESA	Establishment of a Surveillance Authority
ff.	Folios
Ibid.	Ibidem
i.e.	id est
OECD	Organisation for Economic Co-operation and Development
p.	Page
para.	Paragraph
paras.	Paragraphs
v.	Versus

1 Introduction

1.1 Background

For a long time the European Court of Justice (ECJ) has been applying the prohibitions of discrimination on grounds of nationality, as provided by the EC Treaty[1], very strictly. It has been limiting the scope of discrimination prohibitions strictly to the wording of the EC Treaty. However, from the 1990s the ECJ started to apply a restriction-based reading of the EC Treaty and the prohibitions provided by it, something unfamiliar in traditional income tax law.[2] By applying a wider interpretation of the EC Treaty, the ECJ started to put more emphasis on the aim of the European Community (EC).

At the same time as the ECJ began to see beyond the mere wording of the EC Treaty provisions prohibiting discrimination and started to deem national measures restrictive, it also started to see beyond the wording of the EC Treaty provisions providing the justifications for such restrictions. The ECJ clarified its rule of reason (as established in the Cassis de Dijon case[3]) in the Gebhard case[4], which meant that Member States could justify restrictive provisions on grounds not expressly mentioned in the EC Treaty.

When looking back at the ECJ's application of the rule of reason in the area of direct taxes, it becomes evident that the ECJ has chosen a very restrictive path. In over forty cases involving the rule of reason a national legislation has been justified only once[5], namely the Belgian legislation in the Bachmann case and in Commission v. Belgium[6] on the ground of cohesion of the national tax system.[7] After this justification ground was accepted by the ECJ, it started a wave throughout the European Community where Member States tried to invoke the cohesion of the national tax system in order to justify their EC incompatible tax rules. However, the ECJ has never again accepted this principle as a valid justification ground.

In the doctrine, authors have been questioning the validity of the cohesion justification due to the ECJ's reluctance to accept it again. In connection with recent case law concerning cross-border dividend taxation, voices have been heard demanding the ECJ to address the cohesion justification once more in order to set out clear boundaries for its application and to disperse the current legal uncertainty regarding the matter. The question is whether this discussion will be the end for the cohesion justification, as predicted by some, or whether it will lead to a more clear-cut definition of the principle, enhancing the legal certainty.

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[1] Treaty establishing the European Community, Rome 25 March 1957.

[2] *Hinnekens, Luc* EC Tax Review 2004/2, p. 65.

[3] Case 120/78 Rewe-Zentrale AG v. Bundesmonopolverwaltung für Branntwein [1979] ECR 649.

[4] Case C-55/94 Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori de Milano [1995] ECR I-04165.

[5] *Hinnekens, Luc* EC Tax Review 2004/2, p. 66.

[6] Case C-300/90 Commission v. Belgium [1992] ECR I-305.

[7] Case C-204/90 Hanns-Martin Bachmann v. Belgium [1992] ECR I-249.

1.2 Aim

The aim of this paper is to analyze the application of the cohesion justification to cross-border dividend situations from a legal certainty perspective.

1.3 Delimitation

Considering our aim, we choose to examine only the cohesion justification, leaving any other justification grounds outside the scope of this paper. In case other justifications are mentioned after all, it is done to a very limited extent in order to make a certain point. When analyzing the chosen cases, we do not leave much room to descriptions of the circumstances but try to limit ourselves only to the relevant facts which are needed for us to make our point.

1.4 Method and Materials

In this paper we investigate EC law as it stands today. We do that in the first place by using the EC Treaty. However, our references to the EC Treaty are limited because of the EC Treaty's characteristic as constituting only a frame for EC law, setting out merely the aims, as expressed in Articles 2-4 EC, to be achieved by the European Community.[8] It is then up to the institutions of the European Community, i.e. the Commission, the Parliament and the Council, to "fill the gaps" through secondary legislation, such as regulations, directives or decisions according to Article 249 EC.[9] Direct taxation within the European Community is only indirectly mentioned in Article 94 EC and harmonization by secondary legislation is very limited due, to a large extent, to the requirement for unanimity. [10]

Because of that lack of harmonization in the field of direct taxation, the ECJ has also been playing an important role in "filling the gaps" in the EC Treaty.[11] The main task of the ECJ is to make sure that in the interpretation of the EC Treaty and its provisions the law is observed.[12] The interpretation of the EC Treaty itself falls, according to Article 234 EC, within the jurisdiction of the ECJ. That has been done by applying the teleological method of interpretation which means that the purpose and aim of the EC Treaty is taken into consideration when interpreting it.[13] Regarding direct taxation, the ECJ has repeatedly stated that even though direct taxation falls within the competence of the Member States, they may not exercise that competence by breaching EC law, especially not by discriminating on grounds of nationality.[14]

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[8] See also *Steiner, Josephine and Woods, Lorna* Textbook on EC Law, p. 32.

[9] See also *Craig, Paul and de Burca, Gráinne* EU Law Text, Cases and Materials, p. 96ff.

[10] *Terra, Ben and Wattel, Peter* European Tax Law, p. 14.

[11] *Steiner, Josephine and Woods, Lorna* Textbook on EC Law, p. 26.

[12] Article 220 EC.

[13] *Craig, Paul and de Burca, Gráinne* EU Law Text, Cases and Materials, p. 98.

[14] See for example Case C-279/93 Finanzamt Köln-Altstadt v. Roland Schumacker [1995] ECR I-0225, paras. 21 and 26, Case C-80/94 Wielockx v. Inspecteur der directe belastingen [1995] ECR I-2493, para. 16 and Case C-107/94 P. H. Asscher v. Staatssecretaris van Financiën [1996] ECR I-3089, para. 36.

With regards to our aim, which is to analyze the cohesion justification it has to be noted that that justification ground is a part of the rule of reason[15], which is not derived directly from the EC Treaty but has been developed through the ECJ's judgments in its case law. That is the reason why we present the development of justification grounds. Therefore, when analyzing the development of the cohesion justification, we have to rely on the ECJ's case law since the cohesion justification is not expressly mentioned in the EC Treaty.[16] We do not examine every case where the cohesion justification has been invoked by the Member States. Instead, we prioritise the cases where the ECJ, in our view, has developed the cohesion justification and its application. Our method of selection has consisted mainly of examining every case where the cohesion justification has been invoked; to our help we have considered what different authors believe to be the most important cases.

In some of the cases we examine in this paper, the involved Member States have concluded double taxation agreements between each other, which also affect the cohesion of their tax systems one way or another. In those cases where the actual double taxation agreement is based on the OECD Model Tax Convention[17] we find it sufficient to refer merely to the OECD Model Tax Convention and the relevant articles therein. Therefore, the actual agreements between the involved Member States are not looked at.

We also make a reference to established case law by the EFTA Court.[18] Some words have to be said at this point about the EEA Agreement[19] and the EC Treaty and their relationship to each other. The EEA Agreement is based on the EC Treaty.[20] Particularly the provisions concerning the freedoms of movement are formulated as closely as possible to the wording of the EC Treaty.[21] According to Article 6 of the EEA Agreement, the provisions of the EEA Agreement have to be interpreted in the light of case law established by the ECJ. The wording of the article provides that it is only case law which has been established by the ECJ before the signing of the EEA Agreement that has to be followed. However, according to Article 3(2) of the ESA/EFTA Court Agreement[22] even future rulings by the ECJ have to be considered.[23] Also, the ECJ is to take the rulings of the EFTA Court into consideration when interpreting the EC Treaty.[24] Such mutual recognition of the different findings is needed in order to attain a uniform interpretation of EC law.

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[15] The first case where the rule of reason was established was Case 120/78 Cassis de Dijon.

[16] See chapter 2.

[17] OECD Model Convention on Income and Capital, as of 2003.

[18] See chapter 4.4.

[19] Agreement on the European Economic Area, Oporto 2nd May 1992.

[20] *Norberg, Sven and others* EG-rätten i EES, p. 181.

[21] *Ibid.,* p. 180.

[22] Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice.

[23] See also *Norberg, Sven and others* EG-rätten i EES, p. 192 and *Graver, Hans Petter* Arena Centre for European Studies WP 04/18, p. 15.

[24] *Brown, L. Neville and Kennedy, Tom* The Court of Justice of the European Communities, p. 253.

We refer to Advocate Generals and their opinions to the different cases since their opinions, although not binding, often provide an adequate indication of the reasoning that the ECJ may apply.[25] Further, we use the doctrine, such as literature and articles, in order to fortify our arguments and conclusions which we draw from the established case law. Also we try to illustrate different sides of our arguments by referring to authors of differing opinions.

1.5 Outline

In chapter two we show the development of justification grounds. We start by presenting the justification grounds provided by the EC Treaty. After that, we present the rule of reason and the development of it. In chapter three we make a thorough examination of the principle of cohesion of the national tax system and its application so far. We examine the cohesion justification from a legal certainty perspective. In the fourth chapter we concentrate on the aim of our paper. This chapter contains an analysis of cases concerning cross-border dividend taxation from a legal certainty perspective. This is accomplished by examining the cross-border dividend cases in the light of the principle of cohesion as analyzed in chapter three. In the final fifth chapter we sum up the conclusions we draw in the preceding chapters.

[25] *European Industrial Relations Observatory (EIRO)* ECJ Advocate-General issues opinions in on-call work and equal treatment cases, http://www.eiro.eurofound.eu.int/2003/05/feature/eu0305204f.html (08.05.2006)

2 The development of justifying grounds

2.1 Introduction

Considering our aim, we show in this chapter the development of possible justifications in general, from the justifications provided by the EC Treaty to the rule of reason, which the cohesion justification itself is a part of. Since the EC Treaty constitutes the primary legal source in EC law, it is natural to apply first and foremost the justification grounds provided in it. That is however not the case when it comes to cases concerning tax measures. That is why it is important to show the development of justifying grounds outside the scope of the EC Treaty.

2.2 Treaty-provided justifications of restrictions

All restrictions on the free movement of capital between Member States of the European Community are prohibited by Article 56 EC.[26] Being formulated that way, the provision goes further than just prohibiting discriminatory measures. Mere restrictions are prohibited, meaning that national measures, without making a distinction between nationalities or places of residence, yet still hindering the intra-Community movement of capital and payments and thus making it unattractive for individuals to exercise their basic freedoms, are incompatible with the EC Treaty.[27] However, the EC Treaty also provides exceptions. Article 58(1)(a) EC states that, even though a provision is restrictive in the sense of Article 56 EC, it will not be considered incompatible with the EC Treaty if it makes a distinction between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested. The general definition of discrimination has been formulated by the ECJ as meaning different treatment of similar or same situations or same treatment of different situations.[28] Article 58(1)(b) EC provides another exception, which gives the Member States the right to restrict the free movement of capital if it is necessary "…to prevent infringements of national law and regulations, in particular in the field of taxation…". According to the ECJ, Article 58(1)(b) EC includes measures which are needed in order to ensure effective fiscal supervision or to prevent illegal activities such as tax evasion.[29] Article 58(1)(b) EC also provides that restrictions to the free movement of capital according to Article 56 EC can be justified on grounds of public policy or public security, yet without precisely defining what such grounds could be.

Usher compares Article 58 EC with Article 30 EC, which regards the free movement of goods, since the formulation of the two articles is quite similar.[30] Both provisions fulfill the

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[26] Similar prohibitions concerning the other freedoms are to be found in Articles 28 and 29 EC (goods), Article 39 EC (workers), Article 43 EC (establishment) and Article 49 EC (services).

[27] See for example Case C-118/96 Safir v. Skattemyndigheten I Dalarnas län [1998] ECR I-1897, para. 23 and Case C-381/93 Commission v. France [1994] ECR I-5145, para. 17.

[28] See for example Case C-311/97 Royal Bank of Scotland plc v. Elliniko Dimosio [1999] ECR I-2651, para. 26.

[29] Case C-478/98 Commission v. Belgium [2000] ECR I-7587, para. 38. See also Joined Cases C-358/93 and C-416/93 Bordessa and others [1995] ECR I-361, paras. 21 and 22, and Joined Cases C-163/94, C-165/94 and C-250/94 Sanz de Lera and others [1995] ECR I-4821, para. 22.

[30] *Usher, John A* The Law of Money and Financial Services in the European Community, p. 27.

same purpose, namely permitting restrictions under certain circumstances while still prohibiting arbitrary discrimination and disguised restriction. Because of that similarity between the two provisions, guidance on the definition of public security and public health can be found in the ECJ's interpretation of Article 30 EC.

2.3 Rule of reason

2.3.1 Application to the free movement of goods

The rule of reason was introduced by the ECJ for the first time in the Cassis de Dijon case.[31] The case concerned the free movement of goods between France and Germany and the interpretation of Article 30 EC.[32] There, the ECJ held that obstacles to the free movement, caused by restrictive measures, may be justified if those measures constitute mandatory requirements in the public interest.[33] That statement by the ECJ is the essential meaning of the rule of reason. In the Cassis de Dijon case the German government opposed the import of an alcoholic beverage from France because it did not contain a minimum amount of alcohol.[34] The German government argued that the requirement for a minimum level of alcohol content was justified with regards to the public health. The argument was based on the assumption that a low alcohol content would induce a tolerance towards alcohol more easily than beverages containing higher amounts of alcohol. Nevertheless, the ECJ pointed out that consumers on the German market actually were able to obtain beverages ranging widely in their alcohol content, from considerably low to high.[35] Consequently, the ECJ found that such a requirement for a minimum alcohol content did not serve a purpose which is in the general interest.[36]

The rule of reason, as established in the Cassis de Dijon case, has been applied by the ECJ in later cases such as the Campus Oil case.[37] The case concerned the restriction put on imports of petroleum products by the Irish government.[38] The restriction manifested itself in a requirement by the Irish government that all importers of petroleum products had to buy a certain proportion of their need from a state owned refinery.[39] Firstly, the ECJ held in that case that purely economic matters do not fall within the scope of Article 30 EC and hence could not justify the restriction of a basic freedom provided by the EC Treaty.[40] Nevertheless, the ECJ pointed out that petroleum products constitute a fundamental im-

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[31] See chapter 1.1.

[32] Case 120/78 Cassis de Dijon, para. 1.

[33] *Ibid.,* paras. 8 and 14.

[34] *Ibid.,* para. 10.

[35] *Ibid.,* para. 11.

[36] *Ibid.,* para. 14.

[37] Case 72/83 Campus Oil v. Minister for Industry and Energy [1984] ECR-2424.

[38] *Ibid.,* para. 20.

[39] *Ibid.,* para. 3.

[40] *Ibid.,* para. 35.

portance for a country's existence.[41] Since the Irish government's motive behind its actions was to secure a long-term supply of oil,[42] the ECJ found that the consequences of eliminating barriers to intra-Community trade, namely the interruption in supplies of petroleum products, were more than of just an economic nature. They were seen as "…constituting an objective covered by the concept of public security."[43] The ECJ then actually held that in order for a restrictive measure to be permitted under Article 30 EC, it had to be justified by objective circumstances.[44]

Consequently, it can be concluded that even Article 58(3) requires a restrictive measure to be objectively justified in order not to be seen as arbitrarily discriminating and to be permitted.[45] That conclusion can be drawn considering the above mentioned opinion by Usher and the relationship between Articles 30 and 58 EC,[46] together with the ECJ's interpretation of Article 30 EC in the Campus Oil case.

