

8. Kerckhaert & Morres: A European “Switch in Time?”

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8.1. Introduction

International public law imposes few limits on the tax power of sovereign states other than the requirement of jurisdictional nexus.¹⁶⁸ Cross-border economic activities may be exposed to multiple juridical income taxation in the absence of a general international law prohibition of

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¹⁶⁸ See S. Douma, “The Three Ds of Direct Tax Jurisdiction: Disparity, Discrimination and Double Taxation”, 46 *European Taxation* (2006), pp. 522 et seq, at p. 523.

double taxation.¹⁶⁹ Although international law permits double taxation, the question remains whether double taxation should be eliminated in highly integrated markets, such as the European Union or the United States. In this article, we ask whether the EC fundamental freedoms prohibit juridical double taxation.¹⁷⁰

Undoubtedly, abolition of double taxation is an aim of the EC Treaty,¹⁷¹ since overlap of taxing jurisdictions leads to distortions of the Internal Market.¹⁷² Thus, “[d]ouble tax conventions and the EC Treaty are natural friends, because they pursue mutual objectives,” such as reducing impediments to cross-border economic activity.¹⁷³ The network of bilateral double tax convention (DTCs) for avoiding double tax in the international context also serves as the primary mechanism for avoiding double taxation in the Community. However, because bilateral treaties

¹⁶⁹ See K. Vogel in K. Vogel and M. Lehner, *DBA* (Munich: C.H.Beck, 4th edition 2003), Einl Para.14; in a broader context M. Lehner, “Das Territorialitätsprinzip im Licht des Europarechts”, in R. Gocke, D. Gosch and M. Lang (eds.), *Körperschaftsteuer – Internationales Steuerrecht – Doppelbesteuerung, Festschrift für F. Wassermeyer* (Munich: C.H. Beck, 2005), pp. 491 et seq, at pp. 242 et seq.

¹⁷⁰ See extensively G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007), pp. xxx et seq.

¹⁷¹ ECJ, 12 May 1998, C-336/96, *Gilly* [1998] ECR I-2793, Para. 16; ECJ, 19 January 2006, C-265/04, *Bouanich* [2006] ECR I-923, Para. 49; see also Opinion Advocate General Ruiz-Jarabo Colomer, 26 October 2004, C-376/03, *D* [2005] ECR I-5821, Para. 78.

¹⁷² See the Discussion paper for the Informal Meeting of ECOFIN Ministers “Taxation in the European Union,” SEC(96)487, p. 7; see also G. Fibbe and A. de Graaf, “Is double taxation arising from autonomous tax classification of foreign entities incompatible with EC law?” in H. van Arendonk, F. Engelen and S. Jansen (eds.), *A Tax Globalist, Essays in honour of Maarten J. Ellis* (Amsterdam: IBFD, 2005), pp. 237 et seq, at p. 238.

¹⁷³ E. Kemmeren, *Principle of Origin in Tax Conventions* (Dongen: Pijnenburg, 2001), p. 246.

cannot cover every transaction in the Single Market, it may not be possible to completely eliminate double taxation through DTCs.¹⁷⁴ For example, although the network of treaties between Member States is nearly comprehensive,¹⁷⁵ and many countries grant relief unilaterally, juridical double taxation still occurs in the Community due to diverging applications of treaty provisions by the contracting Member States. Additionally, triangular and multi-angular situations raise well-known tax treaty problems.¹⁷⁶ The inadequacy of DTCs raises the question of whether Community law offers taxpayers a direct solution to double taxation. This is one of “today’s trickiest issues concerning the scope of the prohibition of national tax practices based on the fundamental freedoms.”¹⁷⁷

¹⁷⁴ See the Commission Communication on “Guidelines on company taxation,” SEC(90)601 final, Para. 10.

¹⁷⁵ The treaty network between the 15 “old” Member States was recently completed so that 102 bilateral treaties and the multilateral Nordic treaty cover all 105 possible bilateral relations between the 15 States. Since the accession of 10 Member States in mid-2004, and Bulgaria and Romania in 2007, 336 of possible 351 bilateral relations are covered by treaties in force. See G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007), pp. xxx.

¹⁷⁶ As do classification conflicts and conflicts in the attribution of income, but those are generally instances of economic double taxation and are not further examined here; for an analysis see G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007), pp. xxx et seq; see also G. Fibbe and A. de Graaf, “Is double taxation arising from autonomous tax classification of foreign entities incompatible with EC law?” in H. van Arendonk, F. Engelen and S. Jansen (eds.), *A Tax Globalist, Essays in honour of Maarten J. Ellis* (Amsterdam: IBFD, 2005), pp. 237 et seq.

¹⁷⁷ L. Hinnekens, “AMID: The Wrong Bridge or a Bridge Too Far? An Analysis of a Recent Decision of the European Court of Justice”, 41 *European Taxation* (2001), pp. 206 et seq, at p. 208.

Article 293 EC urges Member States, “so far as is necessary, [to] enter into negotiations with each other with a view to securing for the benefit of their nationals... the abolition of double taxation within the Community.” But the ECJ has made it clear that Article 293 EC is not directly applicable and does not grant rights to individual taxpayers in *Mutsch*,¹⁷⁸ *Mund & Fester*,¹⁷⁹ and *Gilly*.¹⁸⁰ No serious objection to this conclusion has been raised in legal¹⁸¹¹⁸² scholarship. But the lack of direct effect of Article 293 EC does not take the issue of double taxation completely out of

¹⁷⁸ ECJ, 11 July 1985, 137/84, *Mutsch* [1985] ECR 2681, Para. 11 (concerning Art 293 1st indent EC).

¹⁷⁹ ECJ, 10 February 1994, C-398/92, *Mund & Fester* [1994] ECR I-467, Para. 11 (concerning Art 293 4th indent EC).

¹⁸⁰ ECJ, 12 May 1998, C-336/96, *Gilly* [1998] ECR I-2793, Para. 15 (concerning Art 293 2nd indent EC)

¹⁸¹ However van Thiel argues that a directly applicable prohibition of juridical double taxation can be read in the Treaty Articles on free movement of persons, services and capital. See Servaas van Thiel (2005): “Income tax payments and social security contributions from a Community law point of view: how the European Court of Justice could streamline its approach in the interest of the internal market”, Contribution to the July 2005 Rust Conference and published in “Income tax payments and social security contributions in a European perspective” (at 37 to 114), Kluwer International Law EUCOR Series on International and European tax.

the Community law line of fire.¹⁸³ It is possible that the fundamental freedoms protect taxpayers from double taxation, even where no such right exists under tax treaty law or domestic law, because “the fact that a taxable event might be taxed twice is the most serious obstacle there can be to people and their capital crossing internal borders.”¹⁸⁴ In this article, we give a brief overview of the arguments for and against the conclusion that the fundamental freedoms offer EU nationals protection from double taxation, and we analyze the ECJ’s conclusion in *Kerckhaert & Morres* that no such protection is available.

¹⁸² See also Servaas van Thiel (2006): “The future of the principle of non-discrimination in the EU: towards a right to most favoured nation treatment and a prohibition of double taxation?”, Contribution to the October 2005 Conference on comparative fiscal federalism at Michigan University, Ann Arbor Michigan (USA), published as Chapter 9 in Avi-Yonah, Hines and Lang (2006): “Comparative fiscal federalism”, Kluwer International Law EUCOR Series on International and European tax. An updated version is to be published in Weber’s proceedings of the ACIL Conference on European Taxation (Amsterdam, 24 November 2006) also to be published in the EUCOR Series. For an early exploration of this view see S. van Thiel, *Free Movement of Persons and Income Tax Law: the European Court in Search of Principles* (Amsterdam, IBFD, 2002), p. 133.

¹⁸³ But see M. Gammie, “Double taxation, bilateral treaties and the fundamental freedoms of the EC Treaty”, in H. van Arendonk, F. Engelen and S. Jansen (eds.), *A Tax Globalist, Essays in honour of Maarten J. Ellis* (Amsterdam: IBFD, 2005), pp. 266 et seq, at p. 278.

¹⁸⁴ Opinion Advocate General Ruiz-Jarabo Colomer, 26 October 2004, C-376/03, D [2005] ECR I-5821, Para. 85.

8.2. Juridical double taxation and the fundamental freedoms

8.2.1. Overview

The question whether unrelieved double taxation, like any other tax hindrance, constitutes a violation of the fundamental freedoms, is nearly as old as the EC Treaty itself.¹⁸⁵ Since the risk of unrelieved double taxation of cross-border economic activities in the Community poses a hindrance to competition and hampers the effectiveness of the Internal Market,¹⁸⁶ the ECJ unsurprisingly views the abolition of double taxation as a Community goal.¹⁸⁷ However, double taxation could occur even if all the Member States had perfectly discrimination-free tax systems. Indeed, double taxation would persist even if all Member States had the *same* tax system; as long as source- and residence-based taxation remain in place, they will overlap.¹⁸⁸

¹⁸⁵ See A. J. Rädler, “Entspricht unser Außensteuerrecht der Neuordnung unserer Außenwirtschaft im Gemeinsamen Markt?”, *Steuer und Wirtschaft* (1960), pp. 729 et seq, at p. 731.

¹⁸⁶ M. Lehner, “Beseitigt die neue Verfassung für Europa die Verpflichtung der Mitgliedstaaten zur Vermeidung der Doppelbesteuerung?”, 14 *Internationales Steuerrecht* (2005), pp. 397 et seq, at p. 398; M. Lehner, “A Significant Omission in the Constitution of Europe”, 50 *British Tax Review* (2005), pp. 337 et seq, at p. 338.

¹⁸⁷ ECJ, 12 May 1998, C-336/96, *Gilly* [1998] ECR I-2793, Para. 16; ECJ, 19 January 2006, C-265/04, *Bouanich* [2006] ECR I-923, Para. 49; see also Opinion AG Ruiz-Jarabo Colomer, 26 October 2004, C-376/03, *D* [2005] ECR I-5821, Para. 78.

¹⁸⁸ Opinion Advocate General Geelhoed, 23 February 2006, Case C-374/04, *ACT Group Litigation*, not yet reported, Para. 48.

