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Editorial

Common (tax) law of the ECJ

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The ECJ has been awash in a tide of criticism lately. This criticism has come not only from the usual Euro-sceptics, but also from some unexpected quarters such as some Ministers of Member States and some academics (cf. the last annual meeting of the European Association of Tax Lax Professors), who until quite recently would take a rather benevolent view of the decisions of the Court. So the questions are: what did happen to change their views, and is this criticism justified?

In the case of the Ministers of Finance the reasons for the change are clear. The ECJ heard some cases and took some decisions (*Bosal*, *Lankhorst Hohorst*, *Marks & Spencer*, *Ritter-Coulais*, *Cadbury-Schweppes*, *Denkavit Internationaal* to name a few) punching holes in the budgets of some Member States, thereby inviting the ire of the paymasters of the Member States. Their criticism is that the ECJ does not care about the legitimate interests of the Member States – but then caring about those interests is not exactly the primary mission of the ECJ under the EC Treaty. The criticism of the academics is mainly based on two considerations, the first of which is also shared by politicians:

(1) the ECJ is acting like a tax legislator not like a court, which should interpret the EC Treaty rules and nothing more; and
(2) in doing so the ECJ is creating material rules of taxation for cross-border operations which cannot be found in the EC Treaty and for which it does not give adequate justification on the basis of that Treaty.

Let us have a look at these two points.

There can be little doubt that the decisions of the ECJ in direct taxation have been changing the outlook of the landscape of international taxation. The most important change has been that the Court has decided:

(1) that it is a violation of the fundamental freedoms to treat taxpayers differently on the basis of residence, or any other criterion which would result in a less advantageous tax situation for non-residents; and
(2) that resident taxpayers should be allowed to exercise their fundamental freedom to move to another Member State without any restriction.

On the basis of these principles the ECJ has decided that non-residents are entitled to claim the protection of a tax treaty between Member States, that non-residents are entitled to personal deductions if a substantial part of their income was located in the state of source, that exit taxes are not allowed, that thin-capitalization rules, and withholding taxes on dividends, mainly applicable to non-resident companies are not allowed, that domestic shareholders should be granted tax credits for corporate income tax on foreign source dividends paid in another Member State and that CFC rules could only be admitted under very narrow circumstances, to name just a few. Taken together all these decisions amount to a major tax reform in many of the Member States and raises the question of whether the ECJ is justified in taking these decisions on the sole basis of the EC Treaty.

There can be no discussion about the role of the ECJ as the guardian and executor of the EC Treaty. The questions are: what does the EC Treaty allow with respect to direct taxation and how should the ECJ interpret the EC Treaty?

In direct taxation it has often been stated and repeated by the ECJ itself that the power with respect to direct taxation remains with the Member States. Indeed, unlike Art. 93 for indirect taxation, there are no provisions in the EC Treaty granting any direct or immediate decision-making power to the EC or the ECJ with respect to direct taxes. That does not mean however that there would be no power at all for the ECJ to interfere with direct taxes. In the same sentence the ECJ has often stated and restated that, in exercising that power, Member States must comply with the overriding principles of the fundamental freedoms. In addition and with respect to double international taxation the EC Treaty provides that Member States should enter into bilateral negotiations to conclude tax treaties, but in *Gilly* the ECJ clearly stated that such treaties were an instrument '*inter alia*', meaning that bilateral treaties were a valid instrument to eliminate double taxation, but not an exclusive one, and that to the extent that double taxation would violate the fundamental freedoms, these freedoms could also be used as an instrument to eliminate such double taxation. There can be no doubt that the EC Treaty and the fundamental freedoms allow the ECJ to interfere with the rules of direct taxation in the Member States, not for harmonization's sake, but for eliminating cross-border obstacles in order to achieve the Internal Market. The question then remains how the ECJ should interpret the EC Treaty?