2.3.2 Extension to other freedoms

Being applicable only to the free movement of goods, the ECJ defined the requirements for the application of the rule of reason and developed it considerably in the Gebhard case, which concerned the freedom of establishment.[47] In the case a German lawyer had moved to Italy where he opened his own chambers.[48] In his work he used the Italian title "avvocato",[49] which he was prohibited from by the Milan Bar Council.[50] The ECJ stated that any restrictive provisions must be applied in a non-discriminatory manner, they must be justified by imperative requirements in the general interest, they must be suitable for securing the attainment of the objective which they pursue and they must not go beyond what is necessary in order to attain it.[51] This statement by the ECJ is an extension of the finding in the Cassis de Dijon case, where the rule of reason was applied merely to the free movement of goods.

In the Gebhard case, the ECJ extended the rule of reason to be applied to all EC Treaty freedoms. For a long time, only reasons which were expressly mentioned in the EC Treaty, such as activities involving the exercise of official authority and grounds of public policy, public security or public health as laid down in Articles 39, 46 and 58(1)(b) EC, could be

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41 Case 72/83 Campus Oil v. Minister for Industry and Energy, para. 34.

42 *Ibid.,* para. 22.

43 *Ibid.*

44 *Ibid.,* para. 36.

45 See also *Craig, Paul and de Búrca, Gráinne* EU Law Text, Cases and Materials, p. 683.

46 See chapter 2.2.

47 Case C-55/94 Gebhard, para. 21.

48 *Ibid.,* para. 6.

49 *Ibid.,* para. 8.

50 *Ibid.,* para. 9.

51 *Ibid.,* para. 37.

relied upon as public interests, as the ECJ held in Commission v. Netherlands[52] for example. In Commission v. Netherlands, the ECJ found that restrictive measures could only be justified if they can be brought within the scope of an expressed exception, as is provided by Article 56 of the EC Treaty (now Article 46 EC).[53] A similar statement was made in Bond van Adverteerders v. Belgium.[54] In income tax cases it has been very difficult for Member States to refer to the traditional public interests as laid down in the EC Treaty since they are not suitable to cover tax measures that restrict free movement.[55] The reason for the traditional public interests not being suitable to be applied in tax cases is probably that economic factors such as taxes are not likely to affect public policy, public security and public health. That is why the rule of reason has played an important role when justifying restrictive tax measures.

2.3.3 Application to tax measures

When the ECJ introduced the rule of reason it also opened the possibility to invoke public interests not specifically mentioned in the EC Treaty, such as the effectiveness of fiscal supervision.[56] As opposed to the list of exceptions to discriminatory measures, which is expressed in the EC Treaty, the list of overriding public interests[57] is an open-ended one.[58] The fact that the list of justifying reasons under the rule of reason is open-ended led Member States, especially in income tax cases, to come up with all kinds of different reasons for justifying certain restrictive measures. Some of the justifications most commonly referred to by Member States are the cohesion of the national tax system, the effectiveness of fiscal supervision and the prevention of tax avoidance.[59] However, the ECJ has applied the rule of reason very strictly[60] and so far only one national legislation has been justified by the ECJ.[61] According to established case law, in order to justify a national measure by invoking

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[52] Case C-353/89 Commission v. Netherlands [1991] ECR I-4069.

[53] *Ibid.*, para. 15.

[54] Case C-352/85 Bond van Adverteerders v. Netherlands State [1988] ECR 2085, para. 32.

[55] *van Thiel, Servaas* Free movement of Persons and Income Tax Law: the European Court in search of principles, p. 543.

[56] Case 120/78 Cassis de Dijon, para. 8.

[57] For examples of such overriding public interests see Case C-288/89 Stichting Collectieve Antennevoorziening Gouda v. Commissariat voor de Media [1991] ECR I-4007.

[58] *van Thiel, Servaas* Free movement of Persons and Income Tax Law: the European Court in search of principles, p. 541.

[59] See for example Case C-204/90 Bachmann, para.17 concerning the cohesion of the national tax system, Case C-250/95 Futura Participations and Singer [1997] ECR I-2471, para. 33 concerning the effectiveness of fiscal supervision and Case C-264/96 Imperial Chemical Industries v. Colmer [1998] ECR I-4695, para.25 concerning the avoidance of tax evasion. See also *van Thiel, Servaas* Free movement of Persons and Income Tax Law: the European Court in search of principles, p. 546.

[60] *Hinnekens, Luc* EC Tax Review 2004/2, p. 66.

[61] See Case C-204/90 Bachmann.

a reason of public interest, which is not expressly mentioned in the EC Treaty, that provision may not be directly discriminative.[62]

The EC Treaty provides certain reasons of public interest which can be relied upon in order to justify a national measure.[63] Article 39 EC is expressly aimed at discriminative measures, whereas Articles 46 and 58(1)(b) EC are aimed at restrictions in general.[64] According to established case law, restrictions are at hand where national measures, without making a distinction between the nationalities or places of residence, hinder the intra Community movement of persons or goods and make it unattractive for individuals to exercise their basic freedoms.[65] Even though Article 39 EC is expressly aimed at discriminative measures, the ECJ has repeatedly stated that even restrictive measures can be prohibited by the provision on free movement of persons as laid down in article 39 EC.[66] Also, in the Avoir Fiscal case[67] the national measure at issue was considered to be indirectly discriminative and yet the ECJ investigated whether it could be justified under the rule of reason. On the other hand, the ECJ has held in the Royal Bank of Scotland case[68] that directly discriminatory measures cannot be justified under the rule of reason but only by reasons mentioned in the EC Treaty.

Weber argues that equally applicable measures, which are measures constituting merely restrictions to the basic freedoms,[69] can only be justified by the unwritten overriding reasons based on the general interest, such as the coherence of the tax system or the prevention of tax evasion.[70] By stating that, Weber seems to be excluding the public interests expressly mentioned in the EC Treaty as possible justifications for restrictive measures. Further, he means that discriminatory measures cannot be justified by unwritten reasons based on the general interest.[71]

We disagree with Weber on both points. First of all, we concur with the findings by the ECJ and argue that equally applicable measures should, at least in theory, be able to be justified even by the traditional public interests, notwithstanding the fact that such reasons are not applied easily to income tax cases. Regarding Weber's argument that discriminatory measures cannot be justified by unwritten reasons, we think that a distinction has to be

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[62] Case C-55/94 Gebhard, para. 37 and Case C-19/92 Dieter Kraus v. Land Baden-Wuerttemberg[1993] ECR I-1663, para. 32.

[63] See Articles 39, 46 and 58(1)(b) EC. See also chapter 2.2.

[64] See the wording of Articles 43 and 56 EC.

[65] Case C-118/96 Safir v. Skattemyndigheten I Dalarnas län, para. 23 and Case C-381/93 Commission v. France, para. 17.

[66] See for example Case C-415/93 Union royale belge des sociétés de football association and others v. Jean-Marc Bosman and others [1995] ECR I-4921, para. 96 and Case C-10/90 Maria Masgio v. Bundesknappschaft [1991] ECR I-1119, paras. 18-19.

[67] Case 270/83 Commission v. France [1986] ECR 273.

[68] Case C-311/97 Royal Bank of Scotland, para. 32.

[69] *Kapteyn, P.J.G. and VerLoren van Themaat, P.* Introduction to the Law of the European communities, p. 585.

[70] *Weber, Dennis* EC Tax Review 2003/4, p. 223.

[71] *Ibid.*

made between direct and indirect discrimination. Considering the ECJ's case law, it is clear that indirectly discriminatory measures should be justifiable under the rule of reason, at least in principle, whereas directly discriminative measures can only be justified by the treaty-provided reasons. Consequently, we believe that Weber is partly right; however, his argument would have been clearer if he had recognized the ECJ's different treatment of direct and indirect discrimination instead of addressing discrimination in general. This shows clearly that the rule of reason is applicable to tax measures; nevertheless, it is important to understand the difference between direct and indirect discrimination and how they relate to the rule of reason as a justification ground.

2.4 Concluding remarks

Any restrictions to the free movement within the European Community are prohibited by the EC Treaty. At the same time, the EC Treaty provides certain exceptions in the form of justifications for national measures resulting in such restrictions.[72] The justification grounds provided by the EC Treaty are however limited and general, covering mainly public policy and public health. Hence, the traditional justifications provided by the EC Treaty are not suitable to justify tax measures.[73] In the Cassis de Dijon case the ECJ developed the rule of reason, making it possible to invoke justification grounds which are not expressly provided by the EC Treaty.[74] Since the Cassis de Dijon case concerned the free movement of goods, the rule of reason was also just applicable to that freedom. In the Gebhard case the ECJ extended the rule of reason even to the remaining freedoms.[75] Since the list of justifying grounds not provided by the EC Treaty is open-ended, the Member States invoked several different justifying grounds which were suitable for tax measures. One of those justification grounds which have been used the most is the preservation of the cohesion of the national tax system.

[72] See chapter 2.2.

[73] See chapter 2.3.2.

[74] See chapter 2.3.1.

[75] See chapter 2.3.2.

3 The cohesion of the national tax system

3.1 Introduction

In order to achieve our aim, we present the development of the cohesion justification from a legal certainty perspective in cases, which do not concern cross-border dividend situations, because it is in those cases where the ECJ has established the application of the cohesion justification. It is important to show the ECJ's process, because the cohesion justification has been reviewed and modified several times during its application. In other words, one cannot understand the meaning of the cohesion justification just by examining one specific case, several cases have to be analyzed and put in their contexts in order to show how they relate to each other. It is also significant to note that the application of the cohesion justification is not limited to any of the basic freedoms provided by the EC Treaty. As we have shown, the rule of reason is applicable to all freedoms, which is the reason for us not limiting ourselves to merely one kind of cases.[76] A quick review of the case law in the field of direct taxation also reveals that this justification ground has been used extensively. It does not come as a surprise, because the first time the cohesion of a national tax system was put forward as a defence for a restrictive measure the ECJ accepted it as a valid justification.[77] That can be seen in contrast to other justification grounds, for example loss of tax revenue which has not been accepted by the ECJ even in principle or the risk of tax avoidance which, even though accepted in principle, never has been accepted as a valid justification ground by the ECJ.[78] However, the ECJ has never again accepted the cohesion justification in its case law following the Bachmann case[79]; instead, the ECJ has refined the application of the principle and limited its scope in subsequent cases.

The cohesion justification can be divided into three different parts. The different parts are the direct link criterion, the need to consider double taxation agreements and the need to consider the aim of the national legislation. Those parts can have different significations in different cases, depending on the circumstances. The cohesion justification has not been developed as one single principle; instead, the development has occurred within the different parts of the cohesion justification. That is the reason why we analyze the different parts separately, instead of analyzing the cohesion justification as a whole. Finally, in this chapter we also show the cohesion justification in another context, where we examine how the ECJ relates to the cohesion justification in conjunction with other justification grounds.

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[76] See chapter 2.3.2.

[77] Case C-204/90 Bachmann, para. 17.

[78] For the loss of tax revenue see cases like: Case C-264/96 ICI para. 28, Case C-324/00 Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt [2002] ECR I-11779, para. 36. For the risk of tax avoidance see cases like: Case C-9/02 Hughes de Lateyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie [2004] ECR I-2409 para. 51, Case C-28/95 Leur-Bloem v Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2 [1997] ECR I-4161 para. 44.

[79] The cohesion argument has also been accepted in Case C-300/90 Commission v. Belgium, however, when we refer to the Bachmann case as being the only case where the principle has been accepted, we mean both cases. The reason for that is the fact that in both cases the ECJ analyzed the same legislation concerning the same circumstances.

3.2 The development of the direct link criterion

3.2.1 The original meaning of the direct link criterion

The first time the cohesion of a national tax system was brought forward as a justifying reason for a restrictive measure was in the Bachmann case.[80] The said argument was basically founded on the assumption that a government had the right to tax an income if it allowed deductibility for the costs incurred for obtaining that income or it had the right to deny deductibility for such costs if the resulting income was exempted from taxation.[81]

In the Bachmann case, the ECJ recognized that there existed a direct link between the deductibility of contributions to an insurance company and the taxation of sums payable by the insurers.[82] The ECJ stated that when there is a direct link as in the case at hand, the Belgian government had the right to deny deduction of insurance contributions in order to preserve the cohesion of the Belgian tax system, if it was not able to tax sums payable by the insurers.[83] The ECJ reasoned that non-residents working in Belgium normally return to their state of origin after having worked in Belgium.[84] Because of that, and because Mr. Bachmann was a German national, he would receive his insurance payments in Germany where they also would be taxed. Accordingly, the Belgian government had the right to deny the said deductions to Mr. Bachmann. Conclusively, after stating that the Belgian measure was proportional with regards to its objective[85], the ECJ accepted the justification brought forward by the Belgian government.[86]

Worth mentioning at this stage is that Advocate General Mischo has drawn a different conclusion based on the facts of the case.[87] He recognized, as the ECJ did in the main proceedings, that there are imperative reasons relating to the public interest that may justify restrictive national legislation. He also concluded that in the case at hand there is a connection between the non-deduction of premiums and the non-taxation of the final insurance payout.[88] However, the Advocate General believed that the Belgian legislation was disproportionate to the objective it was meant to achieve.[89] In his opinion Advocate General Mischo never even examined whether the Belgian provision could somehow be justified by referring to the cohesion of the Belgian tax system, instead he was on the verge of justifying the legislation by the alleged risk of tax evasion.[90] This difference of opinion between

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[80] Case C-204/90 Bachmann, para. 17.

[81] *Ibid.*, para. 22.

[82] *Ibid.,* para. 21.

[83] *Ibid.*, para. 23.

[84] *Ibid.*, para. 11.

[85] *Ibid.*, para. 27.

[86] *Ibid.*, para. 28.

[87] Opinion of Advocate General Mischo in Case C-204/90 Bachmann, para. 17.

[88] *Ibid.*, para. 24.

[89] *Ibid.*, para. 28.

[90] *Ibid.*, para. 26.

the Advocate General and the ECJ shows that the interpretation of the circumstances in the Bachmann case seems to be false at some point.

Some authors believe that the ECJ seems to have based its judgment in the Bachmann case on the assumption that the tax to be paid on the insurance sums was supposed to be paid by the insurance companies, whereas it was in fact paid by the recipient of the insurance sums.[91] That seemingly insignificant detail is crucial however. The general application of the Belgian measure to all situations would indeed be proportional if the insurance companies were the ones paying the tax, as the ECJ seems to have supposed. Since it is the receiver of the insurance sums who pays the tax, a general application of the provision would not be proportional. Such a general application would suggest that all non-residents, paying insurance contributions in their home state, would return to that state when receiving their insurances. We do not agree with that. What is to say that a non-resident, paying contributions to a foreign insurance company, will not decide to stay in Belgium even when the time comes to collect the insurance? In such a case the taxpayer would be liable to pay tax in Belgium on the received payments while not having been allowed to deduct the contributions at an earlier stage. Perceived from that point of view, the Belgian provision in the Bachmann case should not have passed the proportionality test.[92] Even Farmer and Lyal stress that the Court accepted a low standard of justification compared to the severity of the restriction. [93]

The ECJ's decision in the Danner case[94] caused some discussion regarding the cohesion justification and the ECJ's interpretation of it. The reason for that is that the facts in the Danner case were very similar to the ones in the Bachmann case but here the ECJ reached a different conclusion. Because of the different conclusion under similar circumstances, the Danner case is an illustrative example of how the ECJ clarified the direct link criterion as it was applied in the Bachmann case. The case concerned the Finnish legislation on the deductibility of pension insurance contributions.[95] The Finnish legislation excluded deductions of contributions for voluntary pension insurance settled with foreign insurance companies, except in two cases.[96] Finland tried to invoke, amongst others, the need to ensure the cohesion of the Finnish tax system as a possible justification for the legislation at hand. The government meant that, just like in the Bachmann case, there "…was a direct link between the deductibility of contributions to voluntary pension insurance schemes and the liability to income tax of the pensions payable by insurers."[97] Finland also pointed out that it applied taxation at source, in other words it taxed even non-residents if they were paying contributions to Finnish insurance companies.[98] According to that argument the cohesion

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[91] *Knobbe-Keuk, Brigitte* EC Tax Review 1994/3, p. 80. See also *Kamphuis, H.J. and Pötgens, F.P.G.* Bulletin for International Fiscal Documentation January 1996, p. 4, *Hinnekens, L and Schelpe, D* EC Tax Review 1992/1, p. 60, *De Brabanter, Véronique* EC Tax Review 2003/3, p. 169, *Thömmes, Otmar* InterTax 1995/10, p. 535.