Double taxation does not easily fit into the framework created by the ECJ over the last 20 years: it is neither discriminatory (or, more precisely, a discriminatory restriction), nor a mere disparity that would disappear if tax systems were identical. On the other hand, double taxation imposes a higher burden on cross-border transactions and therefore disadvantages taxpayers who exercise their freedoms under the EC Treaty.¹⁸⁹ Analysis of double taxation under the fundamental freedoms is difficult because, unlike the issues the Court has considered previously in the direct tax area, double taxation involves a disadvantage created by two taxing jurisdictions, rather than just one.¹⁹⁰ Until the Court's decision in *Kerckhaert & Morres*, it had given no specific guidance on this issue, even though it arguably had the opportunity in the *Gilly*¹⁹¹ and *van Hilten*¹⁹² cases.¹⁹³

¹⁸⁹ See W. Schön, "Freie Wahl zwischen Zweigniederlassung und Tochtergesellschaft – ein Grundsatz des Europäischen Unternehmensrechts", *Europäisches Wirtschafts- und Steuerrecht* (2000), pp. 281 et seq, at p. 290; J. Englisch, *Dividendenbesteuerung* (Cologne: Schmidt, 2005), p. 254; J. Englisch, "The European Treaties' Implications for Direct Taxes", 33 *Intertax* (2005), pp. 310 et seq, at pp. 323 et seq; M. Lehner, "Avoidance of Double Taxation within the European Union: Is There an Obligation under EC Law?" in M. Lang, J. Schuch and C. Staringer (eds.), *Tax Treaty Law and EC Law* (Vienna: Linde, 2007), pp. 11 et seq, at p. 16. This might be viewed as a *de facto* discrimination. See J. Englisch, "The European Treaties' Implications for Direct Taxes", 33 *Intertax* (2005), pp. 310 et seq, at p. 344.

¹⁹⁰ See J. Schönfeld in D. J. Flick, F. Wassermeyer and H. Baumhoff (eds.), *Außensteuerrecht* (Cologne: Schmidt, 6th edition 2005) Vor § 34c EStG Para. 2; J. Schönfeld, "Doppelbesteuerung und EG-Recht", *Steuer und Wirtschaft* (2006), pp. 79 et seq, at p. 80; see also Opinion Advocate General Geelhoed, 23 February 2006, Case C-374/04, *ACT Group Litigation*, not yet reported, Para. 48.

¹⁹¹ ECJ, 12 May 1998, C-336/96, *Gilly* [1998] ECR I-2793.

¹⁹² ECJ, 23 February 2006, Case C-513/03, *Heirs of M.E.A. van Hilten-van der Heijden* [2006] ECR I-1957.

¹⁹³ For analysis, including the case law concerning economic double taxation, see G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007) pp. xxx et seq.

However, the ECJ has given guidance on disadvantages arising from the application of two states' laws in its non-tax jurisprudence. It has recognized that even non-discriminatory restrictions may be contrary to the fundamental freedoms if they hamper market access or market exit.¹⁹⁴ This is especially true for "dual burden" situations where the disadvantage is created by the uncoordinated application of two or more national legal systems,¹⁹⁵ as a long line of social security cases suggests.¹⁹⁶ The Court has also recognized in the indirect tax field that certain effects of double taxation must be avoided.¹⁹⁷ In the early stages of value added tax (VAT) harmonization, for example, cross-border

¹⁹⁴ For a detailed analysis of the prohibition of non-discriminatory restrictions see, e.g., A. Cordewener, *Europäische Grundfreiheiten und nationales Steuerrecht* (Cologne: Schmidt, 2002), pp. 249 et seq., and A. Cordewener, "The prohibitions of discrimination and restriction within the framework of the fully integrated market", in F. Vanistendael (ed.), *EU Freedoms and Taxation* (Amsterdam: IBFD, 2006), pp. 7 et seq.

¹⁹⁵ See, e.g., J. Englisch, "The European Treaties' Implications for Direct Taxes", 33 *Intertax* (2005), pp. 310 et seq, at pp. 324. ("twofold or even multifold 'regulation'"); see also Opinion Advocate General Fennelly, 16 September 1999, C-190/98, *Volker Graf* [2000] ECR I-493, Para. 26.

¹⁹⁶ E.g., ECJ, 3 February 1982, 62/81 and 63/81, *Seco* [1982] ECR 223; ECJ, 15 February 1996, C-53/95, *Kemmler* [1996] ECR I-703; ECJ, 28 March 1996, C-272/94, *Guiot* [1996] ECR I-1905; ECJ, 23 November 1999, C-369/96 and C-376/96, *Arblade* [1999] ECR I-8453; ECJ, 15 June 2000, C-302/98, *Sehrer* [2000] ECR I-4585; see also ECJ, 9 August 1994, C-43/93, *Vander Elst* [1994] ECR I-3803; for an analysis of this line of case-law in the light of secondary Community law and for further discussion of cases on the principle of mutual recognition see G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007).

¹⁹⁷ ECJ, 5 May 1982, 15/81, *Schul I* [1982] ECR 1409; subsequently also ECJ, 25 February 1988, 299/86, *Drexel* [1988] ECR 1213, Paras. 9 et seq. See also ECJ, 21 May 1985, 47/84, *Schul II* [1985] ECR 1491, Paras. 12 et seq; ECJ, 23 January 1986, 39/85, *Bergeres-Becque* [1986] ECR 259, Paras. 10 et seq.

private-to-private dealings could lead to double taxation insofar as the exporter could not utilize input VAT and the importer had to pay VAT upon the import. The *Schul I*-case,¹⁹⁸ however, made it clear that the Member State of destination had to grant a (limited) credit for the input VAT levied in the state of exportation to avoid such double taxation.

The ECJ expressly limited the approach taken in *Schul I* to areas harmonized by secondary Community law, in which the contours of the tax (e.g., taxable event, tax liability, and tax base) are uniform throughout the Community.¹⁹⁹ Nevertheless, the ECJ could be seen as extending the “dual burden” approach beyond areas harmonized by secondary Community law. In *Lindfors*,²⁰⁰ the ECJ held that a Member State could not assess an automobile registration tax on new residents if that tax would place new residents in a less favourable position than permanent residents, taking into consideration similar taxes the new resident may have paid in other Member States.²⁰¹ The ECJ came to this conclusion even though it held that the car tax was not, in principle, precluded

¹⁹⁸ See ECJ, 5 May 1982, 15/81, *Schul I* [1982] ECR 1409.

¹⁹⁹ ECJ, 5 December 1989, 165/88, *Oro Amsterdam Bebeer* [1989] ECR 4081, Para. 18; ECJ, 27 October 1993, C-72/92, *Scharbatke* [1993] ECR I-5509; see already in this sense ECJ, 19 June 1978, 142/77, *Statens Kontrol* [1978] ECR 1543, Paras. 33 et seq; see also Cordewener, *Europäische Grundfreiheiten und nationales Steuerrecht* (Cologne: Schmidt, 2002), pp. 867 and 881; D. Weber, “In Search of a (New) Equilibrium Between Tax Sovereignty and the Freedom of Movement Within the EC”, 34 *Intertax* (2006), pp. 582 et seq, at p. 589; G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007) pp. xxx et seq.

²⁰⁰ ECJ, 15 July 2004, C-365/02, *Lindfors* [2004] ECR I-7183 (concerning car registration taxation).

²⁰¹ *Id.* at Para 35. *Lindfors* can be seen as a double burden case because the Commission argued on behalf of the taxpayer that a similar tax had already been assessed by the State of origin. *Id.* at Para. 23.

under harmonized secondary Community law.²⁰² Also, the Court applied the “double burden analysis” to several social security cases, none of which concerned situations covered by secondary Community law. These cases are legally and factually similar to double juridical income taxation: simultaneous application by two Member States of their laws lead to cumulative burdens for the cross-border economic actor. The ECJ’s holdings that cumulative social security and car tax burdens contravened the fundamental freedoms suggest that double taxation in the largely non harmonized area of direct taxation could likewise contravene the fundamental freedoms.

Although the relevance of the “double burdens” jurisprudence to the field of direct taxation has not yet been fully explored,²⁰³ the disadvantage for cross-border activities created by multiple taxation arguably falls within the broad scope of the fundamental freedoms. Article 14 EC gives weight to that conclusion because it foresees an internal market without internal frontiers in which the free movement of goods, persons, services and capital is ensured. Against the background of Article 14 EC and the developing case-law of non-discriminatory restrictions created by “double burdens,” a shift in prevailing legal opinion has taken place.

²⁰² *Id.* at Para. 26.

²⁰³ For the breadth of the fundamental freedoms and their prohibition of both discriminatory restrictions (in inbound and outbound situations) and non-discriminatory restrictions and for the relevance of these concepts for direct taxation, see G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007) pp. xxx and the references therein.

While early legal scholarship regarded juridical double taxation as outside the scope of the fundamental freedoms,²⁰⁴ recently, legal scholars have argued that such “double burdens” are prohibited under the fundamental

²⁰⁴ See, e.g., A. J. Rädler, “Entspricht unser Außensteuerrecht der Neuordnung unserer Außenwirtschaft im Gemeinsamen Markt?”, *Steuer und Wirtschaft* (1960), pp. 729 et seq, at p. 731; E. Wessel, *Doppelbesteuerung und EWG-Vertrag* (Münster, 1988), pp. 146 et seq; U. Eyles, *Das Niederlassungsrecht der Kapitalgesellschaften in der Europäischen Gemeinschaft* (Baden-Baden: Nomos, 1990), pp. 377 et seq; P. Farmer, “Article 48 EC and the Taxation of Frontier Workers”, 20 *European Law Review* (1995), pp. 310 et seq, at pp. 315 et seq; M. Mössner and D. Kellersmann, “Grenzenlose Steuern – Fiktion oder Wirklichkeit?”, *Deutsches Verwaltungsblatt* (1995), pp. 968 et seq, at p. 970; H. Schaumburg, *Internationales Steuerrecht* (Cologne: Schmidt, 2nd edition 1998), Para. 14.5; P. Farmer, “EC law and national rules on direct taxation: a phoney war?”, 7 *EC Tax Review* (1998), pp. 13 et seq, at p. 14; P. J. Wattel, “Corporate tax jurisdiction in the EU with respect to branches and subsidiaries; dislocation distinguished from discrimination and disparity; a plea for territoriality”, 12 *EC Tax Review* (2003), pp. 194 et seq, at p. 199; M. Gammie, “Double taxation, bilateral treaties and the fundamental freedoms of the EC Treaty”, in H. van Arendonk, F. Engelen and S. Jansen (eds.), *A Tax Globalist, Essays in honour of Maarten J. Ellis* (Amsterdam: IBFD, 2005), pp. 266 et seq, at pp. 276 et seq; see also E. Reimer, “Die Auswirkungen der Grundfreiheiten auf das Ertragsteuerrecht der Bundesrepublik Deutschland”, in M. Lehner (ed.), *Grundfreiheiten im Steuerrecht der EU-Staaten* (Munich: C.H.Beck, 2000), pp. 39 et seq, at pp. 58 et seq; see also *Finanzgericht Rheinland-Pfalz*, 16 June 2005, 4 K 1951/04, *Entscheidungen der Finanzgerichte* (2005), p. 1446.

