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The compatibility of "national tax principles of the Member States" with a fully integrated market - *complete*

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1. INTRODUCTION

1.1 The questions to be answered

I am asked to address five questions in this segment. They are as follows:

1. *What are in your opinion with respect to market access and the conditions of free and non-discriminatory competition the standards of a fully integrated market as prescribed by the Treaties of the European Union?*

2. *What is the exact extent of the territoriality principle that was briefly mentioned in the* Futura Participation *case as being compatible with the fully integrated market? In your view is this principle indeed compatible with such market?*

3. *What is the exact impact of the holding of the ECJ that resident and non-resident taxpayers are not in a comparable situation on both nationality non-discrimination and non-restriction principles? How does this holding of the ECJ compare with its decisions in similar situations in non-tax cases and is this compatible with the idea of a fully integrated market?*

4. *Do you think that it would make a difference in the application of the basic economic freedoms by the ECJ if the European legislature would be more successful in establishing European tax rules or if the national legislatures would respond to the challenge by the ECJ in a more coordinated way?*

5. *Would in your opinion a wider application of qualified majority voting in tax matters help in establishing a balance between the fully integrated market and the legitimate fiscal interests of the Member States?*

I implicitly answer questions 1 to 3 in Sections 2 to 5 of this paper. Section 2 considers the scope and application of the Treaty freedoms in the context of the single market. Sections 3 and 4 examine the concepts of nationality discrimination and of market access. Section 5 considers the application of the *Dassonville* formulation of market access in the direct tax area. Section 6 concludes with my answers to Questions 4 and 5.[1]

1.2 The terminology used in this paper

Before I start, I should explain my use of certain terms in this paper and say something about the language of the Court's case law.

The Treaty freedoms guarantee the free movement of goods, persons, services and capital within the Community. I refer to these subjects of free movement as "**products**" and "**producers**".

The Treaty freedoms comprise two principles, which I call "**the market access principle**" and "**the nationality non-discrimination principle**". I explain these in Section 2.2 below. The application of these principles to States depends upon whether a State is acting in its capacity as importer or exporter. I call an importing State the "**Host State**" and the exporting State the "**Origin State**".

In Treaty terms, the "**origin**" of goods corresponds to the "**nationality**" of persons. The Court's use of covert discrimination and of disguised restriction mean, however, that in the direct tax field origin and nationality can be equated broadly to source and residence. Products are the source of a producer's income – his goods, labour, business activities, services and capital – and have their origin in the source State; the producer's State of residence is his Origin State.

The nationality non-discrimination principle relates to the "**internal market rules**" that a State adopts to define and regulate its market. "**Market access rules**" are those rules that a State adopts to regulate entry and exit to its market. Market access rules in particular set out the terms upon which a product or producer may enter or leave the State's market and this is the sense in which I shall use the term.

What appear at first sight as internal market rules may in fact be disguised market access rules if their terms deny benefits or impose penalties on products or producers that enter or leave the State's market. In particular, national tax systems historically have sought to protect national tax revenues by denying the benefits of the internal market rules to products or producers – sources or taxpayers – who enter or leave the national tax market. Such rules can be characterised as internal market rules with market access effects or "**disguised market access rules**".

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[1] In preparing this paper I have been fortunate to have had the benefit of reading two thought provoking theses, one by Dr Julian Ghosh and the other by Peter Halford, in which they have each considered the application of the Treaty freedoms in the direct taxation field.

The rules of national tax systems also tend to include "**internal market rules with extra-territorial application"**. These rules most commonly appear where a producer (taxpayer) is resident in one State and the product (source) is in another. The real issue with these rules is: do they reflect genuine differences in the situation of the domestic *product* according to whether it is generated by a domestic or foreign owner or a domestic *producer* according to whether his product is at home or abroad?

Both can be characterised as involving nationality discrimination, comparing in the first case products in the same territorial market of producers from different markets and in the second case comparing producers in the same territorial market with products in different markets. The first case concerns equal treatment of products under internal market rules (the market being the territorial market for products). The second case concerns equal treatment of producers under internal market rules with extra-territorial application (the market being represented by the exercise of tax jurisdiction by the producer's Origin State).