[92] *O'Grady, Eileen* Tax Notes International 2003/June, p. 1330.

[93] *Farmer, Paul and Lyal, Richard* EC Tax Law, p. 333.

[94] Case C-136/00 Rolf Dieter Danner v. Finish Government [2002] ECR I-8147.

[95] *Ibid.,* para. 3.

[96] *Ibid.,* para. 8.

[97] *Ibid.,* para. 33.

[98] *Ibid.,* para. 34.

of the Finnish tax system could not be upheld if deductions for contributions paid to foreign companies were allowed, because the insurance payments received by such companies would not be taxed in Finland. However the ECJ rejected that argument.[99] The ECJ repeated again that a direct link was necessary in order to justify a restrictive measure on ground of the cohesion argument, yet that there was none in the present case.[100] The difference between the two cases is that in the Bachmann case there was a direct connection between the deductibility of insurance contributions and the taxation of sums payable by the insurers.[101] Whenever contributions had been exempt from deduction, there was no taxation on the corresponding insurance payments. Under the Finnish legislation, on the other hand, all insurance payments to Finnish residents were taxed, notwithstanding where the contributions had been paid.[102] That means that a Finnish resident would have to pay tax on received insurance payments even if he had paid the contributions in Germany and thus had not been entitled to any deductions. It is obvious that such a system cannot be seen as being even similar to the Belgian one in the Bachmann case and therefore it is understandable why the ECJ reached a different verdict in the Danner case.

The ECJ's findings in the Asscher[103] and Lankhorst-Hohorst cases are further clarifications of what the ECJ meant by introducing the direct link criterion in the Bachmann case. The circumstances in the Asscher case concerned a Dutch national, Mr. Asscher, who worked but did not reside in the Netherlands.[104] The question arose regarding the taxing of his salary at a rate that was higher compared to taxpayers who were resident in the Netherlands. The rules laid down by the Dutch legislation stated that a non-resident taxpayer is treated as a resident in cases where he can show that all or almost all, that is to say 90 per cent, of his worldwide income is taxable in the Netherlands.[105] The condition can automatically be fulfilled if the taxpayer was subject to contributions under the national compulsory social insurance scheme. For such persons, the tax rate to be applied is 13 per cent. That could be compared to non-resident taxpayers who had to pay tax at the higher tax rate of 25 per cent.[106] The ECJ started by referring to its finding in the Bachmann case and confirmed the cohesion justification as a possible justification ground.[107] However, the ECJ did not find a direct link in the contested national legislation, which concerned the relation between a higher tax rate on income and the fact that no social security contributions were paid.[108] Basically, what the Dutch government argued was that the advantage a taxpayer enjoyed by not paying any social security contributions had to be offset by a higher tax rate on his income in order to preserve the cohesion of the Dutch tax system. The ECJ on the other

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[99] Case C-136/00 Danner, para. 37.

[100] *Ibid.*

[101] Case C-204/90 Bachmann, para. 21.

[102] Case C-136/00 Danner, para. 38.

[103] Case C-107/94 Asscher.

[104] *Ibid.,* para. 2.

[105] *Ibid.,* para. 6.

[106] *Ibid.,* para. 8.

[107] *Ibid.*, para. 56.

[108] *Ibid.*, para. 59.

hand replied that the application of a higher tax rate did not provide any social security protection.[109] The rationale is that when a taxpayer is paying social security contributions he actually gets something in return, namely the insurance. So, charging a higher tax rate instead of the contributions does not put the taxpayer in the same situation as if he had paid the contributions. It puts the government in the same situation, that is to say the government continues to charge money from the taxpayer, but the taxpayer ends up with no insurance while having to pay a substitute for the contributions. Accordingly, the direct link was not recognized and the justification attempt by the Dutch government was rejected.[110]

The Lankhorst-Hohorst case[111] concerned a corporation called Lankhorst-Hohorst, which had its seat in Germany and was a subsidiary of a company situated in the Netherlands. That company in return was owned by another company in the Netherlands.[112] This latter company gave a loan to Lankhorst-Hohorst, which was intended as a substitute for raising capital and for which interest was paid every year.[113] However, the German authorities considered the loan to be a disguised distribution of profits for which a tax rate of 30 per cent was to be applied.[114] The question now arose whether the German legislation was discriminatory because German companies were entitled to a tax credit for paid interests, unlike companies situated outside of Germany.[115] The German authorities invoked the cohesion of their tax system in order to justify the difference in treatment.[116] The ECJ referred to the Bachmann and the Commission v. Belgium cases by pointing out that in those cases a direct link was established since the taxpayer in question was one and the same person.[117] However, the ECJ held that in the Lankhorst-Hohorst case there did not exist a direct link in the sense of the Bachmann case because the German measure in question led only to a less favourable treatment of the taxpayer, without providing any advantage to offset such negative treatment.

Considering the judgments in the Asscher and the Lankhorst-Hohorst cases, it can be concluded that the notion of the cohesion justification entails a certain balance which has to be provided by the national legislation, if it is to be justified. The balance between tax advantages and disadvantages, which have to be set off against each other, must be at hand if a Member State is looking for a prospect to justify its legislation.

3.2.2 The limitation of the direct link criterion

Although the finding in the Bachmann case was clarified on some points in cases such as Asscher and Lankhorst-Hohorst, meaning that the direct link entailed a certain balance be-

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[109] Case C-107/94 Asscher, para. 60.

[110] *Ibid.*, para. 62.

[111] Case C-324/00 Lankhorst-Hohorst.

[112] *Ibid.*, para. 6.

[113] *Ibid.*, para. 6-7.

[114] *Ibid.*, para. 11.

[115] *Ibid.*, para. 14.

[116] *Ibid.*, para. 39.

[117] *Ibid.*, para. 42.

tween tax advantages and disadvantages, the ECJ continued to limit the scope of the direct link criterion. According to Karlqvist and Spirén, the ECJ's reasoning in the Lankhorst-Hohorst case can also be interpreted as meaning that the cohesion principle must entail one and the same taxpayer to be affected by the tax advantage and disadvantage in order to be successfully invoked.[118] We agree with the authors on that point. The ECJ actually pointed out that the taxpayer in the Bachmann case was one and the same person, which was decisive for the establishment of the direct link. Reading paragraph 42 of the Lankhorst-Hohorst case, however, we believe that the ECJ did not reject the direct link because the taxpayer was not one single entity. Instead, it seems as if the decisive factor for rejecting the direct link was the lack of balance between advantages and disadvantages. Even though the requirement for one single taxpayer was not crucial in the Lankhorst-Hohorst case, it was significant in other cases. One such case is the ICI case.[119]

The case concerned the United Kingdom tax authorities' refusal to grant Imperal Chemical Industries plc (ICI) a tax relief in respect of trading losses incurred by a subsidiary of the holding company owned by ICI through a consortium.[120] ICI, together with another company, both of which have their residence in the UK, held shares in a third company whose only purpose was to function as a holding company.[121] The holding company in return held shares in 23 different companies around the world, of which four were resident in the UK.[122] The UK tax authority refused ICI the tax relief on grounds that the holding company did not constitute a holding company within the meaning of the British law.[123] In the case the ECJ confirmed the possibility of justifying a restrictive measure by referring to the cohesion argument, yet it found that there was no direct link at hand which was decisive in the Bachmann case.[124] The direct link was not established since the question under scrutiny concerned the relation between reliefs granted to a resident company and the taxation of profits made by non-resident companies. This finding by the ECJ seems to have been the first time the ECJ actually introduced the criterion that the tax in question had to concern only one single taxpayer in order for the direct link to be established. The clarity of the ECJ can be questioned at this point. The ECJ did not expressly formulate the requirement; instead, it just held that the relation between a resident company and a non-resident company did not entail a direct link.

Also, Ton Daniels has criticised the ECJ for its unclear statement in the ICI case.[125] He holds that the vague statement by the ECJ on the cohesion justification created a lot of uncertainty for other Member States treating non-resident companies in a similar way as the UK. Presumably, he meant that the ECJ should have made clear if resident and non-

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[118] *Karlqvist, Anette and Spirén, Henrik* Iur Information 8-2004, p. 6.

[119] Case C-264/96 ICI.

[120] *Ibid.,* para. 2.

[121] *Ibid.,* para. 3.

[122] *Ibid.,* para. 4.

[123] *Ibid.,* para. 7.

[124] *Ibid.*, para. 29.

[125] *Daniels, Ton* EC Tax Review 1999/1, p. 42.

resident companies in general were affected by what the ECJ stated or if it was applicable only to specific situations.

The Baars case is significant for the development of the direct link criterion. The circumstances in the case concerned the taxation of a taxpayer holding shares in a foreign company and his right to a tax exemption based on that holding.[126] In this particular case the circumstances were that the taxpayer was not liable to any dividend tax but to wealth tax on his investments in the company.[127] Consequently, the ECJ held that there was no direct link in the case since it concerned two different taxpayers paying two different taxes, i.e. the company paying corporation tax on its profits and the taxpayer paying wealth tax independent of the company's profits.[128] Compared to the ICI case, the ECJ is clearer in its findings in the Baars case concerning the direct link criterion. It is evident that the ECJ could not have held in the ICI case that both one tax and one taxpayer have to be concerned since the circumstances in the case did not make it necessary, the tax was of one and the same kind. It is understandable that new circumstances in new cases will lead the ECJ to develop its established principles and introduce new ones, especially considering the characteristics of the EC Treaty and the method of interpretation the ECJ is using.[129] However, the fact that the ECJ's interpretation of EC law is dynamic puts an obligation on the ECJ to be very clear and detailed in its findings in order to achieve a high level of predictability. Even Kellgren holds that continuity and openness are crucial for the prediction of a court's judgments.[130] Comparing the Baars case to the ICI case, we believe that in the ICI case the ECJ must have meant what it expressly stated in the Baars case, that is to say a direct link can only exist if it is a question concerning one and the same taxpayer.[131] Considering that, we believe that the ECJ should have been clearer in the ICI case and should have stated that it is in particular situations involving two different taxpayers which cannot be justified.

Seeing ICI, Baars and Lankhorst-Hohorst in relation to each other, it becomes clear that the ECJ has not been consistent in its application of the direct link criterion. In the ICI case, the ECJ rejected the direct link criterion on the ground that taxation and tax benefits concerned two different companies. Obviously, the rejection of the direct link was based on the fact that two different taxpayers were involved, however no explicit requirement has been made by the ECJ. In the following Baars case, such a requirement was explicitly formulated and expressed by the ECJ. Nevertheless, in the Lankhorst-Hohorst case the ECJ merely referred to the Bachmann case and the fact that there the direct link was established because the taxpayer was one and the same person.[132] Whether there was one single taxpayer or different taxpayers in the Lankhorst-Hohorst case, was not given any significance. Instead, the direct link was rejected because of a lack of balance between the fiscal advantages and disadvantages. We believe that, as a taxpayer, one should have been able to ex-

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[126] Case C-251/98 C. Baars v. Inspecteur der Belastingen [2000] ECR I-2787, para. 12.

[127] *Ibid.*, para. 39.

[128] *Ibid.*, para. 40.

[129] *Hilling, Maria* Free Movement and Tax Treaties in the Internal Market, p. 45.

[130] *Kellgren, Jan* Mål och metoder vid tolkning av skattelag, p. 61.

[131] Case C-251/98 Baars, para. 40.

[132] Case C-324/00 Lankhorst-Hohorst, para. 42.

pect the ECJ to continue to apply the direct link criterion the same way it did in the Baars case. Instead, it derogated from its application without any actual explanation. At the same time, a taxpayer might not be able to have the same expectations on the ECJ as he might have on a national court. As opposed to a national court, which has to take into consideration only one set of laws and one political system, the ECJ has to consider a variety of national laws and political systems. Since the ECJ adapts its methods of interpreting laws to the methods national courts are familiar with, the result is often a variation in approaches.[133] Consequently, the ECJ may leave certain issues unexplained due to different reasons, such as practical or political ones.[134]

3.2.3 Concluding remarks

Following the development of the direct link criterion, it is apparent that the criterion has been clarified after the Bachmann case. However, whereas the criterion was clarified on certain points, it was not applied very consistently.[135] The criterion, as applied in the Bachmann case, was made clear particularly in the Asscher case, where the ECJ held that a direct link was meant to entail a certain balance between tax advantages and disadvantages. Consequently, the direct link criterion was made clear and at the same time it was subject to limitations in the Baars case, meaning that it could entail only one single tax and one single taxpayer.[136] However, in the later Lankhorst-Hohorst case, the ECJ did not give any significance to the requirement for one single tax and one single taxpayer.

3.3 The need to consider double taxation agreements

3.3.1 A careful approach to double taxation agreements

A second part of the cohesion justification is the need to consider double taxation agreements when determining whether a national legislation is to be justified or not. Therefore, we need to examine the ECJ's approach to double taxation agreements and if its application of this criterion has been predictable from a legal certainty point of view.

In the Bachmann case, the ECJ recognised that double taxation agreements between Member States exist, which give one of the contracting states an exclusive right to tax insurance payments, such as the ones at issue in the case.[137] As the ECJ has held later, the existence of such a convention would in fact make the cohesion argument superfluous.[138] That argument is based on the assumption that the cohesion of a national tax system may, in certain cases, be secured by a double taxation agreement. In such cases, there is no need to rely on a national legislation in order to secure that cohesion. Nonetheless, the ECJ did not find that in the Bachmann case. The ECJ stated that such a solution is only possible by

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[133] *Brown, L. Neville and Kennedy, Tom* The Court of Justice of the European Communities, p. 323.

[134] *Von Quitzlow, Carl Michael* Skattenytt 2003, p. 90.

[135] See chapter 3.2.1.

[136] See chapter 3.2.2.

[137] Case C-204/90 Bachmann, para. 26.

[138] Case C-80/94 Wielockx, para. 24.

means of such agreements or if the Council adopts the necessary harmonisation measures.[139] What the ECJ meant by that statement becomes clear after taking a close look at the Wielockx case and especially the opinion of Advocate General Léger.[140] He points out that Article 18 of the OECD Model Tax Convention, which the double taxation agreement at hand is based on, has a very general meaning.[141] Because of that the ECJ chose to interpret the double taxation agreement in the Bachmann case with caution.[142] The Advocate General means that according to the ECJ it has to be clear that the Member States concerned have somehow renounced the principle of correlation between deductions of contributions and taxation of payments, and instead have chosen to base that principle exclusively on the reciprocity of the double taxation agreement.