freedoms.^{205, 206} This position was also favoured by the European Commission, which argued that “Member States are bound by the

²⁰⁵ See, e.g., W. Schön, “Europäische Kapitalverkehrsfreiheit und nationales Steuerrecht”, in W. Schön (ed.), *Gedächtnisschrift für B. Knobbe-Keuk* (Cologne: Schmidt, 1997), pp. 743 et seq, at pp. 761 et seq and 773; N. Dautzenberg, *Unternehmensbesteuerung im EG-Binnenmarkt* (Lohmar: Eul, 1997) pp. 687 et seq; C. R. Beul, “Beschränkung europäischer Niederlassungsfreiheit und Art. 220 EGV – Doppelbesteuerung und Meistbegünstigung –”, 6 *Internationales Steuerrecht* (1997), pp. 1 et seq, at 2 et seq; A. Cordewener, *Europäische Grundfreiheiten und nationales Steuerrecht* (Cologne: Schmidt, 2002), pp. 876 et seq; S. van Thiel, *Free movement of Persons and Income Tax Law: the European Court in search of principles* (Amsterdam, IBFD, 2002) pp. 41 and 313 et seq; S. van Thiel, “Removal of income tax barriers to market integration in the European Union: litigation by the Community citizen instead of harmonization by the Community legislature?”, 12 *EC Tax Review* (2003), pp. 4 et seq, at p. 10; V. Heydt, “Einfluss des Gemeinschaftsrechts auf die Doppelbesteuerung”, in W. Haarmann (ed.), *Auslegung und Anwendung von Doppelbesteuerungsabkommen* (Cologne: Schmidt, 2004), 32 et seq, at p. 48 and 53; J. Schönfeld, “Hinzurechnungsbesteuerung zwischen Steuerwettbewerb und Europäischen Grundfreiheiten”, *Steuer und Wirtschaft* (2005), pp. 158 et seq; J. Englisch, *Dividendenbesteuerung* (Cologne: Schmidt, 2005), pp. 252 et seq; J. Englisch, “The European Treaties’ Implications for Direct Taxes”, 33 *Intertax* (2005), pp. 310 et seq, at p. 323; J. Schönfeld in D. J. Flick, F. Wassermeyer and H. Baumhoff (eds.), *Außensteuerrecht* (Cologne: Schmidt, 6th edition 2005) Vor § 34c EStG Para. 2; J. Schönfeld, “Doppelbesteuerung und EG-Recht”, *Steuer und Wirtschaft* (2006), pp. 79 et seq, at p. 80; S. Enchelmaier, “Meistbegünstigung im EG-Recht – Allgemeine Grundsätze –“, in A. Cordewener, S. Enchelmaier and C. Ph. Schindler (eds.), *Meistbegünstigung im Steuerrecht der EU-Staaten* (Munich: C.H.Beck, 2006), pp. 93 et seq, at p. 100; J. G. Kofler, “Treaty Override, juristische Doppelbesteuerung und Gemeinschaftsrecht”, 16 *Steuer und Wirtschaft International* (2006), pp. 62 et seq; H. Loukota, “Gebietet EU-Recht einen DBA-Anrechnungsvortrag?”, 16 *Steuer und Wirtschaft International* (2006), pp. 250 et seq; F. Vanistendael, “The ECJ at the Crossroads: Balancing Tax Sovereignty against the Imperatives of the Single Market”, 46 *European Taxation* (2006), pp. 413 et seq, at pp. 418 et seq; A. Schnitger, *Die Grenzen der Einwirkungen der Grundfreiheiten des EG-Vertrages auf das Ertragsteuerrecht* (Düsseldorf: IDW, 2006) pp. 258 et seq; G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007).

EC Treaty principle of free movement within the Community to avoid and eliminate double taxation, at least by imputing a tax paid in the other Member State on their own charge to tax.”²⁰⁷ With a growing consensus that double juridical tax contravenes the fundamental freedoms, academic discussion has turned to the question of whether the source State or the residence State has the primary obligation to relieve double taxation, and whether the method of double tax relief is also prescribed by Community law.²⁰⁸

So much for academic conclusions. Advocate General Geelhoed took quite a different position in his opinions in *ACT Group Litigation*²⁰⁹ and *Kerckhaert & Morres*,²¹⁰ arguing that double taxation is a mere “quasi-restriction.” Geelhoed defines quasi-restrictions as disadvantages stemming from the existence of multiple and independent Member State tax systems. Like the obligation to file tax returns in more than one State, double juridical taxation is the inevitable result of the interaction of multiple tax systems and

²⁰⁶ Some have also argued that double taxation might be an issue under the *Francoovich*-principles of state liability; for references and a critical position see G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007).

²⁰⁷ Answer given by Commissioner Bolkestein to Written Question E-2287/99 by Karin Riis-Jørgensen (ELDR) to the Commission concerning “Right to freedom of movement and Danish tax rules” [2000] OJ C 225 E, p. 87.

²⁰⁸ See *infra* Part II.C. and extensively G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007) and the references therein.

²⁰⁹ Opinion Advocate General Geelhoed, 23 February 2006, Case C-374/04, *ACT Group Litigation*, not yet reported.

²¹⁰ Opinion Advocate General Geelhoed, 6 April 2006, C-513/04, *Kerckhaert & Morres*, not yet reported.

divided tax jurisdiction.²¹¹ In contrast with disparities, disadvantages caused by the co-existence of two separate tax jurisdictions would continue to exist even if national tax systems were perfectly harmonized. In Geelhoed's view, such disadvantages may not be challenged under the fundamental freedoms, because: (1) Member States have the power to allocate tax jurisdiction among themselves and to choose criteria for taxation, and (2) no alternative criteria for the distribution of taxing rights can be derived from Community law.²¹² Some scholars support this approach²¹³ and the *Nygård* case has been invoked as a possible precedent for this position (erroneously, in our view).²¹⁴ The ECJ seems to have ratified this result in *Kerckhaert & Morres* by implying that the fundamental freedoms do not

²¹¹ *Id.* at Paras. 31 et seq. See also Opinion Advocate General Geelhoed, 23 February 2006, Case C-374/04, *ACT Group Litigation*, not yet reported, Paras. 48 et seq; Opinion Advocate General Geelhoed, 29 June 2006, C-524/04, *Thin Cap Group Litigation*, not yet reported, Para. 53.

²¹² See Opinion Advocate General Geelhoed, 6 April 2006, C-513/04, *Kerckhaert & Morres*, not yet reported, Paras. 31 et seq; Opinion Advocate General Geelhoed, 23 February 2006, Case C-374/04, *ACT Group Litigation*, not yet reported, Paras. 51 et seq; see also U. Forsthoff, "Treaty Override und Europarecht", 15 *Internationales Steuerrecht* (2006), pp. 509 et seq, at p. 512 (arguing lack of direct applicability).

²¹³ See S. Douma, "The Three Ds of Direct Tax Jurisdiction: Disparity, Discrimination and Double Taxation", 46 *European Taxation* (2006), pp. 522 et seq, at p. 532; D. Weber, "In Search of a (New) Equilibrium Between Tax Sovereignty and the Freedom of Movement Within the EC", 34 *Intertax* (2006), pp. 582 et seq, at p. 591.

²¹⁴ ECJ, 23 April 2002, C-234/99, *Nygård* [2002] ECR I-3657. This case concerned not only two different taxes but also two separate taxable events (export of live animals on the one hand and slaughtering abroad on the other hand), which makes this case easily distinguishable from juridical double taxation in the direct tax area. See S. Enchelmaier, "Meistbegünstigung im EG-Recht – Allgemeine Grundsätze –", in A. Cordewener, S. Enchelmaier and C. Ph. Schindler (eds.), *Meistbegünstigung im Steuerrecht der EU-Staaten* (Munich: C.H.Beck, 2006), pp. 93 et seq, at 100, footnote 48.

provide taxpayers protection from juridical double taxation *per se*.²¹⁵

8.2.2. Kerckhaert & Morres

*Kerckhaert & Morres*²¹⁶ is one of several cases on dividend taxation in the European Union.²¹⁷ It is, however, special in that it involved *juridical* double taxation and posed the question of whether the shareholder's residence state must avoid double juridical taxation by crediting withholding tax levied by the source state.²¹⁸ A married couple, Mr. Kerckhaert and Mrs. Morres, both Belgian taxpayers, received dividends in 1995 and 1996 from a company resident in France. At the time, France operated an imputation system under which the corporate tax was fully or partially imputed onto the income tax due on dividends at shareholder

²¹⁵ ECJ, 14 November 2006, C-513/04, *Kerckhaert & Morres*, not yet reported.

²¹⁶ *Id.* See also Opinion Advocate General Geelhoed, 6 April 2006, C-513/04, *Kerckhaert & Morres*, not yet reported.