In the first place it should be noted that textually

the EC Treaty is not like national tax statute. Tax laws generally are very explicit and detailed and are interpreted in a rather strict or narrow manner. They do not leave much to the fantasy or imagination of a court. The text of the EC Treaty looks much more like the broad and general principles or rules found in written constitutions or even in unwritten constitutions. Hence it is no surprise that the ECJ in its style of interpretation and reasoning has been using methods of interpretation and reasoning that are very similar to those used by Supreme or constitutional courts in interpreting their national constitutions, or by international courts such as the European Court of Human Rights in interpreting the treaties for which they are competent. It is a style and method of interpretation and reasoning that most if not all courts will use when confronted with the application of a text framed in very broad and general wording.

The consequence of this method of interpretation and reasoning is necessarily that a court is creating new rights that did not exist before in the formal and statutory texts of the countries adhering to such constitution or treaty. In this way the European Court of Human Rights, as well as many constitutional courts, have established new specific rights for many minorities or underprivileged groups, such as ethnic, racial and religious minorities, women and gay people. The courts have been literally creating new specific rights on the basis of the treaty texts. No one dares to suggest, however, that in doing so these courts would exceed their powers and act as a legislator, although that is in fact what they do. Fortunately, in most cases, the national legislators quickly incorporated these new material rights in national statutes, so that there was no discordance between the national law and the decisions of the courts.

There is no reason why this should be different in the area of taxation. In the area of criminal investigations of tax fraud the European Court of Human Rights has decided several cases in which essential criminal (!) statutory rules were held to be in violation of the European Convention on Human Rights. These decisions were accepted and no one is suggesting that the European Court exceeded its powers. The same holds true for the ECJ when deciding cases of direct taxation.

Sometimes the criticism is heard that the Founding Fathers of the European Communities could never imagine the far-reaching consequences of the decisions of the ECJ in direct taxation and that therefore the ECJ is overstepping the boundaries of what it is permitted to do under the EC Treaty. No-one, however, is suggesting the application of the same reasoning to the far-reaching decisions of national Supreme of constitutional Courts or the European Court of Human Rights. In many cases many legislators of Member States and many states signatories of the European Convention could never have imagined the new rights which these courts have created. Yet this has never been a valid reason to doubt the legitimacy of these decisions.

It is true that many if not all Member States apply the basic principle of the Magna Charta: 'No taxation without representation'. No tax can be introduced without the consent of a democratically elected parliament. Since the ECJ is not democratically elected, the argument goes, it does not have the right to meddle with national tax laws which have been approved by democratically elected parliaments.

First of all, the Supreme and constitutional Courts of the Member States and the European Court of Human Rights have also not been democratically elected, but the legitimacy and the validity of their judgments are not in doubt. Some of their decisions have been on issues of tax law or criminal law, which in most Member States would also require statutory legislation formally approved in parliament. This is exactly the same situation as the ECJ. These courts derive their power and authority from constitutional texts, principles or from treaties which have all been approved by a democratically elected parliament. The same holds for the ECJ. The ECJ is exercising its powers on the basis of a Treaty, which has been approved by political majorities in the democratically elected parliaments of all the Member States, and it is from that approval that the ECJ derives its competence and authority to interpret the Treaty and make its decisions. After all, is it not the case that many rules of law including criminal law in English law have been established not by parliament but by the development of what we call the 'common law'? The ECJ is doing nothing other than what the English courts did in the absence of a European legislator in tax matters. In addition it is doing so based on a document approved by all Member States. Finally, in its decision the ECJ is not imposing new taxes, it is liberating taxpayers from taxes that in its view should not have been levied in the first place.

Therefore the answer to the above criticisms should be very clear. The ECJ is not exceeding its powers under the EC Treaty. It is doing exactly the same as comparable courts in the national and international legal order. Therefore its decisions should be accepted in the same way as the decisions of these other courts are accepted. The criticism that court decisions are an inadequate way to establish tax law is more a criticism on the Member States, still clinging to their veto power in tax matters. It cannot be a criticism levelled against the ECJ, which can only act on a case-by-case basis. This is not to say that the decisions of the ECJ should not be above criticism – there are many things to be said about the ECJ decisions in tax cases. However, the criticism that the ECJ is exceeding its power and authority and acting as a legislator is not justified.