The ECJ has been highly criticised for not taking the double taxation agreement into consideration when deciding on the Bachmann case.[143] According to Knobbe-Keuk the ECJ did not elaborate the meaning of cohesion as clearly as it should have.[144] She means that one way of seeing it would be that the ECJ intended to "…accept the legimate general interest of each State in designing a system that effectively assures and enforces the taxation of income."[145] We also believe that this was the intention of the ECJ. An explanation for the ECJ's approach might be the fact that the ECJ meant to recognize the corrective function inherent in the cohesion justification.[146] In retrospect, one is able to derive Advocate General Léger's explanation from paragraph 26 of the Bachmann case. Advocate General Léger meant that the ECJ interpreted the double taxation agreement in the Bachmann case with caution.[147] According to the Advocate General, that careful approach meant that it could "…not be inferred from the convention in question…" that the contracting states intended to base the cohesion of their tax systems on the reciprocity of the agreement. In the Bachmann case, the ECJ stated that cohesion of a national tax system could be secured by a double taxation agreement, but "…only by means of such conventions…"[148] Comparing the statement of Advocate General Léger with the statement of the ECJ in the Bachmann case, we believe that the ECJ meant that the intention to base the cohesion of the national tax system on a double taxation agreement had to derive from that agreement. To us, the reasoning of the ECJ, however, did not become clear until reading the explanation by Mr Léger. We believe that it would have been appropriate if the ECJ had been clearer in its explanation in the Bachmann case. As a counterargument, one could claim that, because

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[139] Case C-204/90 Bachmann, para. 26.

[140] Opinion of Advocate General Léger in Case C-80/94 Wielockx.

[141] *Ibid.*, para. 53.

[142] *Ibid.*, para. 56.

[143] See for example *Hinnekens, L and Schelpe, D* EC Tax Review 1992/1, p. 61, *De Brabanter, Véronique* EC Tax Review 2003/3, p. 169, *O'Grady, Eileen* Tax Notes International 2003/June, p. 1330, *Manninen, P.M and Rytöhonka, Risto* European Taxation 2003/February, p. 56.

[144] *Knobbe-Keuk, Brigitte* EC Tax Review 1994/3, p. 80.

[145] Ibid., p. 81.

[146] *Englisch, Joachim*, European Taxation 2004/8, p. 357.

[147] Opinion of Advocate General Léger in Case C-80/94 Wielockx, para. 56.

[148] Case C-204/90 Bachmann, para. 26.

Bachmann was the first case where the cohesion justification was put forward by a state, it was inevitable for the ECJ to take a careful approach and leave some issues, for example the double taxation agreement, open in order to clarify it in subsequent cases. Such an advance taken by the ECJ is a well-known judicial practice.[149] The ECJ expands its jurisdiction by establishing a legal principle but not applying it on the case at hand. The ECJ's intention is to introduce such a principle gradually. First it will introduce it in a case, however not giving it any significant effect. That is done either by making it subject to certain conditions or declaring it not applicable at all to the particular circumstances in the case. The reason for such a way of working is to test the Member States' reactions to the principle. [150] Once this is done and the Member States' reactions are revealed the ECJ will re-affirm the principle in later cases and then reveal the true content of it. One example of this is when the ECJ first established the principle of supremacy.[151] Nonetheless, Kellgren holds that occasional departures by a court from its established findings, weakening the predictability and legal certainty under a transitional period, are needed in order to make new findings and new interpretations settled.[152]

If this approach by the ECJ is to be considered as common, then the criticism directed towards the ECJ's decision not to take the double taxation agreement into consideration should not be severe. Instead, it should be seen as a standard method of introducing principles. However, we do not consider the approach to be legitimate. As mentioned, the fact that principles are being introduced or changed makes it necessary for the ECJ to be as clear as possible as early as possible. Also, according to the described approach used by the ECJ, the eventual affirmation of a principle is made subject to the Member States' reactions. In our view, that cannot be seen as a provision of legal certainty.

Since the ECJ in the Bachmann case chose a careful approach when interpreting the double taxation agreement, one could have expected the ECJ to do the same even in later cases. In the Bachmann case, the ECJ held that double taxation agreements in fact were able to secure the cohesion of a national tax system, yet that had to be clear from the double taxation agreement itself. Nevertheless, the careful approach, as applied in the Bachmann case, was abandoned in the Wielockx case.

3.3.2 Deviation from the careful approach to double taxation agreements

In the Wielockx case, the ECJ was confronted with a double taxation agreement between the Netherlands and Belgium.[153] The case concerned a Belgian national who, while remaining resident in Belgium, was working in the Netherlands and as such was refused the right

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[149] *Alter, Karen J* International Organization vol.52, no.1, p. 6. For a similar line of arguments see *Weiler, Joseph* Comparative Political Studies 1994/January, p. 517 ff. and *Mattli, Walter and Slaughter, Anne-Marie* International Organisation vol.52, no.1, p. 190.

[150] *Hartely, Trevor* The foundations of European Community law, p 78-79. See also *Garrett, Geoffery R, Kelemen Danial and Schulz Heiner* International Organization vol.52, no.1, p. 3. *Kelemen, Daniel* Comparative Political Studies 2001/August, p. 624.

[151] Case 6/64 Costa v. Ente Nazionale per L'Energia Elettrica [1964] ECR 583, for an explanation see *Alter, Karen J* International Organization vol.52, no.1, p. 6.

[152] *Kellgren, Jan* Mål och metoder vid tolkning av skattelag, p. 61.

[153] Case C-80/94 Wielockx, para. 9.

to deduct from his taxable income contributions to a pension reserve.[154] The right to deduction was dependant on the taxpayer's residence since the Dutch provision, which was under scrutiny in the case, made a distinction between "national taxpayers" being residents in the Netherlands and "foreign taxpayers" being residents outside the Netherlands but receiving income there.[155] As a possible justification, the Dutch government invoked the cohesion of the national tax system.[156] However, since there was a double taxation agreement between the involved states the ECJ, which followed the Advocate General Léger's opinion, meant that the cohesion of the Dutch tax system was actually secured by the reciprocity of the double taxation agreement between the Netherlands and Belgium.[157] Therefore, there was no reason for the Dutch government to secure the cohesion of its tax system by means of national legislature. According to Article 18 of the OECD Model Tax Convention, which was at issue in the case, pension payments shall be taxed only in the state of which the taxpayer receiving the payments is a resident, whatever the state in which the contributions were paid.[158] That means that the cohesion of the tax system does not have to be secured by the "…strict correlation between the deductibility of contributions and the taxation of pensions but is shifted to another level, that of the reciprocity of the rules applicable in the Contracting States."[159] Hence, the cohesion argument was rejected by the ECJ as a valid justification for the discriminative provision at issue.[160] A similar line of arguments by the ECJ can be found in the X and Y case.[161]

As we observe from the ECJ's reasoning, it pursued the Advocate General Léger's opinion. However, the Advocate General also stated that the ECJ might, in this case, want to take the approach it did in the Bachmann case and interpret double taxation agreements with caution.[162] Considering that, he then suggests an alternative solution for the case.[163] He concludes that if the ECJ was to take the same approach in the Wielockx case, as it did in the Bachmann case, the outcome would not be the same because of a difference in circumstances.[164] He then goes on by comparing the circumstances in the two cases and by doing so he fails to recognize the misinterpretation of the Belgian legislation made by the ECJ in the Bachmann case.[165] The point is however, that if the ECJ had decided to let the alternative solution provided by the Advocate General prevail, it would have based its judgment on false grounds.

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[154] Case C-80/94 Wielockx, para.2.

[155] *Ibid.,* para.3.

[156] *Ibid.,* para.23.

[157] See opinion of Advocate General Léger in the Case C-80/94 Wielockx, para. 54.

[158] Case C-80/94 Wielockx, para. 8.

[159] *Ibid.,* para.24.

[160] *Ibid.*, para. 25.

[161] Case C-436/00 X and Y v. Riksskatteverket [2002] ECR I-10829, para. 53.

[162] Opinion of Advocate General Léger in the Case C-80/94 Wielockx, para 56.

[163] *Ibid.*, para. 57.

[164] *Ibid.,* para. 59.

[165] *Ibid.*, para. 64. See also chapter 3.2.1.

In the Wielockx case, the ECJ did not go beyond taking the double taxation agreement into consideration. The ECJ stated that as long as the cohesion of a tax system is secured by a double taxation agreement, there is no need to consider whether the cohesion is secured by national legislation. However, in the Danner case the ECJ acted contrary to its established findings on that point.

In the Danner case, the ECJ first examined the internal cohesion of the Finnish legislation and referred to the Bachmann case, arguing that the difference between the two cases was the fact that according to Belgian law insurance payments were exempt from taxation in cases where deduction for contributions was denied.[166] Conversely, in Finland the government taxed insurance payments irrespective of whether they had been deducted in Finland or not.[167] Secondly, the ECJ examined whether the international cohesion was secured. The ECJ observed that the two involved states (Germany and Finland) had concluded an agreement for the avoidance of double taxation which made the cohesion by means of national legislation unnecessary. [168] The ECJ could have rejected the cohesion argument by only referring to the double taxation agreement as was done in the Wielockx case. However, in the Danner case the ECJ examined the cohesion of the Finnish tax system both at the level of the double taxation agreement and at the level of the national legislation.[169]

Taking into consideration the development made by the ECJ through its findings in the Wielockx and Danner cases, we conclude that the ECJ examines the cohesion justification both at the national level and at the level of the double taxation agreement. However, as the Lasteyrie du Saillant case[170] shows, the ECJ has once again deviated from its earlier case law.

The case concerned French exit taxation. The French provisions in question stated that exit taxation was applicable if a taxpayer moved abroad in cases where he either directly or indirectly, or together with family members, held securities which gave him entitlements to more than 25 per cent of the profits of a company during five years prior to his departure.[171] However a deferral on the tax could be granted if the taxpayer fulfilled certain conditions, such as the supply of a security.[172] The ECJ held that the French provision was not necessary in order to uphold the French tax system.[173] However, that conclusion was drawn considering the aim of the legislation and not the double taxation agreement. The plaintiff actually pointed out that there was a double taxation agreement between the involved states.[174] Nevertheless, this argument was never addressed by the ECJ. The measure

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[166] Case C-136/00 Danner, para. 36.

[167] *Ibid.*, para. 38.

[168] *Ibid.,* para. 41.

[169] *Ibid.,* paras. 40 and 41.

[170] Case C-9/02 Lateyrie du Saillant.

[171] *Ibid.,* para. 12.

[172] *Ibid.,* para. 7.

[173] *Ibid.,* para 67.

[174] *Ibid.,* para 35.

which is of interest here is Article 13.5 OECD Model Tax Convention.[175] The rule allocates between the contracting states the right to tax capital gains. It is formulated similarly to Article 18 OECD Model Tax Convention in that it gives one of the contracting states the exclusive right to tax capital gains, notwithstanding where the costs for obtaining that capital were deducted. Consequently, it can be held that Article 13.5 OECD Model Tax Convention and the reciprocity it provides should be able to ensure the cohesion of a national tax system, very much like it is the case with Article 18 OECD Model Tax Convention. A reason for the ECJ's reluctance to examine this issue might, according to Kotanidis, basically be the fact that the ECJ did not want to determine how a double tax agreement would have affected the rules on exit taxation.[176] We consider that this inconsistency from the ECJ's ruling is likely to create uncertainty for other Member States which have similar legislations as the French one. The perception of the ECJ's way of choosing which circumstances to address and clarify and which ones not, corresponds with the above shown examples where the ECJ has made its decisions subject to the Member States' reactions.[177] What predictability can a taxpayer be assumed to have if the ECJ decides not to address a certain issue simply in order to avoid having to deal with it in a specific context?

As we have shown above, the ECJ has not been very consistent when applying the direct link criterion.[178] Seeing how the ECJ's judgments in the Bachmann, Wielockx, Danner and Lasteyrie du Saillant cases, regarding the treatment of double taxation agreements, relate to each other, a similar conclusion can be drawn. Whereas the ECJ chose a careful approach in the Bachmann case, where a double taxation agreement was not considered to secure the cohesion of the national tax system, unless explicitly made clear by the contracting states, it did the opposite in the Wielockx case.[179] In the Wielockx case the ECJ held that the mere existence of a double taxation agreement meant that the cohesion was shifted to the international level, even if it was formulated generally and no explicit intention by the contracting states had been expressed. In such a case, there was no need to examine whether cohesion was secured by national measures. In the Danner case however, the ECJ examined if the cohesion of the national tax system was secured both by the double taxation agreement and the national measure. Surprisingly, in the Lasteyrie du Saillant case the ECJ avoided to address the double taxation agreement between France and Belgium altogether.

3.4 The objective criterion

A third part of the cohesion justification is the objective criterion. According to established case law, which we present in this chapter, the objective criterion means basically that the aim of a national measure has to be taken into consideration when examining whether that measure can be justified by the cohesion justification. The fact that the objective of a restrictive measure has to be considered when determining if it can be justified, has been ex-

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[175] *Kotanidis, Silvia* European Taxation 2004/August, p. 381. According to her, the relevant provision in the double taxation agreement between France and Belgium is based on the OECD Motel Tax Convention. We have to point out that we follow her observations on this point and that we did not consult the double taxation agreement between France and Belgium itself.

[176] *Kotanidis, Silvia* European Taxation 2004/8, p. 381.

[177] See chapter 3.3.1.

[178] See chapter 3.2.2.

[179] See chapter 3.3.2.

pressed by the ECJ in the Gebhard case, when it extended the rule of reason to be applied to all EC Treaty freedoms.[180] The ECJ basically stated that a measure could only be justified if it attained its objective without going beyond what is necessary in order to achieve the aim.[181] The objective criterion has also been subject to examination in the ICI case. In its opinion, Advocate General Tesauro did not find the aim of the UK legislation to justify the restriction the latter caused.[182] The problem was that he did not find the aim to be the cohesion of the national tax system. Instead, he interpreted the aim of the measure to be that of preventing a loss in tax revenue, which could not constitute a justification. Further, the Advocate General held that even if the aim of a national measure was a valid justification it would still have to pass the proportionality test. The ECJ reasoned somewhat differently by confronting the aim of preventing tax avoidance as put forward by the UK government.[183] The ECJ held that the measure was not proportional since it applied generally to all situations where foreign subsidiaries were involved, not being limited merely to artificial arrangements. What we find worth mentioning is the difference between the reasoning of Advocate General Tesauro and the ECJ. Whereas the Advocate General considered the need to prevent tax evasion in connection with the cohesion of the UK tax system[184], the ECJ addressed each argument separately.[185] Since the ECJ examined the aim of the national measure separately from the cohesion justification it could not give it the same significance in relation to the cohesion justification, as it did in subsequent cases.

In the Baars case, the ECJ did go further but still not all the way. There, the Dutch government invoked the aim of its legislation, which was the mitigation of double taxation, in connection with the cohesion argument.[186] Yet, the ECJ held that there was no double taxation of profits, since it was a matter of two different taxes.[187] What the ECJ did however, was not to dismiss the cohesion justification because the objective of the measure was not achieved. Instead, the ECJ dismissed it because of the lacking direct link it has been requiring ever since the Bachmann case.[188] As we said, we think that the ECJ went further in the Baars case compared to the ICI case, but it seems as if it was still just scratching on the surface of the objective criterion, waiting for a more suitable case to go all the way. Such a case seems to have been the X and Y case.[189]

In the X and Y case the ECJ looked at the aim of a Swedish tax rule, being the prevention of tax evasion, in relation with the cohesion justification.[190] The ECJ made a comparison

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[180] See chapter 2.3.2.

[181] See also Case C-415/93 Union royale belge des sociétés de football association and others v. Bosman and others, para. 104.