²¹⁷ See ECJ, 15 July 2004, C-315/02 *Lenz* [2004] ECR I-7063; ECJ, 7 September 2004, C-319/02, *Manninen* [2004] ECR I-7477; ECJ, 12 December 2006, C-446/04, *FII Group Litigation*, not yet reported (all concerning inbound dividends). See also ECJ, 12 December 2006, C-374/04, *ACT Group Litigation*, not yet reported; ECJ, 14 December 2006, C-170/05, *Denkavit Internationaal BV*, not yet reported (both concerning outbound dividends). Cf. EFTA Court, 23 November 2004, E-1/04, *Fokus Bank* [2004] EFTA Court Report 11 (EFTA Court decision concerning outbound dividends in an imputation system)

²¹⁸ See, e.g., P. Smet and H. Laloo, "ECJ to Rule on Taxation of Inbound Dividends in Belgium", 45 *European Taxation* (2005), pp. 158 et seq, at p. 158; J. Malherbe and M. Wathélet, "Pending Cases Filed by Belgian Courts: The Kerckhaert-Morres Case", in M. Lang, J. Schuch and C. Staringer (eds.), *ECJ Recent Developments in Direct Taxation* (Vienna: Linde, 2006), pp. 29 et seq; G. Kofler and C. Ph. Schindler, "Belgium Can Disregard French Withholding Tax on Dividends, ECJ Advocate General Says", 43 *Tax Notes Int'l* (Aug. 7, 2006), pp. 459 et seq; A. Rainer, "ECJ decides on withholding taxes on cross-border income", 35 *Intertax* (2007), pp. 63 et seq.

level. This imputation credit (*avoir fiscal*) was granted to all domestic shareholders, and it was also extended to foreign shareholders through tax treaties. When the imputation credit was extended to foreign shareholders, it was added to the dividend and both were subject to 15% French withholding taxation.²¹⁹ When the Belgian shareholders declared these amounts in their personal income tax return in Belgium, Belgium assessed a tax of 25%, but it did not credit the French withholding tax.²²⁰ Instead, the French tax was merely deducted from the tax base in Belgium.²²¹ Although domestic and cross-border dividends were both subject to a 25% tax rate and thus appeared to be treated equally by Belgium, the combination of French withholding and Belgian failure to credit the French withholding resulted in a higher tax burden for cross-border dividends.²²²

²¹⁹ See P. Smet and H. Laloo, “ECJ to Rule on Taxation of Inbound Dividends in Belgium”, 45 *European Taxation* (2005), pp. 158 et seq, at p. 158.

²²⁰ The language of the applicable tax treaty (Article 19A) suggests that Belgium is obligated to grant a credit for the tax withheld; however, Belgian courts have found this tax treaty provision to be “redundant”—because it merely memorialized benefits available under Belgian domestic law, it provided no rights beyond those contained in Belgian domestic law. Thus, when domestic law was reformed to eliminate the credit, the credit could no longer be claimed under the tax treaty. See M. Quaghebeur, “ECJ to Examine Belgian Treatment of Inbound Dividends”, 37 *Tax Notes Int’l* (Feb. 28, 2005), pp. 739 et seq, at p. 741; P. Smet and H. Laloo, “ECJ to Rule on Taxation of Inbound Dividends in Belgium”, 45 *European Taxation* (2005), pp. 158 et seq, at p. 158.

²²¹ P. Smet and H. Laloo, “ECJ to Rule on Taxation of Inbound Dividends in Belgium”, 45 *European Taxation* (2005), pp. 158 et seq.

²²² *Id.* See also M. Quaghebeur, “ECJ to Examine Belgian Treatment of Inbound Dividends”, 37 *Tax Notes Int’l* (Feb. 28, 2005), pp. 739 et seq.

		Belgian Dividend	French Dividend
	Gross Dividend	1.000	1.000
./.	(Reduced) French Withholding Tax ²²³	—	(150)
=	Income Tax Basis in Belgium	1.000	850
./.	Income Tax (25%)	(250)	(212,50)
+	Credit of French Withholding Tax	—	—
=	Tax Burden in Belgium	250	212,50
=	Total Tax Burden	250	362,50
=	Net Dividend	750	637,50

Ignoring the French *avoir fiscal*²²⁴²²⁵, this case raises the question of whether double juridical taxation is

²²³ In reality, the French withholding was assessed against the principle amount of the dividend plus the *avoir fiscal*. Because we ignore the *avoir fiscal* for purposes of our example, we calculate the French withholding only on the principle amount of the dividend.

²²⁴ Commentators observed that due to the French grant of an imputation credit to shareholders, Mr. Kerckhaert and Mrs. Morres in fact paid less tax on their dividends from France than they would have paid on dividends received from a company resident in Belgium. See P. Smet and H. Laloo, “ECJ to Rule on Taxation of Inbound Dividends in Belgium”, 45 *European Taxation* (2005), pp. 158 et seq). Seizing this line of argument, Advocate General Geelhoed concluded that “the actual effect of the operation of the French system was that Belgian-resident shareholders received a higher amount in the case of French-source dividends than in the case of exactly the same amount of dividends distributed from a Belgian company.”

inconsistent with the fundamental freedoms. Hence, the Belgian *Rechtbank van Eerste Aanleg te Gent* asked if Article 56 EC must be interpreted as prohibiting a restriction resulting from a provision in the income tax legislation of a Member State which subjects dividends from resident companies and dividends from companies resident in another Member State to the same uniform tax rate, without in the latter case providing for the imputation of tax levied at source in that other Member State.²²⁶

In 2003, the Commission addressed this problem in its Communication on “Dividend taxation of individuals in the Internal Market.”²²⁷ It argued that higher taxation of foreign-source dividends should be viewed a restriction within the meaning of Article 56 EC. But if a restriction arises from the imposition of both French dividend withholding and the Belgian shareholder-level tax, which Member State is to blame? The Commission concluded that where a DTC grants the source country the right to levy a withholding tax and foresees a credit in the residence country, the residence State has the obligation under

²²⁵ The Advocate General therefore found that “Belgian residents receiving French-source dividends are not worse off in comparison to those receiving Belgian-source dividends; on the contrary, the combined effect of the French and Belgian tax systems means that overall they are better off.” Accordingly, Geelhoed found no discrimination or restriction within the meaning of Article 56 EC. But see P. Smet and H. Laloo, “ECJ to Rule on Taxation of Inbound Dividends in Belgium”, 45 *European Taxation* (2005), pp. 158 et seq, at p. 159; see also J. Malherbe and M. Wathelet, “Pending Cases Filed by Belgian Courts: The Kerckhaert-Morres Case”, in M. Lang, J. Schuch and C. Staringer (eds.), *ECJ Recent Developments in Direct Taxation* (Vienna: Linde, 2006), pp. 29 et seq, at p. 58 with further references. Following the question submitted by the Belgian *Rechtbank van Eerste Aanleg te Gent*, the ECJ did not consider the effects of the *avoir fiscal* but rather focused on the unrelieved double taxation.

²²⁶ ECJ, 14 November 2006, C-513/04, *Kerckhaert & Morres*, not yet reported, Para. 14.

²²⁷ COM(2003)810 final.

Community law to avoid double taxation by granting a credit.²²⁸ Thus, the Commission's position could be understood as concluding that: first, relief of double juridical taxation is required under the fundamental freedoms, and second, where the source and residence State have concluded a tax treaty, priority for which state must relieve double taxation under Community law should be determined by reference to that tax treaty. Hence, although the Belgian courts have found that Belgium's refusal to credit French withholding on inbound dividends did not violate their DTC,²²⁹ under the Commission's position, Belgium would nevertheless be responsible to credit French withholding, because Belgium entered into a tax treaty with France that conferred upon France the power to levy withholding on dividends in contemplation of a credit by Belgium. Thus, the Commission would rely on existing DTCs to allocate responsibility for relieving double juridical taxation that violated the fundamental freedoms. Advocate General Geelhoed and the ECJ, however, took a different approach in the *Kerckhaert & Morres* case.

The ECJ holds that a Member State discriminates when it treats similar situations differently, or different situations the same.

²²⁸ COM(2003)810 final, p.18.

²²⁹ Article 19.A(1) of the French-Belgian DTC provided that Belgium would reduce the tax due in Belgium by "first, the withholding tax imposed at the normal rate, and, second, a fixed percentage of foreign tax that is deductible under conditions fixed by Belgian law, provided that such percentage may not be lower than 15% of that net amount." ECJ, 14 November 2006, C-513/04, *Kerckhaert & Morres*, not yet reported, Para. 8. However, Belgium did not credit the French withholding because it amended its domestic law to eliminate the credit. *Id.* at Para. 12. In Belgium's view, the failure to credit French withholding did not violate the DTC because the credit in the DTC was conditional on its availability under Belgian domestic law. Therefore, abolition of the tax benefit under Belgian law terminated the tax treaty entitlement to that benefit. See references in note 53, *supra*.

Advocate General Geelhoed argued that, even if the overall tax burden in Belgium would be higher for cross-border dividends, “[s]uch a potential disadvantage for Belgian residents receiving French dividends would not...result from any breach of the [EC] Treaty,” and “the free movement provisions of the [EC] Treaty do not as such oblige home states to relieve juridical double taxation resulting from the dislocation of [the] tax base between two Member States.”²³⁰ Based on the ECJ’s decision in *Gilly*,²³¹ he went on to state that: the possibility of juridical double taxation, in the absence of priority rules between the relevant States, is an inevitable consequence of the generally accepted method under international tax law of dividing tax jurisdiction between States.... Under Community law, the power to choose criteria of, and allocate, tax jurisdiction lies purely with Member States....²³² [T]he mere fact that a home State such as Belgium might not have chosen to relieve juridical double taxation on dividends would not in itself be contrary to Articles 43 or 56 EC, as long as that State complied with the obligation not to discriminate between foreign-source and domestic-source dividends in exercising its tax jurisdiction.... Any distortion of economic activity resulting from such a choice would result from the fact that different tax systems must, in the present state of development of Community law, exist side by side, which may mean disadvantages for economic actors in some cases, and advantages in other cases.²³³

²³⁰ Opinion Advocate General Geelhoed, 6 April 2006, C-513/04, *Kerckhaert & Morres*, not yet reported, Paras. 29 et seq.

²³¹ ECJ, 12 May 1998, C-336/96, *Gilly* [1998] ECR I-2793.

²³² Opinion Advocate General Geelhoed, 6 April 2006, C-513/04, *Kerckhaert & Morres*, not yet reported Para. 31.

²³³ *Id* at Para. 36.

