1216-2574/USD 20.00

Acta Juridica Hungarica
52, No 3, pp. 183–206 (2011)
DOI: 10.1556/AJur.52.2011.3.1

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Removing Tax Barriers From The Clearing and Settlement of Cross-border Capital Market Transactions**

Abstract. Where the institutions of the retention at source of taxes and the prevention of foreign financial intermediaries from assuming in the source country the liability to file tax information and arrange for the payment of tax in fair conditions comparable to their domestic counterparts are to be assessed in the light of the relevant Community law as communicated by the ECJ, it is crucial while concluding whether national legal practices of withholding taxation are consistent with Community law to apply the proportionality principle in specific cases. Where the application of the proportionality principle dictates us in a specific case respect of the effectiveness principle in enforcing rights both on the side of the tax authorities and taxpayers, an avenue may open up for progressively removing barriers from the clearing and settlement of securities transactions across the border. This paper is to discuss how the EC principles of effectiveness and proportionality are to be enforced by the European Court of Justice with regard to removing barriers from the free movement of services and capital upon withholding taxation.

Keywords: effectiveness principle, proportionality principle, withholding tax, retention versus relief at source of or from taxes, paying and information agent

I. Procedural rule of reason and industry-specific problems

As the procedural aspect is the compliment of, and corollary to, the exercise of substantive law rights,[1] it is worth distinguishing between procedural and substantive tax law. Procedural possibilities that are available for taxpayers must be interpreted some times in the context of the positive standard of effectiveness as developed in *Arcaro* (and later in the tax case of *Persche*): national procedures are to be assessed in the light of the purpose that they should be aimed at ensuring fulfilment of the substantive law contents of Community freedoms. At the same time, the national public authorities must be consistent in interpreting national law in the light of Community law. Connection between procedural and substantive tax law can also be reversed: procedural law may fill the gaps left for lack of Community law harmonisation, substituting for substantive law. This is to proceduralise a substantive law problem. An example for this is *Inizan* or 446/03 *Marks and Spencer*: the national authorities are not required to change their legislation, but are expected to grant the taxpayer an extra opportunity for the easy enforcement of rights consistently with the proportionality principle where the taxpayer has otherwise exhausted all other possibilities.

Upon the clearing and settlement (finalisation) of cross-border capital market transactions, it is a common problem that foreign resident taxpayers and foreign financial intermediaries are discriminated, or even they are deprived from fundamental procedural rights. Domestic resident market players may also suffer from the lack of effectiveness in

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** The study was written with the support of the TÁMOP-4.2.1/B-09/1/KMR-2010-005 project.

[1] 309/85 *Barra*, ECR 1988, 355, para. 17.

enforcing their rights. For example, the business of local paying agents with foreign investors may be burdensome or domestic resident taxpayers may face problems in their own legal system if they enter the border while investing between two Member States in the internal market.

Even if the procedural rules are part of the constitutional order of Member States, harmonisation promoted by reference to the so-called procedural rule of reason.[2] Accordingly, the national legislation on procedural rights curtailing the taxpayer's claim may be compatible with Community law, it is subject to the following conditions, however:

(i) it must not be intended specifically to limit the consequences of an ECJ judgment; and

(ii) the restriction on taxpayer rights (e.g. the introduction of a time-bar) must be sufficient to ensure that the right to (re)payment is effective (e.g. by introducing transitory provisions).

The major industry-specific problems that will be discussed below in the light of the above considerations can be highlighted as follows:

(i) Lack of effectiveness to be granted to foreign resident taxpayers can be mentioned in brief as follows:

– access to fiscal relief may be difficult; relief at source is not always possible, e.g. in Germany or the Netherlands;

– availability of quick refund procedures may be limited, delay in refund may occur (good examples are, on the contrary, e.g. in Germany:
"Datentraegerverfahren" or "Data Medium Procedure");

– lack of European-wide harmonised relief models; and

– foreign resident taxpayers may be deprived of procedural rights.

(ii) Non-discrimination of foreign financial intermediaries can be highlighted at the major points as follows:

– local tax ID is usually required for foreign financial intermediaries; representation through a national subsidiary or a local PE may be obliged to serve as a paying agent (e.g. in Italy);

– payment to foreign intermediaries is not possible in gross; no responsibility is given to a foreign intermediary either to transfer information;

– foreign intermediaries have to bear strict and unlimited liability for any failure (high level of the standard of care) instead of applying a good faith standard; and

– limited possibility of self-certification through contracting out (good examples are, e.g. the "Know Your Customer" rules in the U.S. or the institution of "Qualified Intermediaries" in Ireland).

(iii) Lack of effectiveness to be granted to domestic resident taxpayers active across the border can be exemplified as follows:

– paying agents may be obliged to bear strict, and joint and several, liability for withholding taxation (e.g. in Hungary);

– the centralised model developed in major European capital-exporting countries (e.g. through Euroclear, called "Central Securities Depository") has not yet been proliferated in many Member States (like in CEE countries); and

– the opportunities of simplified reporting of taxpayer information (like the Dutch pattern of GGC or "Large Authorised Representative"), have not yet proliferated.

[2] C-62/00 *Marks and Spencer*, ECR 2002, I-6325, para. 36.

Lessons can be drawn in particular from the ECJ cases as indicated in a matrix below:

Community harmonisation of tax procedural rights	**Cases not decided in favour of the MS**	**Cases decided in favour of the MS**
(i) Procedural rights: effectiveness to be granted to foreign resident taxpayers (exercising, as a last resort, the freedom of capital)	*Fokus Bank* (free movement of capital), *ELISA* (free movement of capital)	*FKP Scorpio* (freedom to provide services), *Skatteverket v. A.* (free movement of capital), *Rimbaud* (free movement of capital)
(ii) Access to relief: equivalence or non-discrimination to be granted to foreign resident financial intermediaries (usually exercising the freedom to provide services)	*Svensson and Gustavsson* (freedom to provide services), *Safir* (freedom to provide services), *Danner* (freedom to provide services), *Skandia and Ramstedt* (freedom to provide services)	
(iii) Procedural rights: effectiveness as a positive standard to be granted to foreign resident citizens and enterprises (exercising the freedom of persons) to ensure fulfilment of Community freedoms and to be consistent in interpreting national law in the light of Community law	*Heylens* (free movement of workers), *Marleasing* (freedom of establishment), *Vlassopoulou* (freedom of establishment), *Arcaro* (harmonisation of the protection of environment)	
(iv) Procedural rights: effectiveness to be granted to domestic resident taxpayers active across the border (exercising, as a last resort, the freedom of capital)	*San Giorgio* (free movement of goods), *Barra* (free movement of workers, non-discrimination), *Peterbroeck* (freedom of establishment), *Société Baxter* (freedom of establishment), *Vestergaard* (freedom to provide services), *Metallgesellschaft and Hoechst* (freedom of establishment), *Laboratoires Fournier* (freedom of establishment), *Persche* (free movement of capital)	*Algera* (not in favour of more harmonisation), *Rewe* (free movement of goods), *Comet* (free movement of goods), *Deutsche Milchkontor* (free movement of goods), *Berlin Butter* (free movement of goods), *Inizan* (freedom to provide services), *Twoh Int.* (free movement of goods), *X and Passenheim* (free movement of capital)
(v) Procedural rights: effectiveness to be granted to domestic and foreign resident taxpayers through the possible harmonisation in fiscal matters	C-349/03 *Commission v. UK* (free movement of goods)	C-338/01 *Commission v. Council* (not in favour of more harmonisation), C-533/03 *Commission v. Council* (not in favour of more harmonisation)

II. Analysis of ECJ cases

1. Effectiveness in the protection of the rights of foreign resident taxpayers

The taxpayers who are active across the border want to benefit usually from the free movement of capital principle. In a few Member States, relief at source (based on a respective bilateral double tax convention) is not available. Instead, those who claim treaty

relief must enter into burdensome procedures to get tax refund. The difficulties arising from national practices in claiming treaty relief results in restriction on the fundamental Community freedoms, mainly on the freedom of capital. The national legislator or the national public authorities do not have the explicit intention to do discrimination. It can still be problematic that foreign taxpayers cannot get easy access to the national law facilities of the host Member State. They are thus not able to protect their rights effectively.

It can be criticised that foreign resident shareholders do not always have rights as parties to administrative proceedings. It is apparently more comfortable for the national tax authorities to get in contact with the relevant domestic resident subsidiary. It is discriminatory, however, if foreign resident shareholders are not recognised as parties to the procedures of tax administration. Apparently, their interests are not necessarily the same as those of the subsidiary. They are thus deprived of the possibility effectively to protect their rights.