[182] Opinion of Advocate General Tesauro in Case C-264/96 ICI, para. 28.

[183] Case C-264/96 ICI, para. 26.

[184] Opinion of Advocate General Tesauro in Case C-264/96 ICI, para. 29.

[185] Case C-264/96 ICI, paras. 26 and 29.

[186] Case C-251/98 Baars, para. 34.

[187] *Ibid.*, para. 39.

[188] *Ibid.*, para. 40.

[189] Case C-436/00 X and Y.

[190] *Ibid.*, paras. 56 and 58.

between the situation in the present case and the one in the Bachmann case. The difference between the two situations is that in the Bachmann case, the tax base has always been abroad. The situations affected by the Belgian legislation concerned non-residents paying contributions to foreign insurance companies. According to the ECJ, the insurance sums would consequently in any case be paid abroad by those insurance companies. Because of that the payments were "…likely to evade taxation by the Member State which granted the tax advantage…"[191] Due to that fact, the Belgian rule was considered to be proportional when applying generally to all non-residents paying contributions to foreign insurance companies. Conversely, the situation was different in the X and Y case. There the tax base was initially in Sweden and it was liable to disappear only following a definitive move abroad by the taxpayer. In such a situation, the tax rule cannot be applied generally to all taxpayers moving abroad, since not every such action can be considered to be motivated by tax evasion reasons. Consequently, the Swedish measure was not considered to be proportional since the cohesion of the tax system could have been preserved by less restrictive means.[192] As a result, the cohesion justification was rejected because the national measure did not achieve its objective.[193] A similar conclusion has been drawn in the Lasteyrie du Saillant case.[194] There, the ECJ found the French legislation to be applied too generally, affecting all situations where a taxpayer chose to exercise his right to free movement, not only arrangements which were purely artificial.

The objective criterion has been introduced carefully, merely stating in the Gebhard case that the objective of a national legislation had to be taken into consideration when justifying that legislation. In the ICI case the ECJ actually took the objective of the UK legislation into consideration, yet it did so separately from the cohesion justification. The objective criterion and the cohesion justification were addressed by the ECJ as different, from each other independent, arguments. In the Baars case the ECJ actually considered the objective of the national legislation in connection to the cohesion justification, but the reason for rejecting the cohesion justification was not the fact that the objective was not achieved. Instead, the cohesion justification was rejected because of the missing direct link. In the X and Y case the ECJ examined the objective of the Swedish legislation in relation to the cohesion argument. The legislation was not considered to be proportional to its objective and hence the cohesion justification was rejected on that ground. The presented case law shows that the objective criterion has been introduced carefully; however, we conclude that this careful approach taken by the ECJ has been affecting the legal certainty because from our perspective the ECJ had no reason to be unclear in its reasoning from the beginning.

3.5 The cohesion justification put in another context

It is not always that the ECJ deviates from established case law by modifying or changing the cohesion justification. Sometimes, it is simply the application of the cohesion justification that is different compared to established case law. Such an example is shown by the comparison between the judgments in the ICI case[195] and the Marks & Spencer case[196]. In

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[191] Case C-436/00 X and Y, para. 58.

[192] *Ibid.*, para. 59.

[193] *Ibid.*, para. 63.

[194] Case C-9/02 Lasteyrie du Saillant, para. 50.

[195] For background description of the case see chapter 3.2.2.

the ICI case the ECJ scrutinized whether the national rule was justifiable by examining three different justification grounds. The UK government invoked the need to prevent tax avoidance on the one hand and the need to prevent a reduction in revenue on the other as justifying grounds.[197] Further, the ECJ examined the cohesion justification on its own behalf.[198] What the ECJ did in this case was to examine each of the justifications separately, rejecting them based on individual reasons.

The Marks & Spencer case concerned a UK resident company, which had subsidiaries in 36 different countries; amongst those were the subsidiaries in Belgium, France and Germany.[199] However these subsidiaries made huge losses and as a consequence the subsidiaries in France were sold out and those in Belgium and Germany were liquidated.[200] Nonetheless the parent company in the UK claimed a group tax relief for the losses occurred from those subsidiaries.[201] In the case the ECJ also examined three different justifications, namely the fiscal principle of territoriality, the need to preserve the cohesion of the national tax system and the need to prevent tax avoidance.[202] What the ECJ did in the Marks & Spencer case, contrary to the ICI case, is that it never examined whether the invoked justifications separately could be accepted or not. Instead, the ECJ analyzed the justification issue in the light of the three justifications taken together.[203] In order to really understand the meaning of the ECJ's holding in the Marks & Spencer case, it is important to observe it in the context of the opinion of Advocate General Maduro. The reason for that is that the ECJ did not explicitly refer to the different justification grounds; instead, the ECJ disguised the grounds by circumscribing them.[204] On the other hand, the Advocate General explicitly mentioned the justification grounds and elaborated them.

Advocate General Maduro confirmed initially that according to established case law the cohesion of a national tax system is in principle a valid justification for a restrictive provision.[205] Further, he stressed that the cohesion concept constitutes an important corrective function by correcting the effects of the extension of the EC Treaty freedoms to direct taxation.[206] He meant that one of the purposes of the cohesion concept is to prevent the freedoms of movement from interfering with the internal logic of national tax systems. He also pointed out that, even though Member States have to comply with Community law, they still remain autonomous in the field of direct taxation. Nevertheless, the corrective

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196 Case C-446/03 Marks & Spencer plc v. David Halsey [2005] ECR I-0000.

197 Case C-264/96 ICI, para. 25.

198 *Ibid.*, para. 29.

199 Case C-446/03 Marks & Spencer, para. 19.

200 *Ibid,* para. 21.

201 *Ibid,* para. 22.

202 Case C-446/03 Marks & Spencer, para. 43. Compare with opinion of Advocate General Maduro in Case C-446/03 Marks & Spencer, paras. 58 ff, since the ECJ did not explicitly refer to the cohesion justification.

203 Case C-446/03 Marks & Spencer, para. 51.

204 *Ibid.,* para. 43.

205 See Opinion of Advocate General Maduro in Case C-446/03 Marks & Spencer, para. 65.

206 *Ibid.*, para. 66.

function, which is inherent in the cohesion argument, may not jeopardize the objectives pursued by the internal market. That means that there has to be a balance between the freedoms provided by the EC Treaty and the national tax systems of the Member States. As a consequence, the Advocate General stated that the requirement for one tax and one taxpayer, as applied by the ECJ, is too rigid and needs to be relaxed.[207]

Advocate General Maduro seems to have made a convincing point here which, in our view, led the ECJ to follow his opinion. However, the ECJ did not explicitly refer to the cohesion of the national tax system as the Advocate General did. Instead, the ECJ replaced the cohesion argument with three different justification grounds which had to be taken together. Lang means that if the ECJ had addressed the cohesion justification explicitly, it also would have had to change its earlier established case law explicitly.[208] So what the ECJ did instead was to disguise that deviation from established case law.[209] Lang concludes that what is alarming is not merely the fact that the ECJ is changing its case law but that it is concealing that change and pretending that the case law is still consistent.[210] Our point is that the outcome of the Marks & Spencer case must be viewed as very surprising considering the ECJ's decision in the ICI case. Bearing in mind the two judgments, it is very difficult to predict how the ECJ might judge the next time a similar situation is brought before it. Cordewener for example thinks that the ECJ sometimes acts unsystematically regarding the cohesion justification and that it by doing so endangers the legal certainty for tax payers.[211] Even Wathelet thinks that legal uncertainty is high and that it is difficult to predict the compatibility of national tax systems with Community law.[212]

3.6 Conclusive remarks

From the ECJ´s case law it is evident that the ECJ's application and interpretation of the cohesion justification has not been a rigid one. Instead, the cohesion justification has been evolving throughout the case law. The ECJ has been refining the principle since its first application, limiting the scope of the cohesion justification in subsequent cases. Within the cohesion justification we distinguish three different criteria which the ECJ takes into consideration when examining the cohesion justification.[213] We have also chosen to put the cohesion justification in another context in order to scrutinize how the ECJ examines the cohesion justification in relation to other justification grounds.[214] Hence, the cohesion justification has not developed as one single occurrence. Instead, the different criteria have been developing fairly independent from each other.

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[207] Opinion of Advocate General Maduro in Case C-446/03 Marks & Spencer, para. 71.

[208] *Lang, Michael* European Taxation 2006/February, p. 60.

[209] See also *Isenbaert, Mathieu and Valjemark, Caroline* M&S judgment: the ECJ caught between a rock and a hard place, EC Tax Review 2006/1, p. 13.

[210] *Lang, Michael* European Taxation 2006/February, p. 66.

[211] *Cordewener, Axel*, as cited in Book Review EC Tax Review 2004/4, p. 232.

[212] *Wathelet, Melchior* EC Tax Review 2004/1, p. 3.

[213] See chapters 3.2, 3.3 and 3.4.

[214] See chapter 3.5.

It can be mentioned that the judgment in the Bachmann case, as significant as it is considered to be, has been proclaimed to be undermined through the ECJ's findings in its following case law.[215] Von Quitzlow holds that the ECJ's finding in the Bachmann case has lost its value as a general principle and that it can be expected to return only in cases concerning the exact same legislation as the Belgian one in the case.[216] We find however, that not even that much can be expected.[217] As Ståhl points out, the Bachmann case would most probably have a different outcome if it was judged today.[218] Because of that we find that at present even if a taxpayer would be confronted with the exact same situation as the one in the Bachmann case, he could not be certain about what to expect. Therefore, it would be in the interest of the taxpayers if the ECJ would clarify the cohesion justification by redefining it and setting up clear definitions instead of just "patching together" statements from previous decisions as has been done on other occasions.[219]

As we have shown, the application by the ECJ of the direct link criterion has not been consistent after the Bachmann decision.[220] The ECJ went from being quite unclear about the requirement for one single tax and one single taxpayer to be involved in the ICI case to formulating and defining that requirement rather explicitly in the Baars case.[221] However, in the Lankhorst-Hohorst case the ECJ deviated from what could have been expected following the Baars case. In the Lankhorst-Hohorst case the ECJ in fact pointed out that the direct link in the Bachmann case was established due to the fact that the taxpayer in question was one and the same person. Nevertheless, the ECJ did not examine whether the circumstances in the Lankhorst-Hohorst case concerned one and the same taxpayer or not. Instead, the ECJ simply rejected the direct link criterion because of a lack of balance between the fiscal advantages and disadvantages affecting the plaintiff.

A similar development can be seen in the treatment of double taxation agreements.[222] When confronted with double taxation agreements, the ECJ started off by being quite moderate and approached the agreements carefully.[223] Since the relevant provision in the double taxation agreement, in the Bachmann case, was formulated generally the ECJ did not give it any further notice. The ECJ held that if the cohesion of a national tax system was based on a double taxation agreement, then it should somehow be explicitly expressed. Such an assumption could not be done based merely on the reciprocity provided by the double taxation agreement. In the Wielockx case the ECJ deviated from the careful approach as chosen in the Bachmann case.[224] In the Wielockx case, the ECJ stated that as

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215 *Von Quitzlow, Carl Michael* Skattenytt 2003, p. 90.

216 *Ibid.*, p. 92.

217 See chapter 3.2.1.

218 *Ståhl, Kristina* Möjligheter att rättfärdiga inskränkningar i den fria rörligheten – några aktuella frågor, SvSkT 2001/8, p. 745.

219 *Cordewener, Axel* European Taxation 2003/April, p. 111.

220 See chapter 3.2.

221 See chapter 3.2.2.

222 See chapter 3.3.

223 See chapter 3.3.1.

224 See chapter 3.3.2.

long as there exists a double taxation agreement, which can secure the cohesion of a national tax system, then the cohesion of the tax systems of the contracting states was shifted to an international level. Hence, national legislation did not have to be taken into consideration. The Danner case meant yet another deviation from what could have been expected after the Wielockx case. In the Danner case, the ECJ took the same approach as in Wielockx, taking the double taxation agreement into consideration. Yet, despite its finding in the Wielockx case, the ECJ examined the cohesion of the Finnish tax system even under the Finnish legislation. In the Lasteyrie du Saillant case, the ECJ did not take the double taxation agreement between the involved states into consideration at all. Instead, the ECJ dismissed the cohesion justification based solely on the objective criterion.

The ECJ's application of the objective criterion has also been inconsistent to a certain degree.[225] As was the case with the rest of the cohesion justification, the objective criterion was introduced carefully and generally, stating that the objective of a national legislation had to be taken into consideration when justifying that legislation. In the ICI case, the ECJ took the objective of the UK legislation into consideration, but it examined it separately from the cohesion justification. The ECJ addressed the objective of the UK legislation independently from the cohesion justification. After that, in the Baars case, the ECJ took the objective of the national legislation into consideration and even examined it in relation to the cohesion justification. Even though the objective of the national legislation in the Baars case was not achieved, that fact did not fail the cohesion justification. Instead, the cohesion justification was rejected because of the lack of a direct link. It was in the X and Y case that the ECJ rejected the cohesion justification because the objective of the national legislation was considered not to be proportional.

We have also observed that when the ECJ was confronted with several different justification grounds it has not always examined those in the same manner.[226] In the ICI case, the ECJ was confronted with the cohesion justification and two other justification grounds, however it dismissed them all based on individual reasons. This approach taken by the ECJ seems to be the most common one because that is how the ECJ has examined cases where several justification grounds have been put forward by the Member States. The ECJ acted contrary to its usual method of examining cases in the Marks & Spencer case. As we have shown in chapter 3.5, we believe that the ECJ was affected by the Advocate General's opinion regarding the cohesion justification; however, the ECJ avoided dealing with the issue, instead it examined the three justification grounds together. We believe that the difference between how the ECJ examined the cases is a strike to the legal certainty which taxpayers are supposed to expect. This has even been acknowledged by several authors in the doctrine.[227]

Regarding the development of the direct link criterion and the need to consider double taxation agreements, we conclude that the application has been fairly volatile. The ECJ has made certain changes in the application of the criteria which were unexpected and which give some doubts about how they could be applied in the future. The application of the objective criterion has not been a rigid one either, however we find that it has been more predictable than the application of the direct link criterion and the need to consider double

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[225] See chapter 3.4.

[226] See chapter 3.5.

[227] *Ibid.*

taxation agreements. It has been more predictable since it has been moving in the same direction, being limited after each new case. Regarding the cohesion justification as a whole, we find it is obvious that its application by the ECJ has been changing considerably, making its future application difficult to predict.

4 The application of the cohesion justification in cross-border dividend cases

4.1 Introduction

I this chapter, in order to achieve our aim, we analyze the application of the cohesion justification in cross-border dividend situations from a legal certainty perspective. We intend to show how the application of the cohesion justification has changed in different cross-border dividend cases. We show the application of the cohesion justification in cross-border dividend cases before the new line of thought, which has been introduced by Advocate General Kokott in her opinion to the Manninen case.[228] After that we analyze Kokott's new line of thought and how it has affected the ECJ's application of the cohesion justification in cases following the Manninen case.[229]

First off, it should be reminded that the cases which are examined in this chapter concern the free movement of capital and according to Article 56 EC any restrictions to the free movement of capital between Member States is prohibited. Article 58 EC provides certain exceptions to that prohibition. The free movement of capital may for instance be restricted if the circumstances in a case concern objectively different situations.[230] However, we do not look at that possibility to justify a restrictive tax rule. Instead, we concentrate entirely on justifications by means of rule of reason.[231]

Throughout the cases we present in this chapter the ECJ[232] has relied upon mainly two arguments when confronting and testing the cohesion justification. The arguments put forward by the ECJ are on the one hand the requirement for a direct link and on the other the fact that the objective of a tax rule has to be considered when justifying it.[233] Unquestionably, the requirement for a direct link has been maintained by the ECJ ever since it accepted the cohesion justification in the Bachmann case.[234] However, the argument has been used in its refined form, meaning that a direct link had to entail one kind of tax levied on one single taxpayer. That definition of the direct link has been maintained by the ECJ ever since its findings in the Baars case[235], but especially in cases surrounding cross-border dividend taxation and hence free movement of capital. That is not surprising because in such cases it is easy to see a company and its shareholder as two different taxpayers.[236]

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[228] Opinion of Advocate General Kokott in case C-319/02 Petri Manninen [2004] ECR I-7063.