In Geelhoed's view, juridical double taxation was thus a "quasi-restriction," and as such it "may only be eliminated through the intervention of the Community legislator, in the absence of which intervention [quasi-restrictions] should be held to fall outside the scope of the Treaty free movement provisions."²³⁴

The Court's judgment was less elaborate, but it followed the reasoning of Advocate General Geelhoed. The ECJ acknowledged that the disadvantage resulted from the parallel exercise of fiscal sovereignty by two Member States, and it noted the importance of DTCs to eliminate or mitigate the negative effects of the coexistence of national tax systems on the functioning of the internal market. But the Court concluded that – except for the Parent-Subsidiary-Directive, the Arbitration Convention, and the Savings-Directive²³⁵ – no uniform or harmonized measure designed to eliminate double juridical taxation has as yet been adopted at the Community level and, as a result:

²³⁴ *Id* at Para. 38.

²³⁵ Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [1990] OJ L 225, p. 6, Convention of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises [1990] OJ L 225, p. 10, and Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments [2003] OJ L 157, p. 38. That the Court makes reference to the Savings Directive as a measure designed to eliminate double taxation is striking, insofar as the sole aim of this Directive is to ensure effective taxation of savings income. It is not clear why the Court referred to this Directive and did not also refer to the Interest-Royalty-Directive, [2003] OJ L 157, p. 49, which, according to its preamble, explicitly aims to ensure that "*double taxation is eliminated*" and "*that interest and royalty payments are subject to tax once in a Member State.*"

Community law ... does not lay down any general criteria for the attribution of areas of competence between the Member States in relation to the elimination of double taxation within the Community....

Consequently, it is for the Member States to take the measures necessary to prevent situations such as that at issue in the main proceedings by applying, in particular, the apportionment criteria followed in international tax practice.²³⁶

As a result, the Court concluded that although the Belgian tax treatment of the dividend resulted in unrelieved double taxation, it did not infringe the fundamental freedoms.

Although *Kerckhaert & Morres* could on its facts easily be distinguished from other potential cases of juridical double taxation,²³⁷ the decision of the Court seems to imply that juridical double taxation *per se* is not contrary to the fundamental freedoms. Therefore, its elimination would require positive legislative action at the Community level. However, strong opposition has been voiced in the European Commission,²³⁸ the Court,²³⁹ and legal

²³⁶ ECJ, 14 November 2006, C-513/04, *Kerckhaert & Morres*, not yet reported, Paras. 22 et seq.

²³⁷ For example, on the basis of the French *avoir fiscal* or the deduction allowed by Belgium.

²³⁸ The Commission will bring the Belgian legislation at issue in *Kerckhaert & Morres* before the ECJ again, although it announced its intention to “take into account the ruling by the European Court of Justice in *Kerckhaert-Morres*, case C-513/04.” See the Press Release “Direct taxation: The Commission decides to refer Belgium to the Court over discriminatory taxation of inbound dividends,” IP/07/67 (22 January 2007).

scholarship,²⁴⁰ so *Kerckhaert & Morres* may not be the final word on the issue of double taxation. We now consider how the Court might deal with cases of double taxation in the future.

8.2.3. Double burdens, responsibility and treaty override

The ECJ's decision in *Kerckhaert & Morres* is disappointing from an Internal Market perspective, and subject to criticism on multiple levels.²⁴¹ *First*, it does not even attempt to distinguish direct taxation from those areas of law where the ECJ has found “double burdens” to infringe on the fundamental freedoms.²⁴² *Second*, if the ECJ had decided that double taxation infringed the fundamental freedoms, the Court arguably would have been called upon to make political decisions as to which Member State must refrain from taxation. Such decisions would limit the political sovereignty of Member States.²⁴³ However, the impact of a ruling by the ECJ that double juridical taxation is contrary to the fundamental freedoms could be limited by the Member States themselves, since the States are free – and even called upon by Article 293 EC – to

²³⁹ Opinion Advocate General Kokott, 15 February 2007, C-464/05, *Geurts and Vogten*, not yet reported, Para 60 with footnote 37.

²⁴⁰ A. Rainer, “ECJ decides on withholding taxes on cross-border income”, 35 *Intertax* (2007), pp. 63 et seq, at p. 64; G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007) pp. xxx et seq.

²⁴¹ For an extensive analysis and critique see G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007) pp. xxx; for references for the prevailing opinion in legal writing on this issue see *supra* note xxx.

²⁴² See *supra* Part II.1. with further references.

²⁴³ See D. Weber, “In Search of a (New) Equilibrium Between Tax Sovereignty and the Freedom of Movement Within the EC”, 34 *Intertax* (2006), pp. 582 et seq, at p. 590. R. Mason, “U.S. Tax Treaty Policy and the European Court of Justice,” 59 *Tax Law Review* (2005), pp. 65 et seq at pp. 95 et seq.

enter into agreements for the avoidance of double taxation. Revision of DTCs to comply with the ECJ's ruling would restore to the Member States the power to decide *which state* must relieve double taxation. Tax treaties have always been respected by the ECJ, which considers the Member States competent to determine – by means, *inter alia*, of international agreements – the criteria for taxation of income and wealth “with a view to eliminating double taxation.”²⁴⁴

Third, in denying direct applicability of the fundamental freedoms to double juridical taxation because Community law lacks criteria to divide taxing jurisdiction between the Member States, the Court failed to take notice of the fact that, in other direct tax cases, the Court imposed such priority rules on the Member States, even where no such priorities were established under Community law. For example, the Court imposed its own priority rules in areas of personal benefits,²⁴⁵ cross-border loss utilization²⁴⁶ or double utilization of depreciation,²⁴⁷ indirect taxation²⁴⁸ and social security. *Fourth*, the Court failed to analyze whether it could derive a priority rule for the elimination of double juridical taxation from a source

²⁴⁴ ECJ, 12 May 1998, C-336/96, *Gilly* [1998] ECR I-2793, Para. 24.

²⁴⁵ See, e.g., ECJ, 14 February 1995, Case C-279/93, *Schumacker* [1995] ECR I-225; ECJ, 11 August 1995, Case C-80/94, *Wielockx* [1995] ECR I-2493.

²⁴⁶ See ECJ, 13 December 2005, C-446/03, *Marks & Spencer* [2005] ECR I-10837, Paras. 47 et seq. See also F. Vanistendael, “The ECJ at the Crossroads: Balancing Tax Sovereignty against the Imperatives of the Single Market”, 46 *European Taxation* (2006), pp. 413 et seq, at p. 416.

²⁴⁷ See, e.g., ECJ, 7 September 2006, C-470/04, *N*, not yet reported, Para. 54.

²⁴⁸ *Schul I* imposed an obligation on the state of destination to credit the input VAT of the private exporter against the VAT liability of a private importer, which was contrary to the destination principle enshrined at the early state of VAT harmonization at issue in *Schul I*. See ECJ, 5 May 1982, 15/81, *Schul I* [1982] ECR 1409. For closer analysis, see G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007) pp. xxx

other than Community law, such as tax treaties or generally accepted norms in international tax law.²⁴⁹

Fifth, the Court's ruling rewards the inactivity of Member States, which – contrary to the obligation in Article 293 EC – have not achieved or attempted to achieve comprehensive abolition of double taxation in the Community by means of a bilateral or multilateral tax treaties.²⁵⁰ *Sixth*, when combined with its prior case-law denying the double utilization of losses, the Court's ruling in *Kerckhaert & Morres* creates a striking asymmetry. Why should the Court protect Member States from taxpayers' double use of losses, but not protect taxpayers from double taxation of their profits?²⁵¹ In an Internal Market neither is acceptable. *Seventh*, if the decision is a political compromise, judicial self-restraint seems inappropriate where “*the fact that a taxable event might be taxed twice is the most serious obstacle there can be to people and their capital crossing*

²⁴⁹ See, e.g., ECJ, 12 May 1998, C-336/96, *Gilby* [1998] ECR I-2793, Para. 31; Opinion Advocate General Kokott, 14 July 2005, C-265/04, *Bonanich* [2006] ECR I-923, Para. 16; Opinion Advocate General Ruiz-Jarabo Colomer, 26 October 2004, C-376/03, *D* [2005] ECR I-5821, Para. 59 with footnote 41.

²⁵⁰ Article 293 EC does not exclude double taxation from scrutiny under the fundamental freedoms. In other contexts, the Court has made it clear that protection under the fundamental freedoms is not dependent on agreements based on Article 293 EC. See, e.g., ECJ, 5 November 2002, C-208/00, *Überseering* [2002] ECR I-9919, Paras. 52 et seq; cf. F. Vanistendael, “The ECJ at the Crossroads: Balancing Tax Sovereignty against the Imperatives of the Single Market”, 46 *European Taxation* (2006), pp. 413 et seq, at p. 419. But see Opinion Advocate General Geelhoed, 6 April 2006, C-513/04, *Kerckhaert & Morres*, not yet reported, Paras. 34 et seq.

²⁵¹ See F. Vanistendael, “The ECJ at the Crossroads: Balancing Tax Sovereignty against the Imperatives of the Single Market”, 46 *European Taxation* (2006), pp. 413 et seq, at p. 416.

*internal borders.*²⁵² The U.S. and Swiss experience demonstrates that double taxation can be resolved judicially.²⁵³

The Court of Justice should have taken some of these arguments into consideration in *Kerckhaert & Morres*. If protection against juridical double taxation were enshrined as part of the fundamental freedoms, it could be limited. The taxpayer should not be assessed higher taxes than would apply in the *less* advantageous jurisdiction.²⁵⁴ Thus, the taxpayer does not have the right to the tax treatment that would obtain in the more favourable jurisdiction. Greater benefits could be extended by Member States at their option, leaving them free to pursue capital import or export neutrality.

A dilemma that follows from the conclusion that double juridical taxation violates the fundamental freedoms is how to determine which state has the obligation to relieve double tax. One possibility is that Member States would be jointly and severally liable to avoid double taxation. In that case, each Member State would have an independent and complete obligation to grant relief, such that the taxpayer could file suit in the source state or

²⁵² Opinion Advocate General Ruiz-Jarabo Colomer, 26 October 2004, C-376/03, D [2005] ECR I-5821, Para. 85.

²⁵³ See G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007) pp. xxx et seq.