The practice has spread over in the European Economic Area that foreigners are not given taxpayer rights upon the withholding of taxes.[3] It comes from that foreign resident taxpayers are subject to tax in the source country without having been granted the right to protect their rights to be associated with the liability to pay tax. Quite frequently, foreign taxpayers are not allowed to initiate disputes with the local tax authorities concerning the title to, and the qualification of, the income they derive from the country. They will only be recognised as parties to administrative procedures if they apply for refund.

National orders must not impair the individual rights flowing from the fundamental freedoms, the EFTA Court holds (in Para. 41 of *Fokus Bank*). Such an obligation of the host country follows from the effectiveness principle enshrined in both the EC Treaty and the EEA Treaty. Even if foreign resident taxpayers have the right to file complaints in the host country, they are not notified of the reassessment of withholding tax. They are thus deprived of the right to be heard (Para. 42).

If the relief at source method is available for foreign taxpayers, they are not in a need of initiating procedures according to the host country's law, provided, however, that no dispute is (and will be) developed between the taxpayer and the tax authorities. During a tax audit, reassessment is not precluded. Then, the taxpayers subject to withholding tax should be recognised as parties to the procedure of tax audit. Refund is obviously less favourable for taxpayers than the use of the relief at source method. However, applying for tax refund, foreign taxpayers are most likely recognised as parties to the procedure of refund. This is a paradoxical development that comes from the sporadic nature of Community law harmonisation.

In *FKP Scorpio*,[4] the procedure of retention at source of tax was not found inconsistent with the freedom to provide services either at the level of the payment creditor (the foreign resident taxpayer) or the payment debtor (the domestic resident paying agent). Restriction can be justified in this case by the host Member State's need to ensure that the taxable income should not escape taxation. Fiscal supervision is thus a legitimate need (Para. 35). The ruling of ECJ does not concern, however, a situation where the EC Mutual Assistance Directive can be invoked, which was not available in this case (Para. 36). The national law procedure of retention at source was also scrutinised in the light of the proportionality principle. The ECJ concluded that the national law restriction could also be justified in this respect. The question has eventually remained open how the retention at source procedure

[3] E-1/04 *Fokus Bank,* judgment of the EFTA Court on 23 November 2004, para. 45.

[4] C-290/04, ECR (2006), I-9461, para. 39.

can be justified by the need of fiscal supervision in a situation where the affected Member States can rely on the armoury to be provided by the Mutual Assistance Directive. The ECJ also holds that it constitutes an obstacle to the freedom to provide services if tax relief can be taken into account at the various stages of the taxation procedure only upon production of a certificate issued by the home Member State, stating that the conditions for treaty relief are satisfied. This obstacle can be justified, however, by the need that the proper functioning of the procedure for taxation at source must be ensured (Paras 58–59).

The judgment does not make an assessment of the affected national taxation procedure in respect of the requirement of certification. It only mentions about that certificates may be required. It does not give guidance of how certification must take place. It is thus not precluded that the requirement of certificates is burdensome, not being proportionate with the objective of the effectiveness in tax collection.

The problem of FKP Scorpio is also raised in respect of a service-provider who is resident in a state outside the EEA. Although the freedom to provide services is not available for those who reside outside the EU, the Community freedom to provide services is applicable not only to the service-provider, but also to the recipient of services who is resident in an EU Member State (Para. 63 in *FKP Scorpio*). Indeed, the paying agent who is liable to respect the law on the retention at source of tax and to obtain certificates that prove eligibility for treaty relief must be provided with the possibility of benefiting from the Community principle that taxpayer rights must be effectively protected. In the specific case, the recipient of services (FKP Scorpio) is not entitled to benefit from the Community freedom to provide services because the provider of services is not established in an EU Member State (Para. 67). Any way, the difficulties arising from the retention at source procedure and from burdensome formalities of certification must in principle be assessed not only in respect of the provider, but also of the recipient of services if otherwise the services are provided within the Community by those who are established in a Member State.

In *ELISA*, it is clarified that the EC Mutual Assistance Directive does not preclude the application of a double tax convention. This is still spelled out not in general terms, but in the instance that the particular provisions of a double tax convention may prevent the requested Member State from collecting, using and transferring information by its laws in accordance with Art. 8 (1) of the Mutual Assistance Directive.[5] This does not mean that restrictive national law practices, such as the procedure of taxation at source, could not be found in certain cases as inconsistent with the free movement of capital principle or with other Community freedoms. Procedural rules must eventually be assessed in the light of Community freedoms. National administrative practices need not be harmonised, and cannot be condemned, unless they prevent citizens and companies from exercising their Community freedoms.

As it also comes from this ECJ case, national law may despite the harmonisation of the mutual assistance in tax matters constitute an obstacle to the exchange of cross-border tax information where a double tax convention excludes from its scope tax haven companies. This is why the French tax legislator felt to be legitimised while categorically excluding non-French companies from tax relief if the respective double tax convention does not make it possible to the French tax authorities to obtain information of them. It is yet another issue

[5] Council Directive 77/799/EEC OJ L 336, 27.12.1977, 15, as amended significantly by Council Directive 92/12/EC, OJ L 76, 23.3.1992, 1; C-451/05 *ELISA*, ECR 2007, I-8251, para. 55.

that it is not consistent with the proportionality principle if taxpayers will not be granted the opportunity to prove on the contrary to the legislative presumption that they meet the legal requirements for the grant of tax relief.

As arises from Para. 102, the free movement of capital principle precludes national legislation when national law does not allow a company established in another Member State to supply evidence to establish the identity of its shareholders and, this way, prevents such a company from obtaining tax relief. The ECJ held that the taxpayer should not be excluded "a priori" from providing relevant documentary evidence enabling the tax authorities of the Member State imposing the tax to ascertain that the taxpayer would not attempt the avoid or evade the payment of taxes.[6] Relief at source cannot thus be precluded if the taxpayer is successful in providing evidence for fulfilling the requirements for the treaty relief claimed. Obviously, the national tax authorities can also rely on the facilities of the EC Mutual Assistance Directive. Even if these facilities are not available for any reason, national law restrictions must not be in breach of the proportionality principle either.

It can happen that there is no possibility to have resort to the framework of Community law harmonisation as provided for by the EC Mutual Assistance Directive. This is clear in cases *Skatteverket v. A*.[7] and *Rimbaud*.[8] The proportionality principle cannot be invoked either. Indeed, the application of the proportionality principle does not seem to be appropriate where the source country entities reside in tax havens (in these cases, in a Swiss canton and in Liechtenstein, respectively), and the source jurisdiction is not willing to provide sufficient information to the residence country's tax authorities.

In *Scorpio*, the legal framework provided for by the EC Mutual Assistance Directive is missing as well. The ECJ did not feel to be compelled to rely on the proportionality principle on its merits, however. The principle is just mentioned (in Paras 37–38), but it is not explained why the retention at source procedure is found to be consistent with the proportionality principle. While in the tax haven-related cases of *Skatteverket v. A*. and *Rimbaud* the tax authorities seem to be authorised not to relax their practices, this standpoint does not seem to be justified in *Scorpio*. It tells us the future only how much the Scorpio-attitude can be maintained, and how the ECJ position taken in *ELISA* that is based on the application of the proportionality principle can be reconciled with its less ambitious approach taken in *Scorpio*.

In *Skatteverket v. A.*, the ECJ clarifies that the concept of restrictions on the free movement of capital is different, depending on whether the movement of capital takes place to or from third countries or within the Community (Para. 36). This is because the liberalisation of the movement of capital with third countries may pursue objectives other than that of establishing the internal market (Para. 31). Upon interpreting the procedural law infrastructure, it must not be out of consideration that it is not the same concept of restrictions on the free movement of capital that must be secured. The procedural law facilities could thus be restricted in respect of third countries where the free movement of capital principle is also restricted in its scope, to be compared to its application in the context of the single European market. As explained by the ECJ, where the legislation of a Member State makes the grant of a tax advantage dependent on satisfying requirements,

[6] Para. 96. See also: Case C-254/97 *Baxter* ECR 1999, I-4809, paras 19 and 20; Case C-39/04 *Laboratoires Fournier*, ECR 2005, I-2057**,** para. 25.

[7] C-101/05 *A*, ECR 2007, I-11531.