[229] C-319/02 Petri Manninen [2004] ECR I-7063.

[230] Article 58(1)(a) EC

[231] See chapter 2.3.

[232] And the EFTA Court in the Fokus Bank case.

[233] See Case C-35/98 Staatssecretaris van Finansciën v. B.G.M. Verkooijen [2000] ECR I-4071, para. 57, Case C-315/02 Anneliese Lenz v. Finanzlandesdirektion für Tirol [2004] ECR I-7063, paras. 36 and 38 and Case C-319/02 Manninen, paras. 43 and 45.

[234] See chapter 3.2.1.

[235] See chapter 3.2.2.

[236] See chapter 3.2.2.

4.2 The application of the direct link and objective criteria in cross-border dividend cases

One of the earlier cases where the cohesion justification has been invoked in relation to the taxation of cross-border dividends is the Verkooijen case. The case concerned the refusal of exemption from income tax on dividends distributed by a non-resident company to a resident shareholder.[237] The Dutch provision stated that an exemption from income tax was granted only for dividends that had been paid in the Netherlands by a company established there.[238] The Dutch government meant that the provisions were intended to compensate for the double taxation that would otherwise result when taxing dividends both at the company and shareholder level.[239] As could be expected from earlier case law, the ECJ maintained the requirement for a direct link in order to justify the Dutch legislation which was under scrutiny in the case.[240] Once again, the ECJ held that a direct link between the grant of a tax advantage and the corresponding taxation of an income could only exist in the case of one and the same taxpayer paying one single tax. However, since the present case concerned shareholders paying income tax on dividends and companies paying corporation tax on their profits, the ECJ did not see a direct link established.[241]

In order to show that the Verkooijen case could be seen from another perspective, we present the opinion of Advocate General La Pergola.[242] Contrary to the ECJ, Advocate General La Pergola recognized a direct link between the tax exemption and the levy of the dividends tax.[243] La Pergola believed that if the Netherlands extended the tax exemption to dividends distributed from non-resident companies it would damage the direct link of the Dutch tax system.[244] He referred to the legislative history of the provision and stated that it is constructed to reduce the effects of double taxation from an economic point of view. Also he concluded that the provision at issue only affected the recipient of the dividends i.e. the demand for one and the same tax payer is fulfilled.[245] As opposed to the ECJ, which looked at shareholders paying income tax and companies paying corporation tax, the Advocate General compared dividend tax with income tax payable by natural persons to determine the direct link. We believe that the Advocate General based his assumptions on the idea that because companies withheld tax on dividends before it was distributed to natural persons the real tax exemption was made on the aggregated income of those individuals.[246] Therefore, it would be more correct to compare dividends tax with income tax in order to find out if a direct link existed. The Advocate General also concluded that because no

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[237] Case C-35/98 Verkooijen, para. 2.

[238] *Ibid.,* para. 9.

[239] *Ibid.,* para. 11.

[240] *Ibid.,* para. 57.

[241] *Ibid.*, para. 58.

[242] Opinion of Advocate General La Pergola in Case C-35/98 Verkooijen.

[243] *Ibid.,* para 27.

[244] *Ibid.,* para 26.

[245] *Ibid.,* para 27.

[246] *Ibid.,* paras 9 and 10.

other alternative solution was suggested, the measure was proportional to its objective.[247] In conclusion, the Advocate General accepted the cohesion justification in principle.[248]

If one took the same view as La Pergola, that more emphasis was to be given to the legislative history of a provision, it would in our view, force the ECJ to more thoroughly examine the coherence of a provision. It would make certain that individual constellations of the legislation were rightly observed. It would force the ECJ to examine whether the national provision is coherent and at a later stage examine whether the provision infringes the free movement. If it is decided that the legislation is discriminatory, it could still be justified unless there are less restrictive ways to achieve the cohesion. At present the contrary seems to prevail, where the national cohesion must be given way to European Community cohesion.[249]

Ståhl makes a good point when using the Verkooijen judgment as an example to show how the ECJ is widening the scope of the provisions providing the free movement of capital by depriving the Member States of their sovereignty in the field of taxation.[250] She points out that the ECJ, by rejecting the cohesion justification based on the fact that different taxes and different taxpayers are involved, ignores and even undermines the close relationship between corporate tax and income tax on dividends, which has been recognized by all states applying one form or another of double taxation reliefs.

In the Lenz case the ECJ continued to hold on to the direct link criterion but it made the cohesion justification subject to the aim of the national legislation as well. The case concerned the issue of an Austrian resident receiving dividends from a German company and being denied a tax benefit which was reserved only for taxpayers' receiving dividends from Austrian companies.[251] Concerning the direct link criterion the ECJ merely concluded that the circumstances in the case at hand were about two different taxpayers paying different taxes, which was the reason a direct link could not be established.[252] Considering the aim of the Austrian legislation, the ECJ reasoned somewhat different than it usually did in preceding case law. The ECJ held that the aim of the legislation, which was the elimination of double taxation, would not be affected if the Austrian government was to extend the benefits it provided to taxpayers receiving dividends from resident companies also to the ones receiving dividends from foreign companies. Instead of examining whether the aim of the legislation was achieved and whether it was proportional[253] the ECJ took some kind of negative approach and looked at if an extension of benefits to cross-border dividends was to jeopardize the aim.[254]

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[247] Opinion of Advocate General La Pergola in Case C-35/98 Verkooijen, para 29.

[248] *Ibid.,* para 35.

[249] *Dourado, Ana*, *Paula*, EC Tax Review 1994/4, p. 182.

[250] *Ståhl, Kristina* SvSkT 2001/8, p. 745.

[251] Case C-315/02 Lenz, para. 13.

[252] *Ibid.*, para. 36.

[253] As has been done in such cases as Case C-478/98 Commission v. Belgium, para. 41, Case C-55/94 Gebhard, para. 37, Case C-436/00 X and Y, para. 59 and Case C-9/02 Lasteyrie du Saillant, para. 67.

[254] Case C-315/02 Lenz, para. 38.

Comparing the Verkooijen and Lenz cases with the ECJ's case law in general, does not show much out of the ordinary. The direct link criterion was applied the same way as in prior case law, where the ECJ required one single tax and one single taxpayer to be present in order to acknowledge the direct link.[255] Also, as in other cases the objective criterion was maintained in the Lenz case.[256] The only difference to earlier cases is the fact that the objective criterion was applied differently in the Lenz case. Instead of examining whether the objective of the national legislation was fulfilled, or whether it was proportional, the ECJ looked at if an extension of the tax advantages to cross-border situations would affect the attainment of the objective negatively. That seemingly insignificant change in the ECJ's approach to the objective criterion could have considerable consequences for future case law.

4.3 A new line of thought

In the Verkooijen case the ECJ only examined the direct link criterion in connection with the cohesion justification, however in the Lenz case the ECJ made the cohesion justification subject to the aim of the legislation as well. The ECJ followed the same approach in the Manninen case. The ECJ considered both the direct link criterion and the aim of the Finnish legislation under scrutiny. Surprisingly, in the Manninen case the ECJ found the direct link to be established.[257] However, the ECJ repeated that an argument based on the cohesion justification had to be examined also in the light of the aim of the tax provision which is to be justified.[258] Since the aim of the Finnish legislation was to eliminate double taxation the ECJ held, by making the same approach as in the Lenz case, that granting the tax credit even to taxpayers receiving dividends from abroad would not threaten the cohesion of the Finnish tax system.[259] We believe that the ECJ's argumentation and explanation concerning the direct link was inadequate. The reason for that is the fact that the direct link criterion has always been an important part of the cohesion justification and the ECJ has been very reluctant to change the criterion and its application. It was the first time that the ECJ recognized the direct link between different taxes and different taxpayers in the Manninen case. We mean that the finding should have been elaborated and clarified much more taking into consideration the judgments in earlier cases and the derogation from them. Some possible explanation for why the ECJ came to a different conclusion in the present Manninen case compared to the previous Lenz case can be found nonetheless.

The ECJ dismissed the direct link criterion in the Lenz case based on the fact that the legislation concerned different taxpayers and different taxes. However, in the Lenz case the ECJ also pointed out that the Austrian legislation did not make the obtaining of the tax advantages subject to the taxation of the companies' profits.[260] Such a system of calculating tax exemption is known as the schedular system.[261] Under such a system the company is

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[255] See chapter 3.2.2.

[256] See chapter 3.4.

[257] Case C-319/02 Manninen, para. 45.

[258] *Ibid.*, para. 43.

[259] *Ibid.*, para. 46.

[260] *Ibid.,* para. 36.

[261] COM (2003) 810 final. Dividend taxation of individuals in the Internal Market, 19 December 2003, p. 4.

taxed on its profits while the dividends distributed to the shareholders are taxed as a separate category of income, meaning that tax paid by the company is not taken into consideration. Conversely, the ECJ recognized that the Finnish legislation in the Manninen case actually did take the corporate tax paid by the companies into consideration.[262] Such a system is referred to as the imputation system.[263] Under such a system both the company and the shareholders are taxed separately, but contrary to the schedular system the tax paid by the company is taken into consideration when determining the credit to be granted to the shareholders.

Consequently, the lack of correlation between tax advantages and tax paid by the companies was one of the reasons the ECJ failed the direct link criterion. Following that, one could imagine that one of the reasons for the ECJ's recognition of the direct link in the Manninen case could have been the fact that the tax system in that case actually took into account the corporation tax paid by the companies. However, we do not find the ECJ's statement to be clear enough to be certain on that point. As opposed to the Lenz case, the ECJ does not make a reference to the tax system used in the Manninen case in relation to the direct link.[264] Instead, reference has been made in relation to the aim of the legislation. We find the ECJ's inconsistency and uncertainty very disturbing and harmful to the legal certainty which the taxpayers are supposed to expect. That being the case especially since the Manninen case seems to be a turning point in the development of the cohesion justification.

The new line of thought which has sparked a discussion concerning the cohesion justification and its scope was clearly expressed by Advocate General Kokott in her opinion to the Manninen case. Advocate General Kokott points out that since its acceptance of the cohesion justification in the Bachmann case the ECJ has been applying that justification restrictively, narrowing it in its case law.[265] That limitation has been expressed especially in the requirement for a direct link, meaning that one single tax and one single taxpayer had to be involved. The Advocate General is however not sure whether the ECJ's demand for one single tax and one single taxpayer constitutes a binding requirement and if both criteria have to be met or if it is merely an indicator, giving room for interpretation.[266] She holds that if the criteria are to be seen as binding, then the cohesion justification could not be invoked successfully by the Finnish government.[267] It is clear that it is not a question of one and the same taxpayer when the circumstances surround a company paying corporate tax and a shareholder paying income tax. In spite of this, Kokott disagrees with established case law when stressing that the corporation tax paid by the company and the income tax paid by the shareholder could actually be seen as one tax. She bases her argument on the fact that both the corporation tax and the income tax are levied on the company's income. She points out that wealth tax could not be seen the same way. The difference Kokott is

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[262] Case C-319/02 Manninen, para. 46.

[263] COM (2003) 810 final., p. 6.

[264] Case C-319/02 Manninen, para. 46.

[265] *Ibid.*, para. 53.

[266] *Ibid.*, para. 55.

[267] *Ibid.,* para. 56.

aiming at is probably the fact that wealth tax is not levied on a company's income but on the investment a stakeholder may hold in a company.

Following that argument the Advocate General holds that a direct link could possibly be upheld in a case where tax is charged on one taxpayer whereas relief is granted to another.[268] However, in order for that to be the case the taxation would have to concern, if not the same taxpayer, at least the same economic process and the tax system would have to be created in such a way that it ensures that it is of benefit to the one taxpayer only when it is of detriment to the other one.[269] Regarding the Manninen case, the Advocate general concludes that the contested Finnish tax rule actually meets the just mentioned conditions.[270] The same economic process is involved, namely the taxation of the company's profits and the tax rule grants the tax credit to the recipient of the dividend only where the company has paid corporation tax. Accordingly, the cohesion justification in the case at hand cannot be rejected simply on the ground that two different taxpayers are involved.[271] According to Englisch, the acceptance by the ECJ of this argument led to the direct link not being ruled out any more, as has been the case in prior case law.[272] However, that relief of the direct link criterion has been set off at the same time by narrowing other requirements. Whereas a direct link can be upheld as long as the same economic process is concerned, the taxation and the tax relief in question have to correspond exactly to each other.[273] Englisch notes that this is a clear deviation from the finding in the Bachmann case since in that case a direct link was recognized even though the tax advantage most probably was not to correspond to the subsequent taxation.[274]

At this point Advocate General Kokott brings up the notion of cohesion on an international level.[275] She underlines that in case cohesion is meant to be secured on an international level, and not merely on a national level, the Finnish tax rule cannot be justified by the cohesion argument, despite the just presented relief of the direct link criterion. Under such circumstances, the Finnish provision should apply the tax credit to cross-border situations, as it does to purely domestic ones, which is not the case.[276] As the Advocate General concludes that the cohesion justification should be rejected[277], we assume that she holds the cohesion argument to be applied internationally. Advocate General Kokott based her new interpretation of the direct link criterion on the conviction that a too strict application of it could have arbitrary consequences in certain situations.[278] However, according to

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[268] Case C-319/02 Manninen, para. 61.

[269] *Ibid.*

[270] *Ibid.*, para. 64.

[271] *Ibid.*, para. 65.

[272] *Englisch, Joachim* Intertax Vol. 33, Issue 5, p. 206.

[273] See Opinion of Advocate General Kokott in case C-319/02 Manninen, paras. 61 and 63 where she requires the correlation between taxation and tax advantage to be of "the same amount".

[274] *Englisch*, *Joachim* Intertax Vol. 33, Issue 5, p. 206 see chapter 3.2.1.

[275] Opinion of Advocate General Kokott in case C-319/02 Manninen, para. 66.

[276] *Ibid.,* para. 67.

[277] *Ibid.*, para. 80.

[278] *Ibid.*, para. 57.

Rosengren, the fact that the Advocate General views the cohesion from an international perspective may not strengthen the cohesion justification; instead it limits it further since it puts an obligation on the national legislation to extend the tax advantages even to cross-border situations.[279] Nonetheless, Cordewener means that an international view of the cohesion of tax systems might be useful in order to achieve a high degree of distributive justice and inter-country equity in taxation.[280] Such a view may also be desirable regarding the fact that the ECJ is considered to have "…transcended national borders and taken the perspective of the Internal Market as a territory without borders in which free and fair competition is the rule."[281] Also, Lupo believes that the question of relief from double taxation is viewed from a European standpoint meaning that Member States must take into account the tax paid in other Member States, when deciding on the tax relief for residents, otherwise they will be in breach of Community law.[282] Such views will inevitable lead to the conclusion that Member States' tax law are not only an internal matter but becomes more and more an international matter. That development gives rise to certain discussion points as in what way the application of the justification itself and its conditions can be affected. For example, it can be debated how the international view of the cohesion justification might affect requirements such as the need to consider the aim of a national legislation when justifying it. It can be discussed whether the aim of a legislation could be seen from a national as well as from an international point of view since the cohesion justification itself is to be seen that way.