²⁵⁴ See J. Englisch, “The European Treaties’ Implications for Direct Taxes”, 33 *Intertax* (2005), pp. 310 et seq, at p. 325; J. Schönfeld in D. J. Flick, F. Wassermeyer and H. Baumhoff (eds.), *Außensteuerrecht* (Cologne: Schmidt, 6th edition 2005) Vor § 34c EStG Para. 2; J. Schönfeld, “Doppelbesteuerung und EG-Recht”, *Steuer und Wirtschaft* (2006), pp. 79 et seq, at pp. 80 et seq; G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007) pp. xxx et seq.

the residence state, and recover from either.²⁵⁵ Member States could settle resulting revenue issue amongst themselves. The other option would be to try to determine which state is more responsible for the unrelieved double tax, and to make only that state liable to relieve the disadvantage. Perhaps the EC legislator could create a European framework for the division of taxing rights providing priorities for the relief of double tax. In the absence of such harmonized law, the ECJ could try to determine which state is to “blame” by reference to any bilateral tax treaty that may be in place between the two states.

In the absence of a tax treaty, the ECJ might look to international practice, especially the OECD Model Convention (OECD MC).²⁵⁶ Although the OECD MC is not binding, it has become a European standard,²⁵⁷ and it is frequently relied upon by the

²⁵⁵ See S. van Thiel, *Free Movement of Persons and Income Tax Law: the European Court in Search of Principles* (Amsterdam, IBFD, 2002)

²⁵⁶ See A. Cordewener, *Europäische Grundfreiheiten und nationales Steuerrecht* (Cologne: Schmidt, 2002), p. 887; A. Schnitger, *Die Grenzen der Einwirkungen der Grundfreiheiten des EG-Vertrages auf das Ertragsteuerrecht* (Düsseldorf: IDW, 2006), p. 266. See also G. Fibbe and A. de Graaf, “Is double taxation arising from autonomous tax classification of foreign entities incompatible with EC law?” in H. van Arendonk, F. Engelen and S. Jansen (eds.), *A Tax Globalist, Essays in honour of Maarten J. Ellis* (Amsterdam: IBFD, 2005), pp. 237 et seq, at p. 2258; J. Hey, “Perspektiven der Unternehmensbesteuerung in Europa”, *Steuer und Wirtschaft* (2004), pp. 193 et seq, at p. 201; F. Vanistendael, “The ECJ at the Crossroads: Balancing Tax Sovereignty against the Imperatives of the Single Market”, 46 *European Taxation* (2006), pp. 413 et seq, at p. 419.

²⁵⁷ M. Lehner, “The Influence of EU Law on Tax Treaties from a German Perspective”, 54 *Bulletin For International Fiscal Documentation* (2000), pp. 461 et seq, at p. 465; F. Vanistendael, “The ECJ at the Crossroads: Balancing Tax Sovereignty against the Imperatives of the Single Market”, 46 *European Taxation* (2006), pp. 413 et seq, at p. 419.

ECJ.^{258, 259} Even if the OECD MC were accepted as a guideline, serious procedural issues would arise. For example, if the taxpayer files her claim in the wrong Member State, her claim against the liable Member State might expire before she learns of her error. The risk of suing the wrong Member State could be mitigated by the Commission, by initiating infringement proceedings against the other Member State, so that the cases could be joined before the ECJ.

The second option, in which only one of the States is liable to relieve double taxation, is most compelling where the two states have a bilateral tax treaty, but one Member State disregards its obligations under the treaty (e.g., a treaty override). In this situation, the tax treaty itself could provide the guidelines needed

²⁵⁸ See, e.g., ECJ, 12 May 1998, C-336/96, *Gilly* [1998] ECR I-2793, Para. 31; Opinion Advocate General Kokott, 14 July 2005, C-265/04, *Bouanich* [2006] ECR I-923, Para. 16; Opinion Advocate General Ruiz-Jarabo Colomer, 26 October 2004, C-376/03, *D* [2005] ECR I-5821, Para. 59 with footnote 41.

²⁵⁹ For an extensive discussion and further references see G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007) pp. xxx et seq.

to allocate responsibility.²⁶⁰ If the defendant Member State obliged itself in a legally binding tax treaty to waive its taxing rights in favour of the taxing rights of the other Member State, EC law should defer to that allocation.²⁶¹

One might extend this approach beyond cases of clear treaty override. Assume, for example, that the view of the Belgian courts is correct: by refusing to credit French withholding on dividends, Belgium did not violate the French-Belgian DTC.²⁶² Nevertheless, it still could be argued that Belgium consented to the French withholding tax in their DTC.²⁶³ Under this view, Belgium's grant of permission to France to levy withholding on outbound dividends (in the French-Belgian DTC) and the putative prohibition of double taxation within the Community under the

²⁶⁰ A. Cordewener, *Europäische Grundfreiheiten und nationales Steuerrecht* (Cologne: Schmidt, 2002), pp. 882 et seq; J. Englisch, *Dividendenbesteuerung* (Cologne: Schmidt, 2005), pp. 257 et seq; J. Englisch, "The European Treaties' Implications for Direct Taxes", 33 *Intertax* (2005), pp. 310 et seq, at p. 324; G. Kofler, "Treaty Override, juristische Doppelbesteuerung und Gemeinschaftsrecht", 16 *Steuer und Wirtschaft International* (2006), pp. 62 et seq, at pp. 69 et seq; A. Schnitger, *Die Grenzen der Einwirkungen der Grundfreiheiten des EG-Vertrages auf das Ertragsteuerrecht* (Düsseldorf: IDW, 2006), pp. 263 et seq; G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* (Vienna: Linde, 2007) pp. xxx et seq.; see also W. Schön, "Europäische Kapitalverkehrsfreiheit und nationales Steuerrecht", in W. Schön (ed.), *Gedächtnisschrift für B. Knobbe-Keuk* (Cologne: Schmidt, 1997), pp. 743 et seq, at pp. 772 et seq.

²⁶¹ This position is also implied by *Merida*, in which the ECJ relied on the allocation of taxing powers under a DTC to determine responsibility. ECJ, 16 September 2004, C-400/02, *Merida* [2004] ECR I-8471,

²⁶² See *supra* Part II.2.

²⁶³ G. Kofler, "Treaty Override, juristische Doppelbesteuerung und Gemeinschaftsrecht", 16 *Steuer und Wirtschaft International* (2006), pp. 62 et seq, at pp. 69 et seq. See also Commission Communication on "Dividend taxation of individuals in the Internal Market," COM(2003)810 final, 18.

fundamental freedoms combine to place the primary responsibility for relieving double tax on dividends in-bound from France on Belgium. Thus, Belgium would be liable to relieve the double tax in *Kerckhaert & Morres*.

This approach also has limits. Suppose the interpretation of the DTC is disputed, or one treaty partner, by way of treaty interpretation, either extends its taxing rights or narrows its obligations, but the other treaty partner does not share its view. Since the ECJ is not competent to interpret DTCs,²⁶⁴ it would be for the referring national court and the parties in the proceedings to demonstrate the responsibilities of a Member State under a DTC.

8.3. A little help from our American friends

If an economic actor faces double taxation in the cross-border context, but not in a purely domestic context, the additional cross-border burden acts as a disincentive for cross-border commerce. Since the fundamental freedoms of the EC Treaty aim to eliminate such disincentives, it is sensible to ask whether they preclude double juridical taxation. Looking at how other common markets handle double juridical taxation may shed valuable light on the

²⁶⁴ See, e.g., ECJ, 14 December 2000, C-141/99, *AMID* [2000] ECR I-11619, Para. 18; see also Opinion Advocate General Kokott, 14 July 2005, C-265/04, *Bonanich* [2006] ECR I-923, Para. 53 with footnote 47; Opinion Advocate General Geelhoed, 6 April 2006, C-513/04, *Kerckhaert and Morres*, not yet reported, Para. 37.

question of whether eradication of double tax is necessary for a successful internal market.

8.3.1. US Legal background

The U.S. Constitution does not contain explicit free trade provisions comparable to the EC fundamental freedoms, but the Supreme Court has interpreted the “dormant” Commerce Clause to prohibit states from imposing taxes that discriminate against or unduly burden interstate commerce.²⁶⁵ The Court interprets the dormant Commerce Clause similarly to how that ECJ interprets the fundamental freedoms. The Commerce Clause protects the common market and the free flow of persons and commerce across state lines.²⁶⁶ Thus, it is not surprising that the ECJ and U.S.

²⁶⁵ The Supreme Court has held that even where the federal government has not regulated an area of interstate commerce, and has not announced any intention to occupy the field for regulation, the states are nevertheless constrained in their ability to take action that affects interstate commerce because the power to regulate interstate commerce was granted exclusively to Congress by the Constitution. U.S. CONST. art I, § 8, cl. 3 (“[Congress shall have power] [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.”). See *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318 (1977) (striking down heavier taxes for inter-state stock transfers than in-state stock transfers); *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869 (1985) (considering whether the dormant aspect of the Commerce Clause prohibited a state from charging a higher tax on premiums paid to out-of-state insurance companies); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) (setting forth the standard of review for state taxes under the Commerce Clause).

²⁶⁶ Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his exports, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any. *H.P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 665 (1949).

Supreme Court have come to similar decisions on factually similar tax discrimination cases.²⁶⁷ Neither the U.S. states nor the EU Member States may use their tax systems to favour purely domestic commerce over interstate or inter-Community commerce.

Since the late 1800s, the Supreme Court has applied a number of different standards and methods to analyze tax discrimination cases, and by the Court's own description, the resulting jurisprudence is a "quagmire" and "tangled underbrush."²⁶⁸ This may suggest that there is little to be gained by looking to the United States for answers to the double tax question, but the methodology the U.S. Supreme Court uses to evaluate state tax apportionment formulas is relevant to our double tax inquiry.

The U.S. states use formulary apportionment to determine what portion of a company's unitary business profits will be taxable in each state. Each state defines its own tax base, though most use the federal tax base as a common starting point and then make

²⁶⁷ Compare. e.g., *Shaffer v. Carter*, 252 U.S. 37 (1920) with ECJ 12 June 2003, C-234/01, *Gerritse* [2003] E.C.R. I-5933 and ECJ, 15 February 2007, C-345/04, *Centro Equestre*, not yet reported (both holding that host states must allow as a deduction expenses related to the generation of host-state taxable income, but host states need not allow unrelated expenses). For more comparisons of U.S. and EU tax discrimination cases, see T. Kaye, "Tax Discrimination: A Comparative Analysis of U.S. and EU Approaches", 7 *Florida Tax Review* (2005) pp. 47 et seq.