[8] C-72/09, ECR 2010, 00000.

compliance with which can be verified only by obtaining information from the competent authorities of a third country, it is, in principle, legitimate for that Member State to refuse to grant that advantage. This is the case, in particular, because that third country is not under any contractual obligation to provide information. Thus, it proves impossible to obtain such information from that country.[9]

It has been the standard in the ECJ practice that the justification based on the fight against tax evasion is permissible only if it targets purely artificial contrivances. Accordingly, a general assumption of tax avoidance or evasion fails to justify a restrictive national tax measure.[10] The retention at source of tax procedure is a restriction on the free movement of capital at least because it discourages the taxpayer to be active in investment in another Member State if encountered with difficulties in enforcing treaty benefits. It cannot surely be justified by the general assumption of tax avoidance because–as held by the ECJ–such justification would be in breach of the proportionality principle. Even if the national tax authorities of a Member State are not able for any reason to have recourse to the exchange of tax information to be provided by the tax authorities of another Member State or EEA country, the tax authorities should conduct a case-by-case assessment of the information provided by the taxpayer whether this information can be verified, the Commission argues in *Rimbaud* (Para. 45). A case-by-case assessment could perfectly be possible in a procedure of claiming the relief of double tax conventions as well. The national tax authorities are usually able to verify the information the taxpayer may have provided of fulfilling the conditions for treaty relief.

The argument that the case of *Rimbaud* did not differ from that of *ELISA* due to the fact that the Luxembourg tax authorities were prevented from providing information like the Liechtenstein tax authorities was dismissed by the ECJ. The ECJ held that, even though, in the situation which was under consideration in *ELISA*, the Luxembourg authorities were not, by virtue of Art. 8(1) of Directive 77/799, under any obligation in principle to provide information, the fact remained that the regulatory framework was quite different (Para. 46). Such a regulatory framework for cooperation between the tax authorities of different Member States is usually not missing in a procedure of taxation at source. There is thus no reason to refrain from switching from the retention at source of tax method to that of the relief at source. The national tax authorities of a Member State should be able to verify the information provided by the financial intermediaries, who accompany their clients active in investing in another Member State.

In the above cases, it was the main problem that foreign resident taxpayers were not granted effectiveness in protecting their rights. As a result, taxpayers were usually prevented from exercising their right to the free movement of capital. They are not only confronted with difficulties in claiming national law or treaty relief, but it can also happen in these cases that they are deprived of their procedural rights. Such mistreatment cannot be upheld in the light of Community freedoms, however.

[9] Para. 63, reiterated in *Rimbaud*, para. 44.

[10] C-196/04 *Cadbury Schweppes*, ECR 2006, I-7995, para. 50, reiterated in *Rimbaud*, para. 34.

2. Equivalence accorded to foreign resident financial intermediaries

The practice of Member States to apply withholding taxes at source may constitute barriers to the exercise of fundamental freedoms. This is to hurt foreign resident taxpayers, who derive income across the border. Being discouraged from cross-border investment, they will be prevented from exercising their right to the freedom of capital. Financial intermediaries may also be prevented from offering withholding agent services across the border if they do not enjoy a level playing field with their domestic resident counterparts. The restrictive practice of the retention of taxes at source may thus result in the infringement of both the free movement of capital and the freedom to provide services.

The free movement of capital principle can be applied in parallel to the freedom to provide services (e.g. *Svensson and Gustavsson*).[11] In another legal case (*Safir*), the freedom to provide services is carved out by the EC Court from the national court's question relating to several freedoms, including the free movement of capital.[12] It comes from Barrier 11 (and 12)[13] that the freedom to provide services and the free movement of capital principles are highlighted as the two different sides of the same coin. It depends on the intonation only whether the stress is laid on the services provided by financial intermediaries rather than on the investor's choice. As it comes from the case of *Svensson and Gustavsson*, a rule that makes the grant of interest rate subsidies subject to the requirement that the loans have been obtained from an establishment approved in a certain Member State constitutes discrimination not only against the applicant, but also against credit institutions established in other Member States, and is inconsistent with the freedom to provide services principle accordingly (Para. 12). This is the problem of the missing level playing field. Foreign financial enterprises may suffer from discrimination not only if they cannot gain access to clients who may apply for subsidised loans, but also in cases where they are prevented from performing withholding services by transferring information and untaxed income in a custody chain if necessary.

The taxpayer in *Safir* complains about that when a person holding a policy issued by a company not established in Sweden applies for an exemption from, or reduction of, tax on the life insurance premiums, "Skattemyndigheten" requires precise information concerning the income tax to which the company is subject, unless the authorities already have such information. As Jessica Safir points out, such a requirement is particularly burdensome for the policyholder. It may also dissuade insurance companies, which do not operate on the Swedish market, from offering their services there, since it means that those companies must provide their potential customers with precise information relating to the tax system applicable to those companies in another Member State (Para. 28). Where a Member State introduces a burdensome procedure that is only applicable to cross-border cases, such a policy restricts among other things the Community freedom to provide services, discriminating against foreign financial enterprises. This is also the case with foreign financial enterprises if they are confronted with extra legal requirements associated with

[11] C-484/93 *Svensson and Gustavsson*, ECR 1995, I-3955.

[12] C-118/96 *Jessica Safir*, ECR 1998, I-1897.

[13] Giovannini Group, Second report on EU clearing and settlement arrangements, Brussels, April 2003, 11. The results of the Giovannini reports are reflected within the Commission communication on "Clearing and settlement in the EU–The way forward", COM (2004) 312 final, under heading "3.2. Taxation issues".

withholding taxation, while offering services to their clients, who enter the market of another Member State.

Finally, the ECJ did not find as legitimate the need to fill the fiscal vacuum arising from the non-taxation of savings in the form of capital life assurance policies taken out with companies not established in Sweden (Para. 34). In other words, the Swedish law that provides for the fiscal vacuum to be filled is in breach of the proportionality principle. Similarly, the assumption of a fiscal vacuum that is filled by the retention of tax at source may also be found as inconsistent with the proportionality principle.

In *Danner*, national governments contend that the non-deductibility of contributions paid to schemes operated by foreign insurance enterprises is justified by the need to ensure the effectiveness of fiscal controls, and to prevent tax evasion.[14] That argument cannot be upheld, the ECJ holds because first, Member States may rely on the EC Mutual Assistance Directive (Para. 49), secondly, they may request the taxpayer to provide sufficient proof of fulfilling the legal requirements (Para. 50). The reliance on the Mutual Assistance Directive and on the principle of proportionality are issues that are also relevant to the problem of discrimination both against foreign investors and foreign financial intermediaries that are confronted with the retention at source of income tax.[15]

3. Effectiveness as a positive standard in the protection of the rights of foreign resident citizens and enterprises

Foreign resident citizens or enterprises may be mistreated in a host Member State, where they are not granted effectiveness in law enforcement in the sense that national law practices omit to apply a positive standard. This means that national treatment should ensure fulfilment of Community freedoms. Then, procedural rules must be assessed from the viewpoint whether they constitute obstacles to the exercise of substantive freedoms. Procedural rules are thus not to be assessed taken by itself, but to the extent that they may constitute barriers to the exercise of substantive law rights. Besides, the national public authorities, while exercising their power, are expected to be consistent with Community law in interpreting national law. If this is not the case, Community freedoms may be violated. This problem usually concerns the freedom of persons. In the tax law area, no legal cases emerged for a long time to illustrate the above-mentioned positive standard (see, however, the tax case of *Persche* as discussed below in the next session). Still, it will be interesting to take a look at non-tax cases to try to learn from them with particular regard to the failure of national legal measures to grant foreign resident taxpayers the opportunity of the easy enforcement of rights.

A procedure for the recognition of the equivalence of diplomas must enable the national authorities to assure themselves on an objective basis that the foreign diploma certifies that its holder has knowledge and qualifications, which are equivalent to those certified by the national diploma.[16] The person, who is subject to a procedure before the national authorities must also be able to defend his or her rights under the best possible conditions and have the possibility of deciding with a full knowledge of the relevant facts whether there is any point in their applying to the courts (Para. 15). It is an effectiveness standard that is determined

[14] C-136/00 *Danner*, ECR 2002, I-8147, para. 44.

[15] Reiterated in paras 43 and 45, respectively, in C-422/01 *Skandia and Ramstedt*, ECR 2003, I-6817.