If in the second case the effect of the rules is to withhold benefits from or penalise producers depending upon whether their *products* stay within the Origin State's territorial market or move abroad, an internal rule with extra-territorial application can be regarded as a disguised market access rule on products.

Perhaps the most confusing word, however, is "**discrimination**". At first glance the Court does not always appear consistent or particularly careful in its use of this word.[2] It appears to use the word not only to refer to nationality discrimination but also in a more general sense of any difference (of which nationality discrimination is but one example) that affects market access. As a result, it is not always clear whether the Court regards the discrimination as involving a breach of the nationality non-discrimination principle or of the market access principle.

There are reasons for this, which I shall explain. In doing so, I shall endeavour in this paper to be precise in my language. "**Nationality discrimination**", qualified in places by "**overt**" or "**covert**", refers solely to discrimination on grounds of origin or nationality involving a breach of the nationality non-discrimination principle. Nationality discrimination relates in particular to internal market rules including internal market rules with extra-territorial effects.

"**Market access discrimination**" and "**a difference in treatment**" refer to any difference that identifies a measure as relating to an actual or a potential cross-border movement, raising the question whether there is a breach of the market access principle. In particular, market access discrimination may identify an internal market rule as one that is in reality a disguised market access rule. True market access rules are not usually discriminatory at all.

1.3 A word on **Marks & Spencer**

Finally by way of introduction and as I must necessarily deal with it in the context of this paper, I should say something about *Marks & Spencer* v *Halsey*.[3] Readers should not be surprised to find that the paper opens with the proposition that the Commissioners reached the correct decision in that case.[4] Elsewhere in this paper, I refer as appropriate to the Commissioners' answers on particular issues where that relates to the analysis in this paper.[5]

2 – THE SINGLE MARKET PRINCIPLES OF THE EC TREATY

2.1 The relationship of Community and national law in direct taxation

Throughout its case law, the Court of Justice of the European Communities (hereafter "the Court" or "ECJ") has consistently stated the relationship between Member State and Community competence in direct taxation in these terms [6]—

> "Although, as Community law stands at present, direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law"

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[2] A point that commentaries and articles and, indeed, the case law of Member States, may then reflect.
[3] [2003] Simon's Tax Cases (Special Commissioners' Decision) at page 70.
[4] The author was one of the Special Commissioners.
[5] It bears stating for those unfamiliar with English judicial proceedings, that a decision in any case cannot be divorced from the way in which the parties have chosen to put their case to the Tribunal. The terms of the Commissioners' decision therefore necessarily reflect the arguments put by both parties for and against the proposition that Community law allowed Marks & Spencer the right to claim group relief for the losses of its foreign subsidiaries.
[6] Case C-279/93 *Schumacker*, [1995] ECR I-225, paragraph 21. The ECJ cites Case C-246/90 *Commission* v *UK*, paragraph 12 as its authority. That case concerned the nationality requirements enshrined in sections 13 and 14 of the UK's Merchant Shipping Act 1988. Paragraph 12 of the decision states that "powers retained by the Member States must be exercised consistently with Community law (see most recently Case 57/86 *Hellenic Republic* v *Commission* [1988] 2855, at paragraph 9, and in Case 127/87 *Commission* v *Hellenic Republic* [1988] ECR 3333, at paragraph 7)."

The Court has accordingly drawn a line – and has done so consistently – between:

- the power to tax (or not) – which is exclusively a matter for Member States – and
- the manner in which Member States choose to exercise their powers – which is a matter that falls within the dual competence of the Member States and the Community.

Briefly, the issue is how a Member State exercises its taxing power; not whether or not it chooses to do so.

The Community may not deny a Member State the right to tax; nor may it require it to do so.