²⁶⁸ *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457-8 (1959). See also *Wardair Canada Inc. v. Florida Dept. of Revenue*, 477 U.S. 1, 17 (1986) (Burger, C. J., concurring in part and concurring in judgment) (referring to "the cloudy waters of this Court's 'dormant Commerce Clause' doctrine"). See generally J. Hellerstein & W. Hellerstein, *State Taxation* (USA: Warren Gorham Lamont, 3d. ed. 1999 & Supp. 2007), Paras. 4.8 et seq, at pp. 4-23 et seq.

adjustments.²⁶⁹ Unfortunately, neither the tax base nor the apportionment formula is federally mandated, so double taxation may result from states' selection of overlapping tax bases or apportionment formulas.

In *Moorman Manufacturing*, a taxpayer raised a Commerce Clause challenge against Iowa's single-factor-sales apportionment formula.²⁷⁰ At the time *Moorman* brought its case, 45 out of the 47 states imposing income taxes, including *Moorman*'s home state of Illinois, used a formula that equally weighed sales, property, and payroll.²⁷¹ This formula is known as the "Massachusetts formula."²⁷² *Moorman* argued that Ohio's deviation from the Massachusetts formula could lead to over-taxation.²⁷³ Although the Supreme Court agreed that mismatched formulas could lead to "some overlap" in the tax base, the Court was not willing to prescribe a mandatory uniform apportionment formula for the states because that would overstep the Court's institutional role.²⁷⁴ If it mandated that Ohio use the Massachusetts formula, the Court predicted that it would later be called upon to decide cases involving the definition of the factors.²⁷⁵ Such questions were fundamentally legislative.²⁷⁶ Put in ECJ terms, the Supreme Court decided that Ohio's deviation from the formula used by

²⁶⁹ *Id.* Para. 20.02, at p. 20-1.

²⁷⁰ *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978). The portion taxable in Iowa of was determined by multiplying *Moorman*'s overall income by a fraction equal to its Iowa sales over its overall sales. *Id.* at 270.

²⁷¹ *Id.* at p. 270, 276.

²⁷² *Id.* at p. 281.

²⁷³ *Id.* at pp. 276 et seq.

²⁷⁴ *Id.* at pp. 279 et seq.

²⁷⁵ *Id.* at p. 278.

²⁷⁶ *Id.* at p. 280.

Moorman's home state (Illinois) was a disparity, not discrimination. The Court noted that the:

Iowa statute... treats both local and foreign concerns with an even hand; the alleged disparity can only be the consequence of the combined effect of the Iowa *and* Illinois statutes, and Iowa is not responsible for the latter.

Thus, appellant's "discrimination" claim is simply a way of describing the potential consequences of the use of different formulas by the two States. These consequences, however, could be avoided by the adoption of any uniform rule; the "discrimination" does not inhere in either State's formula.²⁷⁷

The Court concluded that it was not clear that "Iowa, rather than Illinois, was necessarily at fault *in a constitutional sense*."²⁷⁸ The Court conceded that a well-functioning common market may demand a uniform formula. However, imposition of such uniform standards had to be done by Congress, not the courts:

The prevention of duplicative taxation, therefore, would require national uniform rules for the division of income. Although the adoption of a uniform code would undeniably advance the policies that underlie the Commerce Clause, it would require a policy decision based on political and economic considerations that vary from State to State. The Constitution, however, is neutral with respect to the content of any uniform rule....

While the freedom of the States to formulate independent policy in this area may have to yield to an overriding national interest in uniformity, the content of

²⁷⁷ *Id.* at p. 278, footnote 12.

²⁷⁸ *Id.* at p. 277 (emphasis added).

any uniform rules to which they must subscribe should be determined only after due consideration is given to the interests of all affected States. It is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income. It is to that body, and not this Court, that the Constitution has committed such policy decisions.²⁷⁹

The U.S. Supreme Court's unwillingness to interpret the Commerce Clause as demanding a uniform apportionment formula that would prevent double state taxation derived from its view that the judicial branch was not constitutionally empowered to impose such a uniform formula. Uniformity should either be imposed by the states themselves, or by the federal legislature.

8.3.2. "Internal consistency" required for apportionment formula

Building on *Moorman*, the Supreme Court developed the internal consistency test to evaluate state apportionment formulas. The Court began to ask: If all fifty states adopted the challenged formula, would multiple taxation inevitably result?²⁸⁰ If so, the

²⁷⁹ *Id.* at p. 280.

apportionment rule was invalid. The test is meant to target structural rather than factual double taxation.²⁸¹ Consider the formula used by Iowa in *Moorman*. If every state adopted single-factor-sales, all of *Moorman*'s multi-state income would be taxed once, and only once. Therefore, the Iowa formula is structurally internally consistent, notwithstanding that companies taxable under it may in fact suffer unrelieved double taxation. Any double tax would result from disparities between the apportionment formulas of the various states, not from unconstitutional discrimination by Iowa. Contrast a formula that apportioned income based on sales made in *other states*. This formula is structurally internally inconsistent, since multiple taxation would inevitably arise as each state sought to tax the sales taking place in the other 49 states.

Thus, like the ECJ, the U.S. Supreme Court has not interpreted the Commerce Clause to require complete elimination of double state taxation. States may not elect apportionment formulas that would result in double taxation if applied by all the states. However, as long as the state's apportionment rule is non-discriminatory, the Supreme Court seems to be willing to accept that selection of different apportionment rules by different states may result in some double taxation. These distortive disparities are the price of

²⁸⁰ According to the Court, “[i]nternal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear.... A failure of internal consistence shows as a matter of law that a State is attempting to take more than its fair share of taxes from the interstate transaction...” *Oklahoma Tax Comm’n v. Jefferson Lines, Inc.*, 514 U.S. 175, at p. 185 (1995) (upholding Oklahoma’s sales tax on the full price of tickets for interstate bus travel).

²⁸¹ “This test asks nothing about the economic reality reflected by the tax, but simply looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage compared with intrastate commerce.” *Id.*

the autonomy of the states to choose their apportionment formulas. In the Supreme Court's view, if distortions caused by non-discriminatory disparities in state apportionment rules become sufficiently acute to require redress, then Congress should legislate a solution.

8.3.3. US prohibition on restrictions

It is worth mentioning that in addition to prohibiting discrimination against inter-state commerce, the U.S. Supreme Court has interpreted the dormant aspect of the Commerce Clause to prohibit *restrictions* on interstate commerce, which the Court calls “undue burdens.” In the non-tax area, the Supreme Court has struck down non-discriminatory, but unduly burdensome regulations. For example, in *Bibb v. Navajo Freight Lines, Inc.*, the Supreme Court struck down an Illinois safety regulation requiring contoured rear fender mudguards because at least 45 other states permitted or required straight mudguards.²⁸² Even though there would be no burden on interstate commerce if every state adopted Illinois' rule, and Illinois' justification for the contoured mudguard rule was the promotion of safety, the Supreme Court nevertheless struck down the statute because it created an undue burden on interstate commerce. Truckers desiring to cross Illinois' state border would incur expenses in time and money changing their mudguards to comply with the regulation.²⁸³ Thus *Bibb* was “one of those cases—few in number—where local safety measures that are non-discriminatory place an unconstitutional burden on interstate commerce.”²⁸⁴

²⁸² *Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520, at p. 528 (1959).

²⁸³ Two to four hours were required to install or remove a contoured mudguard. *Id.* at p. 525.

²⁸⁴ *Id.* at p. 528 (1959).

However, like the ECJ with its “restriction” analysis, the U.S. Supreme Court has been reluctant to extend its “burden” analysis to tax cases. For example, the internal consistency test does not help determine whether non-discriminatory rules nevertheless unduly restrict cross-border commercial and capital flows. In *Moorman*, the majority never considered whether the adoption by Iowa of a non-discriminatory apportionment formula that differed from all the other states’ formulas created an undue burden on interstate commerce, although Justices Powell and Blackmun argued in their dissent that *Bibb* was a relevant precedent.²⁸⁵ The dissenting Justices acknowledged that there could be “no fixed rule” regarding the degree of uniformity required of state regulations. Rather, the Court must balance the conflicting goals in each case.²⁸⁶ Justices Powell and Blackmun argued forcefully in *Moorman* that “the difficulty of engaging in that weighing process does not permit this Court to avoid its constitutional duty and allow an individual State to erect an ‘unreasonable clog upon the mobility of commerce.’”²⁸⁷ Still, the majority carried the day in *Moorman*, and single-factor-sales was not struck down as unduly burdensome. Thus, if the ECJ will consider whether double juridical taxation is a restriction on intra-Community commerce, the internal consistency test will be of no use to it.

²⁸⁵ “If one State’s regulatory or taxing statute is significantly ‘out of line’ with other States’ rules, and if by virtue of that departure from the general practice it burdens or discriminates against interstate commerce, Commerce Clause scrutiny is triggered, and this Court must invalidate it unless it is justified by a legitimate local purpose outweighing the harm to interstate commerce.” *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978) at p. 294 (Powell, J, dissenting) (citing *Bibb* at p. 359).

²⁸⁶ *Moorman* (Powel, J, dissenting), at pp. 295 et seq.

²⁸⁷ *Id.* (Powel, J, dissenting), at p. 296.

8.3.4. Application of internal consistency to Kerkhaert&Morres

An interesting thought experiment is to imagine how *Kerckhaert & Morres* would fare under the internal consistency test.²⁸⁸ When we hypothetically conform the laws of all the Member States to Belgian law, it is apparent that cross-border dividends suffer a disadvantage not borne by domestic dividends. To understand why, we need to examine the overall treatment by Belgium of cross-border dividends. This means that Belgian taxation of both inbound and outbound situations must be taken into consideration when evaluating the structural internal consistency of its tax system.²⁸⁹ We know from *Kerckhaert & Morres* how Belgium taxes inbound dividends, but to understand whether Belgium's tax system is structurally internally consistent, we must also take into account the fact that Belgium levied withholding on outbound dividends. Assuming a 15% Belgian withholding tax, the analysis of the Belgian tax system under internal consistency would be identical to the analysis we offered of *Kerckhaert & Morres* in Part

²⁸⁸ For more on how the U.S. internal consistency test could be applied to EC direct tax cases, see R. Mason, "A Theory of Tax Discrimination" (forthcoming 2007).

