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Editorial

M&S

The Editorial Board

As every shopper in Great Britain knows M&S stands for Marks & Spencer, the giant chain of department stores. However in this special issue of *EC Tax Review* we will try to demonstrate that in the history of European taxation, from now on and with the courtesy of Marks & Spencer, M&S, will stand for Market & Sovereignty, because these are the two major issues raised by this very special case.

When, approximately 17 years ago in the case *Commission v France*, the ECJ set sail on the wide sea of income tax no tax lawyer, in his wildest dreams, could imagine that this journey would pass through the stormy waters of the present times. One reason for this lack of foresight is the particular conviction of tax lawyers that tax law is an isolated island in the sea of law. Some non-tax lawyers even tend to think that tax law is really no law at all. Somehow many tax lawyers at the time thought that taxation would be immune from the impact of European Community law, because of the generally accepted opinion that Member States were sovereign in the area of income tax. Yet when the ECJ wrote its decisions it did extend basic principles of Community law to the area of income tax and it stated a very radical principle in tax law e.g. that a permanent establishment should be treated for tax purpose like a resident company.

A few years later in the *Bachmann* case the ECJ invented the principle of cohesion or coherence of the national tax system as a valid excuse for some formal violations of the basic freedoms. This principles sparked high expectations from the national tax administrations of the Member States to save their tax sovereignty, the ECJ gradually whittled down this principle until it had only a very minimal impact.

In the first series of cases the analysis of the ECJ was one of non-discrimination. That was a form of reasoning tax lawyers could live with, because it resembled the classical principle of equal treatment, which in many Member States, is used as a constitutional principle to validate some distinctions and to reject some others. It means that if the distinction on which the different treatment was based, was justified by objective and relevant criteria the different treatment could be justified. It also means that in order for the non-discrimination principle to apply, the situation of the two categories of taxpayers should be similar. If the situation is not similar then the non-discrimination does not apply. The paramount example of this way of thinking was the *Schumacker* decision. Mr. Schumacker was considered to be in a similar situation as his German co-workers, because all his income was German sourced. To that situation the ECJ applied the equality principle in a classical way.

Gradually however the reasoning of the ECJ started to shift to what is called the non-restriction approach which of course has also a solid basis in the Treaty and the case law of the ECJ in non-tax cases. The application of the non-restriction doctrine in the area of indirect taxation has resulted in very strict limitations on the freedom of the Member States to legislate in this field. The paramount illustration of this doctrine is provided in the *De Groot* case which was decided not so long ago. In this case the comparison did not involve a non-resident and a resident taxpayer, but two resident taxpayers, one of whom earned a substantial part of his income abroad. The method of comparison was still used but only to illustrate that the peripatetic Mr. De Groot was hampered in his freedom to accept employment in other Member States. The discrimination was viewed from the angle of a restriction on cross-border activities, because the tax rules involved had nothing to do with a distinction between residents and non-resident.

In the *M&S* case this issue is really brought to its extreme consequences. Here the question is a comparison between two groups of companies, one with domestic subsidiaries and one with foreign subsidiaries and the question is about compensation of losses between the foreign subsidiaries and the domestic parent. The basic argument is that the fact that foreign losses cannot be compensated with the domestic profits of the domestic parent company, constitutes a restriction on the establishment of foreign subsidiaries, because they have a disadvantage which does not exist for domestic subsidiaries.

The basic question here of course is whether the full market integration prescribed by the Treaty makes it necessary that losses of a foreign tax jurisdiction should be taken into account in a domestic tax jurisdiction. Under the traditional rules of fiscal sovereignty the answer is obviously no, each national tax jurisdiction retains the absolute right not to take into account the loss situation originating in another jurisdiction. *M&S* has brought us to the end of the road with this stark question: is a Member State obliged (even temporarily) to take budgetary losses, because of the tax losses incurred by foreign companies of the group in other Member States. If the answer is yes it means a serious breach in the principle of tax sovereignty of the Member States, if the answer is no it will supply the national tax administration of the Member States with a serious brake on the road to further full market integration.

The Editorial Board of the EC Tax Review considers the *M&S* litigation a make or break case in the history of the ECJ, where it deals with the two fundamental issues of the impact of the freedoms in direct taxation. Therefore we have requested several colleagues in the EU to write on this issue.

Indirectly Farmer and Lyal already commented the question in the issue no. 2 of this year. In this issue we publish four different views from various corners in Europe and more articles are in the pipeline. In this way we hope to stimulate the debate on this question, which is crucial for the further development of EU tax law.