[16] 222/86 *Heylens*, ECR 1987, 4097, para. 13.

by the ECJ in this case. The public authorities should have the right of full assessment of the private party's case, but the latter is also allowed to defend himself or herself effectively. An alternative to the taxation at source procedure by allowing relief at source could in principle be designed in a way that both the tax authorities and taxpayers could be granted the possibility of effectiveness in enforcing their respective rights.

The Member States' obligation arising from a directive to achieve the result envisaged by the directive and their duty to take all appropriate measures, whether general or particular, to ensure the fulfilment of that obligation, is binding on all the authorities of Member States including, for matters within their jurisdiction, the courts. It follows that, in applying national law, whether the provisions in question were adopted before or after the directive, the national court called upon to interpret it is required to do so, as far as possible, in the light of the wording and the purpose of the directive in order to achieve the result pursued by the latter.[17]

There are two standards the ECJ identifies in this case. First, the purpose of a national law procedure must be to ensure by all appropriate methods the fulfilment of legal obligations consistently with Community law. The national authorities are therefore not only obliged to refrain from what would be a barrier to the exercise of Community freedoms, but they have to do everything necessary to be consistent in their actions with Community law. This is a very high standard, in the light of which it is doubtful whether the "a priori" exclusion of a relief at source procedure is consistent with Community law. Secondly, the national authorities are obliged to give interpretation of national law in full compliance with Community law. The question is in this instance no longer about the enforcement of individual rights and obligations. Instead, the dispute is placed on a higher level. The consistent interpretation of national law principle is a meta-principle, on the level of which subjective rights cannot be discussed. It is still closely connected with the positive expression of the effectiveness principle in cases like *Marleasing*. Other examples for that are *Vlassopoulou* and C-168/95 *Arcaro*.

Subjective rights cannot be enforced in the context of Community law unless they are built into the structure of Community law that has been developed. In addition to the enforcement of individual rights, the meta-principles of Community law–and even the principles of the operation of Community institutions–must be taken into account. Examples of the principles of the operation of Community institutions include the democracy principle and the subsidiarity principle. The principles of the superiority of Community law over national law or that of direct applicability are meta-principles of Community law. The principles of proportionality or legal certainty can also be considered as meta-principles of Community law. Meta-principles do not concern substantive rights or fundamental freedoms. They are authoritative as to the mechanisms, according to which the rules of Community law can be applied, serving as the legal foundation for decisions of the public authorities, where written sources of law fail to provide an answer. All these meta-principles are material to the enforcement of individual rights. They do not imply procedural rights as such, however.

In *Arcaro*, the national court seeks to ascertain whether, upon a correct interpretation of Community law, there is a method of procedure allowing the national court to eliminate from national legislation provisions that are contrary to a provision of a directive which has

[17] C-106/89 *Marleasing*, ECR 1990, I-4135, para. 8, reiterated in C-340/89 *Vlassopoulou*, ECR 1991, I-2357, see paras 17 and 22, and in C-168/95 *Arcaro*, ECR 1996, I-4705, para. 41.

not been transposed, where the latter provision may not be relied on before the national court in criminal proceedings. The answer the ECJ has given is that there is no such method of procedure in Community law. However, the national authorities are obliged to follow a procedure in which it is possible to achieve the result envisaged by Community law (Paras 39–40). In this instance, the ECJ reiterates what was already said in *Marleasing*. The relief at source procedure, and the deprivation of foreign financial intermediaries and their clients of procedural rights in the source Member State does not seem to be consistent with this standard of effectiveness to be granted to taxpayers.

4. Effectiveness in the protection of the rights of domestic resident taxpayers

The Community law principle of effectiveness is applicable not only to foreign, but also to domestic resident taxpayers, who are active across the border (exercising, as a last resort, the freedom of capital). Lack of effectiveness in the enforcement of rights may be a problem that concerns not only foreign resident investors or foreign financial intermediaries, but also domestic resident participants of European capital markets, that is, those domestic taxpayers, who are active as investors entering the state border, or who are the recipients of the services of foreigners. For example, there may be problems in claiming exemption of foreign earned income or foreign tax credit. Or, for instance, Fokus Bank as a domestic subsidiary or FKP Scorpio as a domestic resident recipient of the services of foreign artists may also encounter difficulties in handling the international tax issues of withholding taxation.

The issues of public administration have emerged in the ECJ practice since the early times. Some examples for the matters that have been subject to the ECJ scrutiny are as follows:

– revocation of administrative decisions and protection of vested rights;
– partial validity of administrative decisions;
– passing of time limits;
– taking due care by the public authorities in obtaining information of the relevant facts and data;
– burden of proof;
– activity of monitoring; and
– consideration of national tribunals seized of a matter of their own motion whether national law is compatible with Community law.

It has been spelled out that although the solutions in Member States may vary, the ECJ is invited to rely on the learned writing and case law of Member States, reconciling differences if necessary.[18]

(i) Equivalence and effectiveness

As it comes from *San Giorgio*, it is incompatible with Community law to apply in a Member State legal presumptions or rules of evidence intended to place upon the taxpayer the burden of establishing that the charges unduly paid has not been passed on to other persons, or the national rules of special limitations concerning the form of the evidence to be adduced, such as the exclusion of any kind of evidence other than documentary one. The court seized of the specific matter must be free to decide whether or not the burden of charges has been passed on to other persons.[19] Where the procedure of producing evidence as provided for by

[18] Joined cases of 7/56, 3/57 to 7/57 *Algera*, ECR, 62–63.
[19] 199/82 *San Giorgio*, ECR 1983, 3595, para. 14.

national legislation must not be burdensome to the extent that it would not be proportionate with legislative goals, the retention at source of taxation procedure must not be without alternatives either, and relief or simplified refund procedures should be available as well for both foreign resident taxpayers and the domestic paying agents assisting the former. A burdensome national law procedure of providing evidence may constitute a barrier to the exercise of Community freedoms (freedom of capital in respect of the investor and freedom to provide services in respect of the local paying agent or of foreign financial intermediaries that have accompanied their clients to another Member State).

In *Barra*, the ECJ had the opportunity plainly to express the idea that it can be an impediment to the exercise of Community freedoms if not supported by appropriate procedural law institutions:

> "The right to repayment of amounts charged by a Member State in breach of the rules of Community law is the consequence and complement of the rights conferred on individuals by the Community provisions as interpreted by the court. Whilst it is true that repayment may be sought only in the framework of the conditions as to both substance and form laid down by the various national laws applicable thereto, the fact nevertheless remains … that those conditions … may not be so framed as to render virtually impossible the exercise of rights conferred by Community law."[20]

To the extent that national law restricts repayment of the duty introduced in breach of the rules of Community law solely to plaintiffs, who brought an action for repayment before the delivery of the judgment in case 293/83 *Gravier*, where the ECJ found the imposition to foreign students of a national vocational training fee incompatible with Community law, actually deprives individuals who do not satisfy that condition of the right to obtain repayment of amounts unduly paid. Such a provision renders the exercise of the rights conferred by the effectiveness principle of EC Treaty impossible (Para. 19 in *Barra*). As it is clear from this judgment, the ECJ did not endorse the national law restriction of the possibility of repayment to those, who acted in good faith in accordance with the national law assumption. In the light of this judgment, national law restriction of tax relief to those who are supposed to act in good faith cannot be accepted in cases either where the facility of relief at source is not available, based on the legislative assumption that tax avoidance or evasion cannot be precluded otherwise.

The obligations imposed by national legislation on undertakings wrongly granted pecuniary advantages based on Community law must be no more stringent than those imposed on undertakings which have wrongly received similar advantages based on national law, provided that the two groups of recipients are in comparable situations and therefore different treatment is objectively unjustifiable.[21] It also comes from *Deutsche Milchkontor* (Para. 33) that that Community law does not prevent national law from having regard, in excluding the recovery of unduly-paid aids, to such considerations as

– the protection of legitimate expectation,
– the loss of unjustified enrichment,
– the passing of a time-limit, or
– the fact that the administration knew, or was unaware owing to gross negligence on its part, that it was wrong in granting the aids in question.

[20] 309/85 *Barra*, paras 17–18.

[21] Joined cases of 205/82 to 215/82 *Deutsche Milchkontor and others*, ECR 1983, 2633, para. 23.

Furthermore, national legal rules may also apply to
– the burden of proof, and
– the monitoring activity of the public authorities within the limits of non-discrimination (Para. 39) and loyalty to Community interests (Para. 45).