²⁸⁹ We again set aside the French *avoir fiscal* granted to Kerckhaert and to Morres because the internal consistency test only examines the law of the defendant state—other states' laws are not relevant. In the international context, this would involve applying the same state's laws (here, Belgium's) in both a source and a residence capacity. Thus, France would (hypothetically) apply Belgian, rather than French, source rules. For this reason, the fact that France in fact granted the *avoir fiscal* on outbound dividends is not relevant to the determination of whether Belgium's system for taxing cross-border dividends is structurally internally consistent. See R. Mason, "A Theory of Tax Discrimination" (forthcoming 2007). The fact that another state (here, France) offers a compensatory tax advantage could be relevant for assessing whether the taxpayer is exposed to a disadvantage; see *supra* note 56.

II.B., and again reveals the structural flaws in Belgian taxation of cross-border dividends:

	Domestic Dividend	Cross-Border Dividend
Gross Dividend	1.000	1.000
Source State Withholding Tax	—	(150)
Income Tax Basis in Residence State	1.000	850
Income Tax (25%)	(250)	(212,50)
Credit of Source State Withholding Tax	—	—
Tax Burden in Residence State	250	212,50
Total Tax Burden	250	362,50
Net Dividend	750	637,50

If Belgium's system of taxation for domestic and cross-border dividends were adopted by all the Member States, cross-border dividends would always bear more tax than domestic dividends. Despite the ECJ's ruling, this disadvantage for cross-border dividends is not the result of a mere disparity in the tax treatment of the cross-border dividend between Belgium and the company state, since we have posited that the company state imposes tax *identically* to Belgium. Persistence of the disadvantage despite (hypothetical) harmonization highlights that the disadvantage does not result from tax disparities. Application of the internal consistency test to double tax cases in the Community would lead to the conclusion, in some cases, that unrelieved juridical double taxation is in fact the consequence of only one Member State's internally inconsistent tax laws. Where a single State's tax system is internally structurally inconsistent and that inconsistency leads to a cross-border tax disadvantage, it is easy to assign liability to relieve double taxation to that State. *Kerckhaert & Morres* is an example of a case in which the defendant Member State's laws were structurally internally inconsistent.

8.4. Conclusion

In the late 1930s, the constitutionality of the new U.S. Social Security and National Labour Relations Acts were challenged before the Supreme Court.²⁹⁰ Previously, President Roosevelt's New Deal legislation had met with opposition in a closely divided Supreme Court, with several of his initiatives struck down by the Court on the theory that they exceeded the grant of authority to Congress by the Constitution.²⁹¹ To prevent further interference from the Court, President Roosevelt developed a plan to appoint more Justices to the Supreme Court who sympathized with his political views. He proposed to increase from nine to fifteen the number of Justices on the Court in order to dilute the power of his judicial opponents.²⁹² As the debate over the court-packing plan became heated, the Social Security Act and the National Labour Relations Act were upheld. A moderate Justice switched political sides — though he had ruled against New Deal legislation in the past, Justice Roberts began voting with the liberal Justices on the

²⁹⁰ Both the Social Security Act and the National Labor Relations Act (the Wagner Act) were enacted in 1935.

²⁹¹ See, e.g., *U.S. v. Butler*, 297 U.S. 1, at p. 68 (1936) (invalidating the Agricultural Adjustment Act of 1933, under which the federal government levied a tax to fund agricultural price supports, because a statutory plan to regulate and control agricultural production “[is] a matter beyond the powers delegated to the federal government.”).

²⁹² The mechanism Roosevelt proposed was “simply this: whenever a judge or justice of any federal court has reached the age of seventy and does not avail himself of the opportunity to retire on a pension, a new member shall be appointed by the president then in office, with the approval, as required by the Constitution, of the Senate of the United States.” F.D. Roosevelt, “Fireside Chat on Reorganization of the Judiciary,” March 9, 1937. Since there were six Supreme Court Justices over 70, this would allow Roosevelt to appoint six new Justices. Roosevelt's judicial reform would have applied to all federal courts, not just the Supreme Court.

Court to uphold New Deal legislation. Additionally, a conservative Justice retired, allowing Roosevelt to appoint a political sympathizer in his place.²⁹³ Once the Supreme Court started upholding New Deal legislation, President Roosevelt's court-packing scheme quickly lost support. The new readiness of the Supreme Court to back Roosevelt's legislative program has been called the "switch in time that saved nine."

Until 2005, the direct tax discrimination cases of the ECJ were amazingly consistent in their outcome: the challenged Member State tax provision was almost always held to be contrary to EC law. The ECJ showed little reluctance to finding that Member State tax provisions were discriminatory. But recently, Member States have experienced major victories before the Court of Justice in direct tax cases. One wonders whether the tax provisions the Court now upholds are really so different from the provisions it invalidated earlier in its history. That is, are we now experiencing a European switch in time? Has the Court of Justice succumbed to political pressure from Member States anxious to protect their domestic tax systems? Recent decisions on cross-border losses,²⁹⁴ most-favoured nation treatment under double tax treaties,²⁹⁵ and now on double juridical taxation²⁹⁶ suggest that the Court is only willing to go so far to achieve negative tax integration.²⁹⁷ Although, in our view, a reasonable interpretation of the fundamental freedoms could support a requirement to abolish double taxation in the Community by way of "negative integration," positive

²⁹³ For more on the court-packing scheme, see A. Schlesinger, Jr., *The Age of Roosevelt: The Coming of the New Deal* (Boston: Houghton Mifflin, 1st 1958).

²⁹⁴ ECJ, 13 December 2005, C-446/03, *Marks & Spencer* [2005] ECR I-10837.

²⁹⁵ ECJ 5 July 2005, C-376/03, *D* [2005] ECR I-5821.

²⁹⁶ ECJ, 14 November 2006, C-513/04, *Kerckhaert & Morres*, not yet reported.

²⁹⁷ M. Lang, "Direct Taxation: Is the ECJ Heading in a New Direction?" 46 *European Taxation* (2006) pp. 421 et seq.

integration is clearly preferable. Possible solutions include harmonization by way of a Directive,²⁹⁸ the conclusion of a multilateral tax treaty based on Article 293 EC,²⁹⁹ the creation of an EU Model Convention (either as a recommendation³⁰⁰ or a binding framework treaty³⁰¹), and specific recommendations based on Articles 211 and 249 EC that address the most important issues for the avoidance of double taxation.³⁰² Although the future is unclear, we support the efforts of the Commission which consistently stress that “double taxation is a major obstacle to

²⁹⁸ See the Commission Working Paper “EC Law and Tax Treaties,” DOC(05) 2306, Paras. 32 et seq.

²⁹⁹ See the Commission Communication “Towards an Internal Market without tax obstacles,” COM(2001)582 final, Para. 62 at p. 43. For a concrete proposal see M. Lang, H. Loukota, A. J. Rädler, J. Schuch, G. Toifl, Ch. Urtz, F. Wassermeyer and M. Züger (eds.), *Multilateral Tax Treaties* (Vienna: Linde, 1997) and the analysis by C. Ph. Schindler, “Ist ein Multilaterales Doppelbesteuerungsabkommen eine sinnvolle Lösung für Europa?” in A. Cordewener, S. Enchelmaier and C. Ph. Schindler (eds.), *Meistbegünstigung im Steuerrecht der EU-Staaten* (Munich: C.H.Beck, 2006), pp. 201 et seq. For analysis of the 1968 draft of a multilateral tax treaty, see U. Anschutz, “Harmonization of Direct Taxes in the European Economic Community”, 13 *Harv. Int’l L. J.* (1972), pp. 1 et seq, at pp. 45 et seq, and J. Schuch, “Europa auf dem Weg zum multilateralen Doppelbesteuerungsabkommen”, in W. Gassner, B. Gröhs; M. Lang (Hrsg), *Zukunftsaufgaben der Wirtschaftsprüfung, Festschrift Deloitte & Touche* (Vienna: Orac, 1997), pp. 327 et seq.

³⁰⁰ See Commission Communication “Towards an Internal Market without tax obstacles,” COM(2001)582 final, Para. 62 at p. 43.

³⁰¹ For in-depth analysis and a concrete proposal see P. Pistone, *The Impact of Community Law on Tax Treaties* (Kluwer, 2002). See also P. Pistone, “An EU Model Tax Convention”, 11 *EC Tax Review* (2002), pp. 129 et seq, and P. Pistone, “Ein EU-Modell als Lösung für die Koordinierung der Doppelbesteuerungsabkommen zwischen den EU-Mitgliedstaaten”, in A. Cordewener, S. Enchelmaier and C. Ph. Schindler (eds.), *Meistbegünstigung im Steuerrecht der EU-Staaten* (Munich: C.H.Beck, 2006), pp. 193 et seq.

³⁰² See the Commission Working Paper “EC Law and Tax Treaties,” DOC(05) 2306, Paras. 38 to 54.

cross-border activity and investment within the EU” and that “[i]ts elimination is... a basic objective and principle of any co-ordinated solution.”³⁰³

One word of caution could be added from the U.S. perspective. Before the Court’s 1978 ruling in *Moorman*, 46 out of the 48 states used identical Massachusetts-style apportionment formulas. Today, less than 30 years after the *Moorman* Court found that uniformity must be imposed by Congress, not the courts, Congress still has not acted to impose a uniform apportionment formula. Only 12 states now require or permit the Massachusetts formula, with the remainder using a variety of factors and weights to apportion taxable income.³⁰⁴ After *Moorman*, it seems that no relief from resulting non-discriminatory double taxation will be available from the federal courts under the Commerce Clause, and none has so far been forthcoming from Congress. Still, few would argue that the United States is not a well-functioning common market.

³⁰³ See the Communication on “Co-ordinating Member States’ direct tax systems in the Internal Market,” COM(2006)823 final, pp. 5 et seq.

³⁰⁴ Federation of Tax Administrators, *State Apportionment of Corporate Income* (Jan. 1, 2006) available at http://www.taxadmin.org/fta/rate/corp_app.html