On the other hand, Englisch believes that the Advocate General is too strict when she reasons that the taxation and the tax relief have to correspond exactly to each other for a direct link to exist.[283] Instead, he suggests an alternative solution where the emphasis is put on the autonomous tax laws of the Member States. He considers that Member States to some extent should be allowed to generalize their tax rules. What he means is that because a national tax system is so diverse, standardizations are needed in order to make the system efficient. Such a way of looking at a tax system would mean that it is inevitable that some taxpayers receive higher tax advantages while others receive lower tax advantages. Englisch explains that such a system will not only be discriminative against those who choose to involve in cross-border activities but also between comparable residents. The purpose of the legislation in question will then not be to discriminate between internal and cross-border cases and therefore it will not be in breach of Community law. However, he is very clear to point out that if the legislation due to the internal cohesion treats only domestic activities favourably the above solution is not possible. It is only necessary that the tax burden of an individual who exercises his rights given under the EC Treaty is not higher than the "…overall burden of an average, typical taxpayer with an identical ability-to-pay derived from domestic activity"[284]. Englisch finally concludes that in a system that does not give the shareholders an exact compensation for the corporation tax paid but nevertheless exclude inbound dividends from the application can still be considered coherent. Probably

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[279] *Rosengren, Jonathan* Skattenytt 2004 Nr. 7-8, p. 499.

[280] *Cordewener, Axel* European Taxation 2003/April, p. 110.

[281] *Vanistendael, Frans* EC Tax Review 2005/2, p. 59.

[282] *Lupo, Antonello*, European Taxation 2000/July, p. 274.

[283] *Englisch, Joachim* European Taxation, 2004/August, p. 361.

[284] *Ibid.*

what he is aiming at is the cases, for example Verkooijen[285], where full economic relief is not guaranteed but is dependable on other factors as well, for example the total amount of income.

We believe that the author's description is very interesting because it is the only one that thoroughly analyses the cohesion approach from this alternative solution. However, we cast doubts about this solution being a valid one because the cross-border dividend cases we have analysed all have in common that they put much heavier tax burden on a taxpayer who uses his rights under the EC Treaty compared to an average taxpayer who is only involved in a domestic activity. What we mean is that if his description was taken into consideration when analysing the cohesion justification, none of the examined cross-border dividend cases would be coherent enough to be justified.

In order to link back to what we have said in chapter 4.2 regarding the ECJ's reasoning when confronting the cohesion justification, we now make some conclusive remarks. As mentioned before, the ECJ's arguments surrounding the cohesion justification changed during the course of the Manninen case.[286] In its case law prior to the Manninen case the ECJ required the existence of a direct link, defining it as entailing one single tax and one single taxpayer, in order to accept the cohesion justification.[287] In the Manninen case however, the ECJ followed the Advocate General's opinion and actually recognized the existence of a direct link, yet without actually elaborating the rationale behind that recognition, even though the circumstances surrounded corporation tax and income tax respectively. The ECJ did in fact reject the cohesion justification, however with regard to the aim of the Finnish provision and not because it did not fulfil the direct link requirement. We see it as if the ECJ was affected by the Advocate General's opinion on the matter, to such extent that it changed its definition of the direct link criterion, however inadequately.

4.4 The application of the cohesion justification after the new line of thought

The ECJ's finding in the Manninen case can be seen as a turning point in the development of the cohesion justification. In order to examine how the new line of thought has affected the ECJ's approach in subsequent cases, we must analyze some cross-border dividend cases which have arisen after the Manninen case.

However, the ECJ has not decided on a cross-border dividend case after the Manninen judgment. That is why we, in this chapter, must limit ourselves to examine one case from the EFTA Court and one case which is still pending before the ECJ.

A case which is at present pending before the ECJ, which nevertheless is of importance in this context, is the Meilicke case.[288] In his opinion, Advocate General Tizzano underlines the guidance which the Manninen case can provide due to the similarity in circumstances.[289] In the Meilicke case the German tax law provided that resident taxpayers receiv-

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[285] Case C-35/98 Verkooijen para. 3-11.

[286] See chapter 4.3.

[287] See the Verkooijen and Lenz cases in chapter 4.2.

[288] Case C-292/04 Wienard Meilicke, Heidi Christa Weyde, Marina Stöffler v. Finanzamt Bonn-Innenstadt.

[289] Opinion of Advocat General Tizzano in Case C-292/04 Meilicke, para.15.

ing dividends from German companies were entitled to a tax credit in order to eliminate double taxation of the dividends.[290] However, dividends from foreign companies did not give such an entitlement.[291] The case concerns a German resident who received dividends from companies established in the Netherlands and Denmark respectively.[292] After his death his heirs requested the tax credit but were denied it by the German tax authorities.[293]

Regarding the justification of the German tax rule on the basis of the need to preserve the cohesion of the national tax system, Advocate General Tizzano states that the argument should be rejected on the same ground as in the Manninen case.[294] Considering the fact that Advocate General Tizzano refers to paragraph 46 in the Manninen case, it becomes clear that he is referring to the purpose of the German provision. According to his argument the fact that the tax credit is granted in relation to the tax actually paid by the companies ensures the cohesion of the tax system, which means that the aim of the provision already is being achieved and that there is no need for the provision. The interesting point is that Advocate General Tizzano does not take the direct link into consideration. At least a discussion about it would have been welcome in order to shed some light on its application. To us, it seems as if the direct link criterion is being put off, following the Manninen judgment. It seems as if the criterion is not being taken into consideration yet because a more suitable case is awaited. The tax system which is contested in the Meilicke case seems to be very similar to the one at issue in the Manninen case, namely an imputation system, which means that the corporation tax paid by the companies is taken into consideration when calculating tax advantages. As we have mentioned, the ECJ has stated in the Lenz case that the lack of correlation between the calculation of tax advantages and the tax actually paid by the companies, i.e. a schedular system, was one of the reasons that a direct link was not established.[295] Consequently, the application of an imputation system, especially in relation to Advocate General Kokott's finding that even taxes paid by different taxpayers could establish a direct link, as long as one and the same economic process is concerned, would make a strong argument for the recognition of a direct link. Unfortunately, that discussion has been left aside by Advocate General Tizzano.

A similar trend can be observed in the Fokus Bank case.[296] The case concerns Norwegian tax provisions, and as such it has not been before the ECJ but before the EFTA Court. Even though Norway is not a Member State of the European Community and this case is about the Norwegian provisions' compatibility with the EEA Agreement we choose to examine it. Since the EEA Agreement and the EC Treaty are based on very similar principles and their differences in application are negligible, rulings from the EFTA Court can be of guidance for the application of EC law.[297]

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[290] Opinion of Advocat General Tizzano in Case C-292/04 Meilicke, para. 4.

[291] *Ibid.,* para. 5.

[292] *Ibid.,* para. 8.

[293] *Ibid.,* para. 10.

[294] *Ibid.*, para. 25.

[295] See chapter 4.2.

[296] E-1/04 Fokus Bank ASA v. The Norwegian State.

[297] See chapter 1.4. See also E-1/04 Fokus Bank, para. 23.

The Fokus Bank case is very similar to the cases concerning cross-border dividend taxation we have presented so far. The case concerned a Norwegian company and its liability to withholding tax on dividends paid to shareholders resident outside of Norway.[298] According to Norwegian legislation resident taxpayers receiving dividends from Norwegian companies were entitled to a tax credit in order to eliminate economic double taxation of the dividends.[299] At the same time taxpayers residing outside of Norway were not granted that tax credit.[300] The only difference to the previous cases is that this particular case concerned outbound dividends, i.e. dividends being distributed by a resident company to non-resident shareholders. Nevertheless, according to the EFTA Court the taxation of outbound dividends is to be treated in the same way as inbound dividends.[301] The EFTA Court referred to the ECJ's finding in the Lasteyrie du Saillant case, stating that when examining the cohesion argument consideration had to be taken to the aim of the tax rule which is to be justified.[302] However, the EFTA Court did not follow the ECJ's approach in the referred case; instead it followed the negative approach adopted by the ECJ in Lenz and the following cases.[303] The EFTA Court stated that by granting the tax credit also to non-residents the provision would still be achieving its aim while being less restrictive than it was in the disputed form. What is remarkable is that the EFTA Court has not even mentioned the direct link criterion which has been such an integrated part of the cohesion justification in the ECJ's case law.

Conclusively, the outcome of the Meilicke case should be expected to resemble the outcome of the Manninen case.[304] As mentioned, Advocate General Tizzano did not mention the direct link criterion in his opinion in the Meilicke case. However, we think that the ECJ will have to address the direct link; we do not see a reason for not doing so. In that case, we also believe that the ECJ will have to recognize the direct link as it did in the Manninen case, since the circumstances on that point are very similar to each other. Further, the fact that the tax system under scrutiny is an imputation system is another argument for the recognition of the direct link in the Meilicke case. As mentioned, the lack of an imputation system constituted a reason for not recognizing the direct link in the Lenz case.[305] Also, regarding the objective criterion, we believe that the ECJ will reason in a similar way as it did in the Manninen case. That becomes clear from Advocate General Tizzano's opinion, where he makes a reference to the ECJ's treatment of the objective criterion in the Manninen case. Consequently, the ECJ will examine whether an extension of the tax advantages to cross-border situations could affect the achievement of the objective of the German tax law. That application of the objective criterion should also be expected considering that the ECJ applied the criterion that way both in the Lenz and Manninen cases. Conclusively, the ECJ should be expected to reject the cohesion justification in the Meilicke case on the

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[298] E-1/04 Fokus Bank, para. 4

[299] *Ibid.,* para. 9

[300] *Ibid.,* para. 10

[301] *Ibid.*, para. 30.

[302] *Ibid.*, para. 32.

[303] See chapter 4.2.

[304] See chapter 4.3.

[305] See chapter 4.2.

same ground as it did in the Manninen case, namely the objective criterion. The only difference, which we believe might occur in the Meilicke case compared to the Manninen case, is that the ECJ might actually elaborate its reasoning concerning the direct link and objective criteria. We think that such an elaboration is going to be presented by the ECJ sooner or later, whether it will happen in the Meilicke case is uncertain, however.

Regarding the Fokus Bank case, we mean that a clarification of the ECJ's judgment could not have been expected to be delivered by the EFTA Court. The EFTA Court is to interpret the provisions of the EEA Agreement in the light of the ECJ's case law.[306] In our opinion, that does not mean that the EFTA Court can interpret and explain decisions given by the ECJ. However, what we think could have been expected, is that the EFTA Court had approached the Fokus Bank case as the ECJ approached the Manninen case, since the circumstances in the two cases were similar.[307] Instead, the EFTA Court disregarded the direct link criterion altogether. The reason for not taking the direct link criterion into consideration is unclear. One reason could however have been that the EFTA Court did not consider it to be necessary to examine the direct link criterion in order to make a decision in the case.

4.5 Conclusive remarks

After examining some of the recent cases concerning cross-border dividend taxation it becomes apparent that certain similarities and differences exist between them. Clearly, the examined cases have in common that they all surround the unfavorable taxation of cross-border dividends. Also, the Member States' attempts to justify the different treatment to inbound dividends match since in every case the cohesion justification has been invoked. But the connection between the cases, which may be more interesting, is the way the ECJ has dealt with the cohesion justification.

Regarding differences between the examined cases we can distinguish an alteration in the ECJ's reasoning throughout the cases. As already stated, the ECJ has been relying on mainly two arguments when confronting the cohesion justification, the direct link requiring one single tax to be levied on one taxpayer and the need to take the aim of the national provision into consideration. In the Verkooijen case the ECJ rejected the cohesion justification by referring merely to the direct link requirement.[308] It is understandable that no reference was made to the aim of the national provision since that requirement was developed later in the Lasteyrie du Saillant case.[309] On the other hand, in the Lenz[310] and Manninen[311] cases the ECJ referred to both the direct link requirement and the aim of the national provision. In the subsequent Fokus Bank[312] and Meilicke[313] cases the direct link requirement

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[306] See chapter 1.4.

[307] See chapter 4.2.

[308] *Ibid.*

[309] It should be pointed out that the requirement to take the objective of a national measure into consideration when justifying it was established in the Gebhard case. See also chapter 3.4.

[310] See chapter 4.2.

[311] See chapter 4.3.

[312] See chapter 4.4.

seems to have been abandoned altogether and the ECJ's arguing was diminished to the mere reference to the aim of the national provision.

We find that the Manninen case can be seen as a turning point in the ECJ's case law. It was during that case that Advocate General Kokott redefined the direct link criterion and held that it could be established even if the correlation between taxation and deductions concerned different taxes paid by different taxpayers, as long as they referred to the same economic process.[314] We consider that finding to be groundbreaking bearing in mind the ECJ's reluctance to deviate from its finding throughout the case law that a direct link could entail only one and the same taxpayer and one tax. The fact that the ECJ actually followed the Advocate General's opinion and departed from its earlier case law shows obviously that Kokott makes a relevant point and a sound argumentation, we must find the ECJ's finding surprising nevertheless. What is more astonishing is the fact that the ECJ avoids a real discussion on the matter altogether. We find that regrettable especially seeing this finding to be very significant for the development of the direct link criterion in particular and the cohesion justification in general. It seems as if the ECJ agreed with the Advocate General without actually wanting to, following the strong arguments made by her.

As mentioned, the opinion of Advocate General Kokott must be considered as crucial and groundbreaking, however it can be debated whether her opinion has led to a more relaxed or strict application of the cohesion justification. Obviously, the cohesion justification has been relaxed considerably and made available to Member States more easily by widening the direct link criterion to entail even different taxes and different taxpayers. At the same time, Advocate General Kokott's view that cohesion in intra-Community situations should be seen from an international perspective rather than from a national one obliges the national tax rules of the Member States to extend tax advantages even to cross-border situations. Seen that way, it is not clear whether the new definition of the direct link, as presented by Kokott, has made it easier for Member States to justify any restrictive measures by referring to the cohesion argument. Clarity could have been achieved in cases following the Manninen case; however, the direct link argument seems to have been abandoned for now. Neither in the Fokus Bank case nor in Advocate General Tizzano's opinion to the pending Meilicke case has the direct link criterion been mentioned. We are aware that a reference to a case judged by the EFTA Court and to an opinion by an Advocate General is not as germane as a decision by the ECJ would have been; nevertheless we find the development of the cohesion justification very interesting. Ever since the recognition of the cohesion argument as a valid justification in the Bachmann case, the direct link criterion has played a central role. It has been relied upon by the ECJ as well as Advocate Generals, yet suddenly it is not even mentioned. It is mentioned neither by an Advocate General nor by the EFTA Court, which apart from the direct link is basing its decision entirely on earlier ECJ case law.[315] This development confirms the above mentioned perception that the ECJ sometimes introduces a principle but without clarifying it before it is known what effect it

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[313] See chapter 4.4.

[314] See chapter 4.3.