In the light of the judgment in *Deutsche Milchkontor*, one cannot really argue that recourse to the relief at source or the equal treatment of domestic and foreign financial intermediaries would be precluded, or the smooth operation of paying agents, who provide information and apply withholding tax in respect of foreign investors would be impossible. Simplification and more generosity in legislation does not mean that the tax authorities would not enjoy freedom in raising objections to the taxpayer's conduct if necessary, withdrawing the possibility of having direct access to tax relief. The public authorities–whether at a level of the Member State or the Community–may enjoy in certain areas (such as the Common Agricultural Policy) wide discretion as spelled out in the *Berlin Butter* case.[22] The purpose of giving more emphasis to the effectiveness principle in the procedure of withholding taxation is not to restrict the scope of action of the tax authorities. It is only important to eliminate national legislation, the result of which would be to preclude simplified procedures and easy access to tax relief.

The ECJ does not encroach upon the Member State's right to introduce national procedural rules. This inaction is done, however, with the proviso that national rules must reflect the principles of equivalence (non-discrimination) and effectiveness. This means in procedural matters that it is the national law according to which cases must be decided, with the proviso, however, that the applicable national law–compared to that applicable to purely national cases–must not be for the citizens invoking Community law
– less favourable, and
– less efficient.

Where disparities are experienced, the idea is not to do comparison between national jurisdictions, but to do that between the national rules applicable either to cross-border or purely domestic cases. Harmonisation can thus take place in an indirect way. It is not the national procedural rules that are to be approximated, but the national procedural rules are to be assessed in the context of cross-border and purely domestic cases. To the extent that cross-border cases will not be mistreated, national procedural law systems will not be approximated to each other.

The above idea is plainly expressed in *Peterbroeck*. In this case, the period during which new pleas could be raised by the appellant under Belgian law had expired by the time the national court held its hearing so that the latter was deprived of the possibility of considering the question of compatibility of the national law issue with Community law whether the higher company tax rate applicable to foreigners resulted in restriction on the freedom of establishment. As explained by the ECJ, it is for the domestic legal system of each Member State to lay down the detailed procedural rules governing actions for safeguarding rights, which individuals derive from the direct effect of Community law.

[22] Joined cases 133 to 136/1985 *Walter Rau Lebensmittelwerke*, ECR 1987, 2289, para. 29.

However, such rules must not be less favourable than those governing similar domestic actions, nor render virtually impossible or excessively difficult the exercise of rights conferred by Community law.[23]

The requirements that the public authorities should have recourse to the Community law framework of coordination and that national law restrictions must not go beyond what is necessary to achieve the legislative goal are set in the ECJ practice not only in respect of foreign, but also of domestic resident taxpayers. As held in *Baxter*, the national tax authorities are not prevented from benefiting from the harmonised company law directives on annual accounts.[24] Similarly, it is explained in *Vestergaard* that the EC Assistance Directive can be invoked by tax administrations.[25] Furthermore, it is precluded to prevent the taxpayer from submitting evidence for the expenditure relating to research carried out in another Member State.[26] It is also prohibited to prevent the taxpayer from submitting evidence for the deduction of the costs of training courses, taking place in another Member State.[27] National legislation, which absolutely prevents the taxpayer from submitting evidence that expenditure relating to research carried out in other Member States has actually been incurred and satisfies the prescribed requirements cannot be justified in the name of effectiveness of fiscal supervision. As confirmed in *Laboratoires Fournier*, the possibility cannot be excluded "a priori" that the taxpayer is able to provide relevant documentary evidence enabling the tax authorities of the Member State of taxation to ascertain, clearly and precisely, the nature and genuineness of the research expenditure incurred in other Member States.[28]

(ii) Equally effective treatment, equivalence of the treatment accorded in various Member States

As it comes from *Metallgesellschaft and Hoechst*, it is precluded to apply national law restrictions by the national public authorities on a claim on the grounds that the taxpayer did not get involved in burdensome administrative proceedings to seek remedy first.[29] In other words, there should be enough room available for parties to conduct legal disputes on fair terms. Similarly, the taxpayer should be granted enough room to have direct access to tax relief. Raise the tax authorities doubts on how much the taxpayer's claim is established, they have the opportunity to challenge claims that seem to lack sufficient legal basis in a procedure of tax audit and the subsequent legal dispute.

The ECJ holds in *Inizan* that Arts. 49 EC and 50 EC must be interpreted as not precluding legislation of a Member State which, first, makes reimbursement of the cost of

[23] C-312/93 *Peterbroeck*, ECR, 1995, I-4599, para. 12. See reference to the double requirement of equivalence and effectiveness already in *San Giorgio*, para. 12. They fist appear in 33/76 *Rewe*, ECR 1976, 1989, para. 5, and 45/76 *Comet*, ECR 1976, 2043, para. 13. These standards have been plainly explained in *Brasserie du Pêcheur and Factortame*. Accordingly, national law criteria must not be less favourable than those applying to similar claims or actions based on domestic law, and must not be such as in practice to make it impossible or excessively difficult to obtain rights. See: Joined Cases C-46/93 and C-48/93 *Brasserie du Pêcheur and Factortame*, ECR 1996, I-1029, para. 90.

[24] See reference to *Baxter* above.

[25] C-55/98 *Vestergaard*, ECR 1999, I-7641, para. 26.

[26] C-254/97 *Baxter*, para. 19.

[27] C-55/98 *Vestergaard*, para. 25.

[28] C-39/04 *Laboratoires Fournier*, ECR 2005, I-2057, para. 25.

[29] Joined cases C-397/98, C-410/98, ECR 2001, I-1727, para 107.

hospital care provided in a Member State other than that in which the insured person's sickness fund is established conditional upon prior authorisation by that fund and, secondly, makes the grant of that authorisation subject to the condition that it be established that the insured person could not receive within the territory of the Member State, where the fund is established the treatment appropriate to his condition. However, authorisation may be refused on that ground only if treatment which is the same or equally effective for the patient can be obtained without undue delay in the territory of the Member State in which he or she resides.[30] It is not precluded to introduce in a Member State a prior administrative authorisation scheme. It must be based, however, on a procedural system, which is easily accessible and capable of ensuring that a request for authorisation will be dealt with objectively and impartially within a reasonable time, and refusals to grant authorisation must also be capable of being challenged in judicial or quasi-judicial proceedings (Para. 57).

The Community law requirement of achieving a treatment that is equally effective in comparable cases is a particular expression of the effectiveness principle, in this case spelled out in the context of the freedom to provide services. Interestingly, the problem of *Ms Inizan*, a patient, is dealt with as a matter of the freedom to provide medical services. Similarly, the problem of a taxpayer crossing the border may raise the issue of financial intermediaries that are to exercise the freedom to provide services. In contrast to the case of *Inizan*, the question is either about the domestic financial service-providers, who accompany their clients abroad or about foreign financial intermediaries, who accompany their clients in the source country. In the light of the judgment in *Inizan*, it is any way doubtful whether "a priori" exclusion of gaining access to relief at source or prevention of foreign financial intermediaries from serving their clients in the host Member State is consistent with Community law.

A Member State is not obliged to co-operate with its fellow Member State unless the denial of coordination with the other Member State would prevent citizens from exercising their fundamental rights across the Community. The EC Court made use of this standard in C-446/03 *Marks and Spencer* as well: for lack of a fiscal nexus established in the UK, the United Kingdom is not obliged to grant the opportunity of carrying over the losses of a Luxembourg subsidiary to a UK parent company unless the UK taxpayer proves that in Luxembourg there is no way of recognising any loss carryover for tax purposes. It is a novelty in the Advocate General's opinion delivered on that case that he would extend the equivalence principle, germane to the concept of the internal market as introduced as of 1993, to the matters of direct taxation, that is, to a territory where Member States traditionally enjoy freedom: a key to the solution of the problem is "the comparison and equivalence of the treatment accorded in various Member States".[31]

It is interesting to see in *Marks and Spencer* the way in which the proportionality principle has been utilised. This principle was used before in the simple sense that restrictive national measures could be challenged or approved, depending on whether they meet the proportionality test. The ECJ decision is new, however, at the point of Marks and Spencer that the UK national legislation is subject to the proportionality test in the instance where there is no explicit restriction by national law on any Community freedom that would be

[30] C-56/01 *Inizan*, ECR 2003, I-12403, para. 59.