If a Member State refrains from exercising its taxing power, by not taxing at all or by drawing the boundaries of its taxing jurisdiction at a particular point, the Community acquires no competence to act. In this respect there is a distinction between a case in which the State has drawn its taxing jurisdiction so that a product or producer is outside that jurisdiction and those cases in which products and producers are within the scope of its jurisdiction but exempt from tax. The latter – but not the former – corresponds to abstaining from action or failing to take adequate measures.[7]

The Community cannot create for itself a competence to act in direct tax matters by requiring that a Member State exercise its taxing power in a particular respect when it has chosen not to do so.[8] This would shift the Community's competence in taxation from negative integration to positive harmonisation.[9]

Once a Member State has exercised its taxing power, however, the Community's competence is engaged. The question then becomes to what extent does Community law dictate the manner of its exercise?

To answer that question, I need to examine the basis for Community competence in taxation matters as expressed in the Treaty and interpreted by the case law of the Court.

2.2 The basis of the single market

The single market is founded upon the principle of the free movement of goods and of the factors of production. The Treaty Articles that give effect to the free movement of goods, persons, services and capital have a common basis in the principles in Part 1 of the Treaty establishing the European Community. In this paper I use the terms "**products**" and "**producers**" rather than goods, persons, services and capital. The words "products" and "producers" in my view better convey the essential character or quality of the good, person, service or capital for which the Treaty guarantees free movement.[10] They also reflect the basis upon which States internationally allocate taxing rights by reference to residence (producers) and source (products).

Each of the Treaty freedoms in its own terms encapsulates the abolition of obstacles to the free movement of products and producers and the prohibition of discrimination on grounds of origin (products) or nationality (producers). I refer to these two single market principles as "**the market access principle**" – *the abolition of any obstacle to the movement of products and producers <u>between the different markets</u> of the Member States* – and "**the nationality non-discrimination principle**" – *the ability to compete on equal terms with local products and producers <u>within the market of each Member State</u>*. I refer to these principles collectively as "**the Treaty freedoms**".

As a matter of expression, the principles appear in the Treaty in terms of "an abolition of obstacles" and "a prohibition on discrimination on grounds of nationality". I have, however, underlined the key aspect of differentiation. The market access principle involves the removal of obstacles *between* markets notwithstanding

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[7] See in another context Case C-265/95 *Commission* v *France (Spanish Strawberries)* [1997] ECR I-6959, paragraphs 30 – 32. Products and producers that would be within the State's jurisdiction but for its having agreed to exclude them under a bilateral tax treaty are not outside the scope of the State's exercise of jurisdiction but rather exempt. The entering into the bilateral treaty is in effect an exercise of the State's jurisdiction.

[8] Nor can taxpayers seek to invoke Community competence by requiring the Member State to extend its taxing jurisdiction further than it has chosen to do so. This, briefly, was the basis of the Commissioners' decision in *Marks & Spencer plc* v *Halsey* [2003] STC (SCD) 70. The UK had chosen not to tax the foreign subsidiaries of Marks & Spencer and the Commissioners therefore decided that Marks & Spencer could not invoke Community law to oblige the UK to give relief for their losses. The fact that the UK allowed Marks & Spencer to claim relief for the losses of those subsidiaries or branches over which the UK *had* exercised its taxing power did not oblige the UK to extend relief to losses of foreign subsidiaries over which it had not exercised its taxing power. As the relief applies to *tax* losses (not accounting or commercial losses as such), the relief in question requires a positive assertion of taxing jurisdiction for the losses to have any existence.

[9] The approximation of laws is one of the means recognised in Article 3(1)(h) for achieving the task set by the Community in Article 2. The approximation is only to the extent required for the functioning of the common market and is subject to the overriding principle of subsidiarity recognised in Article 5. Articles 94 to 97 make clear that the approximation of laws, including direct taxation, is a matter for legislative agreement between the Member States rather than action by the Court.

[10] In particular, the word "products" suggests the similarities that can exist between goods, services and capital where services represent the outcome of productive effort and capital the product of saving. "Producers" illustrates in a tax context the differences that arise between the indirect taxation of products and the direct taxation of those who produce them.

their differences (which, as I shall explain, is not the same as a requirement for Member States to establish common markets). The nationality non-discrimination principle involves the removal of discrimination on grounds of origin or nationality *within* the market of a particular Member State.