[315] See chapter 4.4.

might have.[316] The same can be said about the ECJ's explanation of how the direct link relates to schedular/imputation systems.[317]

Michael Lang points out that the ECJ is about to make a "u-turn" and actually change its case law.[318] In our opinion that has become evident in the recent development following the Manninen judgment. Like Advocate General Maduro, Englisch finds the cohesion justification to have a necessary corrective function in Community law.[319] He means that the ECJ's application of the cohesion justification is too narrow and that the ECJ should use the opportunities which present themselves in current case law to reconsider its prior statements.[320] Arguments for the ECJ to readdress and reconsider its prior definitions of the cohesion justification are numerous. As we have mentioned earlier, the initial definition and application of the cohesion justification in the Bachmann case is considered to be false and ill-developed from the start.[321] Also, it should be pointed out once more that the harmonization of direct tax laws within the European Community has been achieved mainly through negative integration, by striking down incompatible systems without creating any compatible alternatives.[322] Such a need for the creation of actual positive criteria becomes also evident when taking Articles 94 and 95 EC, on the approximation of laws, into consideration. According to those rules the achievement of the internal market does not seem possible by way of negative integration alone.[323]

All these arguments show that the legal certainty for tax payers and the predictability of the ECJ's decisions would be enhanced considerably if the ECJ was to address the cohesion justification and would clearly set out and define certain criteria. According to Arnull legal certainty is a general and widespread principle.[324] He also points out that the principle has been acknowledged even by the ECJ holding that Community law "…must be certain and its application foreseeable…"[325] That leads to the question how foreseeable the application of the cohesion justification by the ECJ in the recent cross-border dividend cases really is. The scope and the application of the cohesion justification have been changing throughout the ECJ's case law.[326] One might argue that that fact alone shows that there is not much of a legal certainty. However, a certain level of evolution and adaptation of the case law to new cases and new circumstances seems inevitable, considering the characteristics of the EC Treaty, constituting a legal framework, and the method of interpretation used by the ECJ, taking consideration to the aim of the EC Treaty.

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316 See chapter 3.3.1.

317 See chapter 4.3.

318 *Ibid.*

319 *Englisch, Joachim*, European Taxation 2004/August, p. 357.

320 *Ibid.*, p. 356.

321 See chapter 3.2.1.

322 *Wathelet, Melchior*, EC Tax Review 2004/1, p. 3.

323 See also *Cordewener, Axel and others*, European Taxation 2004/5, p. 221.

324 *Arnull, Anthony* The European Union and its Court of Justice, p. 192.

325 Case 325/85 Ireland v. Commission [1987] ECR 5041, para. 18.

326 See chapter 3.

5 Conclusions

The aim of this paper is to analyze the application of the cohesion justification by the ECJ from a legal certainty perspective. The reason for that is to find out whether the application, such as it has been so far, can be maintained or whether it has to be changed and clarified in order to increase the legal certainty and predictability for the taxpayers. We try to find out what the taxpayers can expect from the ECJ in the recent cross-border dividend cases.

Our conclusion is that the application of the cohesion justification by the ECJ has been inconsistent, meaning that the principle has not been applied in a uniform manner and that the ECJ has not only narrowed it but also applied it differently in different cases. New criteria for invoking the cohesion justification successfully have been introduced and old ones have been applied inconsistently. Therefore, it would be adequate if the ECJ would readdress and reconsider the cohesion justification, clearly stating which criteria is to be applied and in what way. That would lead to increased legal certainty, providing taxpayers with more predictability regarding the ECJ's judgments.

Initially, we want to point out that it is not possible to simply claim that the ECJ has been inconsistent in its application and that its judgments sometimes seem to be arbitrary. It is true that the ECJ has not always motivated its decisions as much as might be desirable.[327] Nevertheless, the ECJ has many times been clear in its judgments, making the application of the cohesion justification and other principles more foreseeable. Such an example is the case law concerning the application of the direct link criterion following the Bachmann case.[328] The ECJ clarified the direct link criterion and its scope, as established in the Bachmann case, in cases like Danner, Asscher and Lankhorst-Hohorst.[329] What the ECJ did was to clarify the direct link criterion by pointing to the differences in circumstances in the different cases and actually explaining the criterion without giving it another meaning. The same conclusion could be drawn from the ECJ's application of the objective criterion as done in cases like X & Y and Lasteyrie du Saillant.[330] There, the ECJ also explained thoroughly why it applied the objective criterion differently compared to its earlier case law. What is regrettable, however, is the fact that the ECJ did not give such a clarification in the cases prior to the X & Y case. The same can be said about the ECJ's finding in the Baars case, where the requirement for one single tax and one single taxpayer was elaborated and clarified somewhat.[331] However, in the following Lankhorst-Hohorst case the ECJ disregarded the requirement for one tax and one taxpayer, causing uncertainty about how the ECJ actually looked at the requirement. We conclude that there exists a certain legal certainty, provided by the clarifications and explanations of the direct link and objective criteria by the ECJ, making its future decisions more foreseeable. However, cases where the ECJ was more unclear and where its findings led to uncertainty are numerous.

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[327] See chapter 3.3.2 concerning the ECJ's treatment of double taxation agreements compared to the Bachmann case.

[328] See chapter 3.2.1.

[329] *Ibid.*

[330] See chapter 3.4.

[331] See chapter 3.2.2.

As is clear from the ECJ's case law, the establishment of new principles is understandable and natural, considering the different circumstances to be taken into consideration in different cases.[332] However, in such cases the ECJ has to be very clear and detailed about the new principles or modifications to old ones. The mere fact that the case law is dynamic and changing makes it difficult for the taxpayers to exactly predict the outcomes of future cases. Therefore, it is important for the ECJ to set out clear criteria in order to reduce the negative effects of such a changing case law. It is on that point in particular, that we believe the ECJ to have been inadequate. As we have mentioned, the ICI case is an example where the ECJ's finding is expressed very unclearly and vaguely.[333] In the ICI case the cohesion justification was rejected based on the lack of a direct link, yet without really exhausting the matter. Instead of grasping the opportunity to clearly set up a principle which could be followed in following case law, the ECJ limited its argumentation only to the specific circumstances in the ICI case. The ECJ has also been criticised for this in the doctrine.

Another example where the ECJ was unclear is the Bachmann case. There, the application of the double taxation agreement did not become evident before reading the explanation by the Advocate General in the Wielockx case.[334] It seems to be a well-known occurrence that the ECJ from time to time introduces a principle without really defining or explaining it right away.[335] It is introduced and its possible effects are mentioned, yet the principle is not given any real significance. Some believe that the ECJ is acting that way in order to test the Member States' reactions to the principle. Both the findings in the Bachmann case and the ICI case are illustrative of that phenomenon. The application of the objective criterion, which was quite unclear in the ICI case, was clarified in following cases ending in an adequate definition and application in the X and Y case.[336] Apparently, the application of principles, which may be seen as unclear, eventually ends in a well-defined explanation, making such an application more foreseeable; however, we believe that the legal uncertainty in the meantime is redundant. Of course, this argument has to be approached with care and its legitimacy may not be taken for granted. Nevertheless, the Manninen case seems to be yet another example where the ECJ chooses to delay the exact definition of a principle.[337]

In the Manninen case the ECJ for the first time recognized a direct link between two different taxes and two different taxpayers, yet the argumentation regarding that groundbreaking finding is very scarce and insufficient. There is no elaboration of the reasoning behind the finding, as compared to the extensive argumentation by Advocate General Kokott. No significant reference is being made to earlier case law, even though the recognition of a direct link, under the circumstances which are at hand in the Manninen case, is a clear derogation from established findings. Also, the development following the Manninen case, which can be observed in the Fokus Bank case and the Advocate General's opinion to the

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[332] See chapter 3.2.2.

[333] *Ibid.*

[334] See chapter 3.3.1.

[335] *Ibid.*

[336] See chapter 3.4.

[337] See chapter 4.3.

Meilicke case, seems to hint that the direct link criterion is put on hold until the ECJ has definitely made up its mind regarding how to apply it.[338]

In our view, these examples are arguments for the ECJ to change its approach to, and the application of, the cohesion justification. As we said, occasional departures from case law may be needed from time to time, especially within EC law; however, such departures have to be made clear and explicit as early as possible in order to avoid unnecessary uncertainty.[339]

As opposed to the examples where the ECJ was unclear in its judgments and did not explain new principles and derogations from established case law sufficiently, there are examples where the ECJ was plainly inconsistent in its reasoning. One of such examples is shown by the comparison between the Baars and Lankhorst-Hohorst cases. In the Baars case the ECJ established that a direct link could only be acknowledged if it concerned one single tax and one single taxpayer.[340] However, in the following Lankhorst-Hohorst case the ECJ merely referred to the Bachmann case and the fact that there one single tax and one single taxpayer was concerned. Instead of examining whether there was one single tax and one single taxpayer involved, the ECJ made the outcome of the case subject to a different criterion. The outcome of the Lankhorst-Hohorst case was not affected by the ECJ's inconsistency since the direct link criterion was rejected and it most probably would have been rejected even if the requirement for one tax and one taxpayer would have been significant. Nevertheless, by now a direct link is established even when different taxes and different taxpayers are concerned. The point is that the ECJ should try to be as consistent as possible when interpreting EC law or at least explain when derogations from earlier case law are being made.

When examining the application of double taxation agreements by the ECJ, it becomes clear how inconsistent the ECJ can be in its decisions.[341] The ECJ went from taking a careful approach in the Bachmann case, not taking the double taxation agreement into consideration, to actually leaving that approach in the Wielockx case. There the ECJ held that in case a double taxation agreement between the involved Member States exists it should be taken into consideration and no significance was to be given to national legislation. The ECJ went on to consider both the double taxation agreement and the national legislation in the Danner case and it finally disregarded the double taxation agreement altogether in the Lasteyrie du Saillant case.[342] In none of the cases the ECJ actually explained the derogation from earlier cases. In the Lasteyrie du Saillant case the ECJ is even considered to have disregarded the double taxation agreement simply in order to avoid being confronted with the application of such agreements in relation to exit taxes. The development of the ECJ's application of double taxation agreements is quite disturbing looking at it from a legal certainty point of view. As mentioned, the ECJ was not very clear in the Manninen case about the rationale behind acknowledging a direct link between different taxes and different tax-

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[338] See chapter 4.4.

[339] See chapter 3.3.1.

[340] See chapter 3.2.2.

[341] See chapter 3.3.2.

[342] *Ibid.*

payers.[343] As a result of that, we find the ECJ not to be consistent in its findings prior to the Manninen judgment compared to the development following the Manninen case. Both, in the Verkooijen and Lenz cases the ECJ relied on the direct link criterion, which has been crucial for the cohesion justification since Bachmann.[344] However, since the ECJ recognized the direct link in the Manninen case the criterion seems to have been abandoned. The direct link criterion is not even mentioned either in the Fokus Bank case or by the Advocate General in his opinion to the Meilicke case. It seems as if the ECJ agreed with Advocate General Kokott and changed its application of the direct link criterion simply because the Advocate General made such a strong case for her proposition. We believe that the ECJ's reluctance to change its application of the direct link criterion explicitly was one of the reasons the ECJ did not explain and elaborate its reasoning.

We have come across numerous arguments for a change of the ECJ's application of the cohesion justification. One such argument is that the concept of cohesion, as established in the Bachmann case, was ill-developed from the start.[345] It is not even clear whether the ECJ actually interpreted the Belgian legislation correctly. Some believe that the Bachmann case, considering the subsequent case law, has lost its value as a general principle and that the ECJ might repeat its findings only in cases concerning the exact same legislation as the one in the Bachmann case.[346] However, that argument has to be reconsidered if the ECJ really did misinterpret the Belgian legislation. Others argue that the Bachmann case would have a very different outcome if it was judged today. We agree with that and find it a strong argument for reconsidering the cohesion argument and setting up new definitions since, even though undermined, the Bachmann case is still referred to by the ECJ.[347] It would be in the interest of the taxpayers and enhance legal certainty if the ECJ would readdress the cohesion justification and clearly state which criteria have to be applied in what way.

Another argument which has to be considered is the fact that the cohesion justification actually has an important corrective function.[348] Its function is to create a balance between the internal market and the national tax systems of the different Member States. Of course, the national tax systems of the different Member States have to comply with EC law and may not lead to arbitrary discrimination. Nevertheless, some believe that the cohesion justification has the important function to prevent the protection of the fundamental movements from interfering with the internal logic of national tax systems. Therefore, seeing the direct link being established only between one single tax and one single taxpayer might be too rigid and might need to be relaxed. Also, there are several authors who consider legal uncertainty to be high, partly because the ECJ is unclear in its statements and changing its case law. But not only is the ECJ changing its case law, it is concealing that change. It is pretending to maintain established case law, when in fact it is derogating from it.

Advocate General Kokott made a very relevant point in her opinion in the Manninen case. As a result, the ECJ agreed with the Advocate General and derogated from its earlier estab-

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[343] See chapter 4.3.

[344] See chapter 4.2.

[345] See chapter 4.5.

[346] See chapter 3.6.

[347] See chapter 3.4 for example.

[348] See chapter 3.5.

lished findings.[349] However, as we have mentioned, the ECJ avoided a real discussion about this new development in its case law. A discussion which we find to be very necessary, since the ECJ's finding in the Manninen case leaves some questions unanswered. First of all, this new view of the cohesion justification leads to the direct link criterion not being ruled out anymore.[350] The acceptance of the direct link concerning different taxes and different taxpayers is a considerable derogation from established case law, making it much easier for Member States to invoke the direct link criterion successfully. Nevertheless, it has to be pointed out that the relaxation of the cohesion justification on the direct link criterion leads at the same time to other stricter requirements. As we have shown, even that change is a derogation from the Bachmann case, which would need to be elaborated in order for the taxpayers to know how exactly the direct link criterion is to be applied. Also, in her opinion Advocate General Kokott discussed the cohesion justification on an international level. This international view of the cohesion justification was not discussed by the ECJ during the main proceedings, even though we believe that there are interesting questions to think about. For example, the objective of a national legislation has to be taken into consideration when justifying it.[351]

Consequently, if the cohesion justification is to be seen from an international perspective, should the objective criterion also be seen from the same perspective?[352] One could argue that if the cohesion justification is to be seen on Community level, then the objective of the European Community, and not of the national legislation, should have to be taken into consideration as well. The main objective of the European Community is the achievement of an internal market by harmonizing the legislations of the different Member States.[353] So far, that harmonization has been done mainly through negative integration, striking down incompatible measures. However, according to Articles 94 and 95 EC the achievement of the internal market is not possible by negative integration alone. Actual positive provisions are needed as well. Consequently, that is an argument for the ECJ to stop applying the cohesion justification as it did so far, namely limiting it and failing it based on the specific circumstances in the different cases. Instead, the ECJ should take the opportunity which presents itself in recent cases to re-examine the cohesion justification and actually set up positive criteria for the Member States to follow.

Some actually believe that the ECJ is about to make a "u-turn" regarding the cohesion justification and change its case law.[354] The outcome of the Manninen case speaks for it. Following the aforementioned, we believe that a change in case law, concerning the application of the cohesion justification, would be very appropriate. Not only that; considering the legal uncertainty, which we find the ECJ's case law leads to, a change of the application of the cohesion justification is even necessary. We find that following the development of the cohesion justification in the ECJ's case law, it is very difficult to predict how the ECJ will reason in the Meilicke case, for example, and what outcome the case might have, especially

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[349] See chapter 4.5.

[350] See chapter 4.3.

[351] See chapter 3.4.

[352] See chapter 4.3.

[353] See chapter 4.5.

[354] *Ibid.*

after the judgment in the Manninen case. The ECJ should really grasp the opportunity now to clarify the cohesion justification and its application for future case law. If the ECJ does not do that now, the cohesion justification might go under due to the ECJ's inconsistency.

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