[31] C-446/03 *Marks and Spencer*, ECR 2005, I-10837, para. 59, opinion of AG L. Poiares Maduro, para. 77.

plainly inconsistent with Community law. The proportionality principle would then be left in a vacuum. This is not yet the case in point because the gap arising from the lack of explicit restrictive national law measures is filled by the special meaning of Community law, suggested by the profession and represented by the ECJ. The expression of this meaning is a result of the recursively closed organisation of interpreting and applying Community law. The law that has been developed in *Marks and Spencer* is a product of self-generation, that is, it has been developed, not having a peculiar legislator, who would have been authorised to adopt the applicable law.

A key to understanding the decision in C-446/03 *Marks and Spencer* lies in the EC Court's assessment whether the opportunity of loss carryover for the company group has been fully exhausted in the particular case. It is not the UK law, strictly speaking, which is being evaluated. Not a single legal measure of the UK tax law has been condemned in the abstract. It is the UK legal practice that has been condemned, not proven friendly enough in a particular case. No statutory provision of the UK tax law has been challenged. The UK law has been criticised, however, because its impact has been detrimental, constituting a restriction on the taxpayer's right for cross-border loss carryover.[32]

(iii) Obligation of the tax authorities to have recourse to the facilities of harmonised Community law on tax procedures

In *Persche*,[33] the ECJ is uncertain, whether the EC Mutual Assistance Directive requires the tax authorities of the residence Member State to have recourse to the assistance of the competent authorities of the recipient body's Member State of establishment to obtain the necessary information or whether, on the other hand, the said tax authorities may require the taxpayer himself or herself to provide all the necessary evidence. The question is here in other words of how to divide the burden of proof between the parties. Upon the finalisation of securities transactions, it is also a question how much foreign financial intermediaries and domestic resident paying agents are obliged to provide relevant information, and how much the local tax authorities may be requested by national law to have recourse to the facilities of the EC Mutual Assistance Directive, and approach their foreign counterparts. Where domestic or foreign intermediaries suffer from the unusually high-level requirement of strict liability, no balance of interests can be achieved. The national procedural law would be consistent with the proportionality principle if foreign intermediaries and domestic ones with foreign clients were obliged to a due care standard like their normal domestic counterparts.

The Commission contends that, even if the EC Mutual Assistance Directive itself does not require a Member State to have recourse to the assistance of another Member State in order to inform itself of a fact, the evidence of which is in that other Member State, the former State would however be required, within the scope of application of Art. 56 EC, to have recourse to the possibilities offered by that directive in order to exclude any less favourable treatment of cross-border situations as compared to purely internal situations

[32] As a consequence of the judgment, the UK legislation was eager to fill the assumed gaps left after the judgment in *Marks and Spencer*, trying to put the issue of last resort into a context of revised statutory law. It is the paradoxical aspect of the case, however, that such a problem cannot simply be solved by statutory means. For more explanation see Deák, D.: Legal autopoiesis theory in operation–a study of the ECJ case of C-446/03 Marks and Spencer v. David Halsey. *Acta Juridica Hungarica*, 49 (2008) 2, 163.

[33] C-318/07, ECR 2009, I-359.

(Para. 36). Hence, the directive itself does not require the national authorities to have recourse to the facilities the directive provides. Such an obligation directly comes, however, from the principle of effectiveness as a positive standard (see its discussion above in connection with *Arcaro*). The requirements are thus relevant that the national authorities are obliged to follow a procedure in which it is possible to achieve the result envisaged by Community law, and that national law must be interpreted consistently with Community law. The positive standard of effectiveness makes a requirement for national procedural law by means of invoking substantive Community law to be extracted from Community freedoms.

Since the EC Mutual Assistance Directive provides for the possibility of national tax authorities requesting information which they cannot obtain for themselves, the EC Court has ruled that the use, in Art. 2 (1) of the EC Mutual Assistance Directive, of the word "may" indicates that, whilst those authorities have the possibility of requesting information from the competent authorities of another Member State, such a request does not in any way constitute an obligation. It is for each Member State to assess the specific cases in which information concerning transactions by taxable persons in its territory is lacking and to decide whether those cases justify submitting a request for information to another Member State.[34] The ECJ argues that it is left for the Member State to legislate whether, and in what conditions, the national authorities are obliged to have recourse to the mutual assistance with the tax authorities of another Member State. The Member State of legislation remains nevertheless to be subject to the proportionality principle. This is a position slightly different from that taken by the Commission. Namely, the latter refers to the positive standard of effectiveness and, therefore, concludes that the affected Member State is obliged to ensure the enforcement of Community freedoms. The ECJ is confined to a meta-principle (proportionality), while the Commission substantiates its position by referring to substantive law.

Furthermore, the ECJ holds that a Member State cannot exclude the grant of tax advantages for gifts made to a body established and recognised as charitable in another Member State on the sole ground that, in relation to such bodies, the tax authorities of the former Member State are unable to check, on-the-spot, compliance with the requirements which their tax legislation imposes. An on-the-spot inspection is not usually required since the monitoring of compliance with the conditions imposed by the national legislation is carried out, generally, by checking the information provided by those bodies (Paras 66–67). The national authorities that preclude the possibility of relief at source cannot thus justify this restriction by referring to the difficulties in organising on-the-spot audits if necessary because the organisation of such audits is always an extra burden for the authorities, no matter whether they have to conduct examination within the country or in another Member State.

The taxpayer in *Twoh*, a Dutch company, supplied computer parts to another company residing in Italy. Twoh was required only to place the goods at the buyer's disposal at a warehouse situated in the Netherlands. Twoh issued invoices on intra-Community deliveries and, consequently, did not pay VAT. The Dutch tax authorities were of the opinion that Twoh did not demonstrate that the goods were transported to another Member State. The taxpayer requested the tax authorities to rely on the EC Mutual Assistance Directive and the

[34] Para 65. See also, in C-184/05 *Twoh International*, ECR 2007, I-7897, para. 32.

EC Administrative Cooperation Regulation[35] and gather information from the competent Italian tax authorities, but the Dutch tax authorities refuted to meet this requirement.

The ECJ considers that, as the Commission has correctly argued, the principle that the burden of proving entitlement to a tax derogation or exemption rests upon the person seeking to benefit from such a right is to be viewed as being within the limits imposed by Community law. Thus, it is for the supplier of the goods to furnish the proof that the conditions for exemption (Para. 26). What is important in this case is the fact that Twoh, being unable to provide the necessary evidence to establish that the goods have in fact been dispatched to the destination Member State, has requested the Netherlands tax authorities to gather information that should be capable of demonstrating the intra-Community nature of its supplies, obtaining information from the competent authority of that latter Member State, in application of the EC Mutual Assistance Directive and the EC Administrative Cooperation Regulation (Para. 28).

As it comes from respect of the proportionality principle, where the taxpayer is unable to obtain the necessary evidence, being not able to approach the competent authorities of another Member State, the local tax authorities are obliged to act and provide the taxpayer with the relevant information. The local tax authorities may thus explicitly be obliged to rely on the EC Mutual Assistance Directive even upon the finalisation of securities transactions where the taxpayer is for objective reasons prevented from gaining access to evidence. For instance, local paying agents with foreign clients may have serious difficulties in approaching the foreign tax authorities if necessary. Similarly, the local authorities may not require from foreign financial intermediaries to obtain a local tax ID where it is easy for the tax authorities to approach the competent tax authorities of the home Member State and check if the tax ID showed is authentic.

In the joined cases of C-155/08 *X* and C-157/08 *Passenheim-van Schoot*,[36] the Dutch tax authorities obtained information from the Belgian tax authorities among other things of the savings account of a Dutch resident taxpayer held with a Luxembourg subsidiary of the Belgian-based Kredietbank. The Dutch tax authorities were not in a position of providing any evidence for tax evasion. They were, however, eager to initiate a procedure of fiscal supervision. This was the case because the assets of the Dutch taxpayer, which were deposited in Luxembourg and concealed from the Dutch tax authorities, were subject to net wealth tax in the Netherlands. The Dutch tax authorities wanted to benefit from the Dutch tax law, which said that the normal five-year period of the statute of limitations for tax assessment could be extended to 12 years (from the date when the tax debt arose) in respect of the assets held outside the Netherlands.

The taxpayer raised the issue as to whether these Dutch rules on the extended recovery period and the related calculation of tax penalty do not constitute an obstacle to the freedom to provide services and the free movement of capital that cannot be justified. The extent to which the Luxembourg bank secrecy should be lifted in order to facilitate the exchange of tax information between the Dutch and Belgian tax authorities in accordance with the EC Assistance Directive is a secondary issue, ancillary to the main subject.

For the purposes of answering the question whether the Netherlands can be forgiven for introducing an extended recovery period in cross-border cases, the ECJ distinguished

[35] Council Regulation 218/92/EEC on administrative cooperation in the field of indirect taxation (as amended), OJ L 24, 1.2.92, 1.

[36] ECR 2009, I-5093.

between fiscal evasion and fiscal supervision (Para. 63). Where there is no evidence available for the tax authorities to combat tax evasion, it can be accepted that an extended period of the statute of limitations is applicable. Where, however, the tax authorities hold any means of evidence in order to discover tax liability in a cross-border case, the tax authorities have already the right to request information from the other Member State.

The provision of information cannot be denied in particular where the requesting authorities have been in a position to gain knowledge of the case, but they need more information to complete their investigation. Where, however, for lack of sufficient information, the tax authorities are not able to provide any evidence of a particular case, a Member State is allowed to console itself by enhancing the chances of discovering unpaid tax even by extending the period of the statute of limitations for the recovery of the assessment of tax.[37] Where the national legislation is proportionate with the aim of discovering fiscal evasion, the restrictions on any Community freedom that are developed because of the application of national law can be justified.[38]

Where cross-border securities transactions are finalised, the tax authorities may obviously hold information that is enough for them to rely on the EC Mutual Assistance Directive in respect of both domestic and foreign resident taxpayers. "A priori" exclusion of relief at source or the mistreatment of domestic resident withholding agents or foreign financial intermediaries cannot thus be justified. With regard to the facilities available due to the operation of the Mutual Assistance Directive, the scope of the national legislator to act by introducing special measures, including restrictions on the legal management of cross-border cases, does not seem to be very wide. The ECJ explained that the mere fact that the taxable items concerned are located in another Member State does not justify the application of an extended recovery period. One can conclude from this statement that the exclusion of the facility of relief at source cannot be justified either by the mere fact that income is derived abroad or by foreigners.

5. *Effectiveness to be granted to domestic and foreign resident taxpayers through harmonisation in fiscal matters*

In the area of tax law, the question can be raised as to whether the exclusion of tax matters from the scope of internal market legislation can be extended not only to substantive tax law, but also to the procedural matters of taxation. One could argue that procedural tax law and cooperation in tax matters between the tax authorities of the Member States constitute issues that go beyond the scope of tax harmonisation. Reference to the EC Taxation Savings Directive,[39] a reporting rather than a tax directive, can also be made in order to enhance the significance of cross-border cooperation in tax matters in terms of the exercise of Community freedoms. The matter of cooperation between the public authorities in tax matters should then extend beyond simply dealing with taxes. Arguably, free competition–the basic institution of the EU–can be distorted for lack of sincere cooperation between the public authorities, whether competent in tax or non-tax matters.

This is the logic the Commission followed in the case of C-533/03 *Commission v. Council*, when it was required before the ECJ–in vain–to base a range of amendments made to the existing EC directives and regulations on the cross-border cooperation in tax matters

[37] Paras 44 and 57.

[38] Paras 52–53, 72–73 and 75.

[39] Council Directive 2003/48/EC (as amended), OJ L 157, 26.06.2003, 38.

on the legal basis of the internal market legislation rather than on the provisions of the old way of fiscal harmonisation to be achieved progressively in the common market (Art. 93 EC, Art. 113 TFEU).[40] In C-533/03 *Commission v. Council*, the Commission contends that Council Regulation 1798/2003/EC[41] and the directive, modifying the EC Mutual Assistance Directive,[42] are not adopted on a correct legal basis. In essence, both the parties and the ECJ follow the arguments known already from case C-338/01.

In the case of C-533/03, the ECJ held (in Para. 45) that "lex specialis" prevails over "lex generalis", and this is why Art. 93 EC Treaty on tax harmonisation should take priority over Art. 95 EC Treaty (Art. 114 TFEU) on overall internal market legislation in this case. As a consequence, the provisions on the cooperation of tax authorities must be treated as tax provisions. The issue of cooperation of the public authorities in tax matters cannot thus be separated from the contents of taxation. In other words, as Community law stands at present, the term of tax sovereignty should comprise not only substantive tax law provisions, but also the rules that are applicable to tax procedures. Unfortunately, attempts to seek to establish distinction between fiscal (substantive tax law) harmonisation and cooperation (procedural tax law harmonisation) have ended in failure, although one can argue that the law on Community cooperation should go beyond the mere subject of the harmonisation of substantive tax law provisions. It remains a task for the future to establish this claim better.

In C-349/03 *Commission v. UK*, the UK tax authorities were condemned to the extent that they denied cross-border cooperation in tax matters in respect of Gibraltar on the grounds that the latter is not part of the EU customs territory, and thus the harmonised rules on VAT and excise duties were not applicable. The ECJ held that the exclusion of Gibraltar from the EU customs territory does not mean that Gibraltar fell outside the requirement of mutual assistance by the competent authorities of the Member States. The substantive tax law issue has thus clearly been separated from the matter of mutual assistance in tax matters.[43]

The ECJ does not seem to be consistent in deciding in these two cases. The difference in the positions the ECJ took can be reconciled, however, in so far as the two questions were raised in different ways. In the first case (C-533/03 *Commission v. Council*), the ECJ supported the standpoint of the EC Council that resisted the extension of the scope of harmonisation in the particular respect of administrative tax law due to lack of political consensus. In the second case (C-349/03 *Commission v. UK*), the ECJ reasoning was driven by the possibly strictest interpretation of the derogation granted to the UK upon the EC accession of the UK. This difference in context seems to give sufficient explanation for the difference in the conclusions that the ECJ arrived at in the two cases.

The Commission contends in C-349/03 *Commission v. UK* that the EC Mutual Assistance Directive does not affect "the tax law as such of the Member States" (Para. 22). The Member States' competence to legislate tax should in this respect be confined to substantive tax law matters. Even if the harmonised rules of VAT do not apply to Gibraltar, the information of the taxpayers registered for VAT purposes in Spain and engaged in contacts with Gibraltar-based parties may be relevant for Spanish VAT purposes. The Commission plainly argues that the effectiveness principle of Community law requires the

[40] ECR 2006, I-1025, para. 25. For the Council's arguments, see para. 33.
[41] OJ L 264, 15.10.03, 1.
[42] That is, Council Directive 2003/93/EC, 15.10.03, OJ L 264, 23.
[43] ECR 2005, I-7321, para. 53.

extension to Gibraltar of the mutual information system (Para. 24). This example shows that the scope of procedural tax rules may exceed that of substantive tax law matters. Where harmonisation in substantive tax law can be a taboo, this is not necessarily true for the procedural aspect of tax law.

The Spanish Government argues that distinction must be made depending on whether a cooperation measure relates to a tax harmonisation objective or relates simply to a measure, which confined itself to laying down rules for cooperation between the Member States (Para. 28). Tax cooperation measures may thus have two layers: they may consist of tax harmonisation provisions, properly speaking, and provisions on unqualified cooperation. The UK argument is, on the contrary, that the administration of a tax system and the revenue-raising power of a Member State are inextricably linked to each other (Para. 34). According to the UK, fiscal provisions concern not only the conditions of substantive tax liability, but also arrangements for the collection of taxes (Para. 36).

The ECJ approved that there should be provisions of simple cooperation that cannot be regarded as acts on tax harmonisation (Para. 44). The EC Mutual Assistance Directive is still interpreted in the context of the UK accession treaty (Para. 46), and it may not affect common cases. Under Para. 47 of the judgment, procedural tax law rules are discussed in this case as acts on harmonisation, and not as fiscal provisions within the meaning of Art. 95 (2) EC [on exceptions to the scope of internal market legislation, currently Art. 114 (2) TFEU]. Where tax procedural rules are discussed under in the disguise of harmonisation acts, they may go beyond the scope of tax law. Harmonisation acts cannot be adopted, however, without the explicit approval of the Member States. Where tax procedural rules are related to fiscal rules, they should mean not only substantive, but also procedural tax law provisions.

In C-338/01 *Commission v. Council*,[44] the Commission contends that the purpose of the directives that modify the EC Recovery Directive[45] is to bring about the internal market. They must accordingly be based on the Treaty basis on internal market legislation (Para. 18). In view of the fact that Art. 95(2) EC [Art. 114 (2) TFEU] constitutes an exception to the principle set out in Art. 95(1) EC, it should be narrowly construed and its application is restricted to what is necessary for the attainment of its objectives, such as the protection of the Member States' sovereignty in matters relating to taxation (Para. 19). The Commission holds that the substantive tax law of the different Member States is not affected by the modification of the Recovery Directive (Para. 20). One could thus argue that sovereignty of the Member States to be exercised in fiscal matters is not extended to procedural tax law issues, and fiscal provisions would not relate to the rules of tax procedures in the context of Art. 114 (2) TFEU.

Furthermore, the modifying directives do not simply concern the smooth operation of the internal market. They are aimed among other things at bringing about the fiscal neutrality of the internal market, the European Parliament contends (Para. 24). The term of fiscal neutrality should go beyond the scope of tax law. It should thus relate to the smooth operation of the internal market. The Parliament also argues that Council Directive 2001/44/EC[46] does not create a "sui generis" European procedure of the recovery of taxes. Instead, it

[44] ECR 2004, I-4829.

[45] Council Directive 76/308/EEC, OJ L 73, 19.3.76, 18, significantly amended by the contested Council Directive 2001/44/EC, L 175, 28.6.01, 17.

[46] OJ L 175, 28.6.01, 17.

merely prescribes national treatment for foreign claims (Para. 25). The Directive provides a framework only that allows Member States to continue to be sovereign in tax matters.

In contrast to the above arguments, the Council gives a broader meaning to the term of "fiscal provisions". They mean not only any measure regulating public revenue, or covering not only the definition and description of taxes, but also the manner in which taxes are assessed and collected (Para. 36). The term of fiscal should therefore be extended not only to substantive, but also to procedural tax law (and it should thus be confined to tax law) in the context of Art. 95 (2) TEC, the Council argues. Further on, a restrictive approach would be dependent on political assessments in respect of tax procedures, something, which would be at variance with the system of the attribution of powers within the Community and with the principle of legal certainty (Para. 37).

The United Kingdom Government criticises the Commission for its unduly strict interpretation of the term "fiscal provisions" and for failing to take account of the opening sentence of Art. 95(1) EC, to the effect that this provision applies only "where nothing in the Treaty provides otherwise". Article 93 EC and Art. 94 EC are both special provisions for the adoption of measures relating to direct and indirect taxes (Para. 50). The UK Government adds that the term "fiscal" used in the English-language version of Art. 95 EC embraces not only taxation "stricto sensu", but also public spending and borrowing. Contrary to the Commission's contention, there is no justification for drawing a distinction between the rules on taxable persons, taxable events, bases of taxation, rates and exemptions, and the rules for the administration and enforcement of taxes (Para. 52).

The ECJ held that, by reason of their general character, the words relating to fiscal matters cover not only all areas of taxation, without drawing any distinction between the types of duties or taxes concerned, but also all aspects of taxation, whether material rules or procedural ones (Para. 63). It should further be added that the decisive criterion for purposes of comparison with a view to the application of Art. 90 EC (Art. 110 TFEU) is the actual effect of each tax on domestic production, on the one hand, and on imported products, on the other. Even where the rate is the same, the effect of the tax may vary according to the detailed rules for the assessment and collection thereof applied to domestic production and imported products (Para. 65).

III. Conclusions

Where the institutions of the retention at source of taxes and the prevention of foreign financial intermediaries from assuming in the source country the liability to file tax information and arrange for the payment of tax in fair conditions comparable to their domestic counterparts are to be assessed in the light of the relevant Community law as communicated by the ECJ, it is crucial while concluding whether national legal practices of withholding taxation are consistent with Community law to apply the proportionality principle in specific cases. Where the application of the proportionality principle dictates us in a specific case respect of the effectiveness principle in enforcing rights both on the side of the tax authorities and taxpayers, an avenue may open up for progressively removing barriers from the clearing and settlement of securities transactions across the border.

The cornerstones for such avenues can be reconstructed from the positions the ECJ has developed in particular as follows:

> "… the use of retention at source represented a proportionate means of ensuring the recovery of the tax debts of the State of taxation. The same is true of the potential liability of the recipient of services who is required to make such a retention, as that

enables the absence of retention at source to be penalised if necessary. Since that liability constitutes the corollary of that method of collecting income tax, it too contributes in a proportionate manner to ensuring the effectiveness of collecting the tax." (paras 37–38 in *FKP Scorpio*);

"… the taxpayer should not be excluded a priori from providing relevant documentary evidence enabling the tax authorities of the Member State imposing the tax to ascertain, clearly and precisely, that he is not attempting to avoid or evade the payment of taxes (see, to that effect, Case C-254/97 Baxter and Others [1999] ECR I-4809, paragraphs 19 and 20, and Case C-39/04 Laboratoires Fournier [2005] ECR I-2057, paragraph 25)." (Para. 96 in ELISA);

"Since Directive 77/799 provides for the possibility of national tax authorities requesting information which they cannot obtain for themselves, the Court has ruled that the use, in Article 2(1) of Directive 77/799, of the word 'may' indicates that, whilst those authorities have the possibility of requesting information from the competent authority of another Member State, such a request does not in any way constitute an obligation. It is for each Member State to assess the specific cases in which information concerning transactions by taxable persons in its territory is lacking and to decide whether those cases justify submitting a request for information to another Member State (Twoh International, para. 32)." (para. 65 in Persche).

Unfortunately, contradictions hidden in the first two items above of ECJ assertions can hardly be reconciled.[47] It cannot then be understood why the domestic resident recipient of a foreign service-provider–being, e.g. a local fiscal agent–is "a priori" excluded from providing evidence, enabling the tax authorities of the source Member State to ascertain that he or she is not attempting to avoid or evade the payment of taxes while seeking to gain access to relief at source of taxation. As an alternative, the position granted to the local paying agent could arguably be extended to a foreign resident investor or a foreign financial intermediary accompanying its clients across the border.

It is bad news for the taxpayers engaged in cross-border securities transactions that the applicability of the proportionality principle is subject to a case-by-case assessment; it is thus for each Member State to assess the specific cases in which information concerning transactions by taxable persons in its territory is lacking and to decide whether those cases justify submitting a request for information to another Member State. The domestic tax authorities may well conclude in a specific case that it is not necessary to initiate mutual assistance with the tax authorities of another Member State. It is good news, however, that the domestic tax authorities must certainly not arrive at a final decision unless they make an assessment of the case under examination before.

It is a key to the application of the proportionality principle that rights and obligations must be allocated according to the facts and circumstances of the specific case. This means, for example, that it is not enough to require alleviation of foreign financial intermediaries from strict liability. Instead, their liability should be adjusted to the real case. There are a

[47] Notably, the ECJ answers the question, whether the procedure of retention at source of tax is consistent with Community law without regard to whether the services provided to FKP Scorpio are deemed to take place within the Community.

few issues[48] that can be highlighted to illustrate how the proportionality principle can be operated as follows:

– "a priori" exclusion of relief at source seems to violate the proportionality principle in general; the introduction of a quick refund procedure (not appearing in the OECD Implementation Package) may be helpful, however, to find a balance between the legislative goals and means in respect of withholding taxation;

– the source country's request for applying for a new tax identification number does not comply with the idea of holding a single European passport, otherwise available for financial enterprises both under the EC Consolidated Banking Directive;[49]

– under the harmonised Community law on VAT refund, appointment of fiscal representatives must not be requested by the source Member State;[50] such a rule could be extended to the tax treatment upon the finalisation of cross-border securities transactions as well with a view to respecting the proportionality principle;

– from the perspective of the application of the proportionality principle, an ideal solution could be the provision of information by the financial intermediary to the source country's authorities and, in turn, the transfer of information by the source country to the residence country; this option is preferred both by the OECD and the EC Taxation Savings Directive;

– while designing the allocation of rights and liabilities of all members that may be engaged in a custody chain, it is necessary to coordinate the status of authorised intermediaries with that of domestic withholding agents; and

– respect of the proportionality principle requires to bear in mind that the intermediary that has the closest relationship with the investor has access to information about the investor what may entail strict liability while the domestic withholding agent does not have strict liability for under-withholding; in fact, proposed procedures are intended the reduce the risk of under-withholding, but not necessarily the authorised intermediary's liability.

[48] OECD Centre for Tax Policy and Administration, Report by the pilot group on improving procedures for tax relief for cross-border investors; Possible improvements to procedures for tax relief for cross-border investors: Implementation Package; Public discussion draft; 8 February 2010 to 31 August 2010, 9–10.

[49] Indent 7 of the recitals of Directive 2006/48/EC of the EP and the Council, OJ L 177, 30.6.06, as amended.

[50] Art. 204 of Council Directive 2006/112/EC, as amended, OJ L 347, 11.12.06.