In the Treaty, the Treaty freedoms first appear as separate principles. The market access principle is found in Article 3(1)(a) and (c) [11] and the nationality non-discrimination principle derives from Article 12.[12] Together they form part of the mechanisms through which the Community seeks to fulfil the task it has set itself in Article 2 of the Treaty.[13] In Community terms, they are therefore closely related.[14]

2.3 The relationship between the Treaty freedoms

The Treaty freedoms are closely related because the Treaty Articles dealing with the free movement of goods, persons, services and capital give effect to both principles in their particular areas of application. This combination of the Treaty freedoms in Titles I (free movement of goods) and III (free movement of persons, services and capital) of Part 3 (Community Policies) of the Treaty reflects that they are a single expression of a Community founded on the free movement of products and producers.

By definition, any product or producer that is of different origin or nationality has to come into a market to experience discrimination *within* that market, i.e. nationality discrimination. Discrimination by reference to nationality or origin in the way in which products or producers are treated *within* a market is almost certainly bound to inhibit access to that market to a degree, and therefore movement between markets.[15]

The extension of nationality discrimination from **overt** discrimination based on origin or nationality *in law* to **covert** forms of nationality discrimination based on other criteria of differentiation that lead *in fact* to the same result,[16] has further muddied the waters between the market access principle and the nationality non-discrimination principle.

In law, covert nationality discrimination is *not* nationality discrimination at all. Accordingly, covert nationality discrimination might be thought to involve a breach of the Treaty freedoms only if the effect of a covertly discriminatory measure is *in fact* to impede market access. In effect, covert nationality discrimination breaches the Treaty freedoms because the criteria of differentiation that lead to the breach identify the measure with the cross-border issues of market access and the discrimination involved in fact impedes access. In those circumstances it may seem unnecessary to decide in any particular case whether covert discrimination is truly nationality

[11] "(1) For the purposes set out in Article 2, the activities of the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein: (a) the prohibition, as between Member States, of customs duties and quantitative restrictions on the import and export of goods, and of all other measures having equivalent effect; (c) an internal market characterised by the abolition as between Member States, of obstacles to the free movement of goods, persons, services and capital;" Article 14(2) describes the internal market as "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty."

[12] "Within the scope of application of this Treaty, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited." The origin of products is equivalent to nationality for producers.

[13] "The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Articles 3 and 4, to promote throughout the Community a harmonious and balanced and sustainable development of economic activities, a high level of employment and social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States."

[14] See Case 270/83 *Commission* v *France* (the *Avoir Fiscal* case), paragraph 15 (emphasis added): "It thus appears that the two submissions put forward by the Commission, namely that concerning discrimination in French law against branches and agencies of insurance companies established in other Member States vis-à-vis companies established in France and that concerning the restriction of the freedom of foreign insurance companies to establish branches and agencies, *are closely linked*. They must therefore be considered together." To understand this paragraph one has to appreciate that the right to choose whether to establish as a branch or a subsidiary is a facet of the market access principle, preventing Origin and Host States impeding the movement of products or producers *between* their markets. For this reason the attempted French justification that foreign insurers could always incorporate a French subsidiary was doomed to failure. The nationality discrimination of which France was guilty by taxing the branches of foreign producers less favourably than local producers (including local subsidiaries owned by nationals of other Member States) concerned the nationality non-discrimination principle that applied to France as the Host State *within* whose market the product or producer was found.

[15] For the expression of this, see Joined Cases C-267/91 and C-268/91 *Keck* and *Mithouard* [1993] ECR I-6097, paragraph 16 (emphasis added), "… national provisions restricting or prohibiting certain selling arrangements is not such as to hinder directly or indirectly, actually or potentially, trade *between* Member States …, *so long as* those provisions apply to all relevant traders operating within the national territory and so long as they affect *in the same manner*, *in law and fact*, the marketing of domestic products and of those from other Member States."

[16] Case 153/73 *Sotgiu* v *Deutsche Bundepost* [1974] ECR 153, paragraph 11.

discrimination in the same sense as *overt* nationality discrimination or represents a form of market access discrimination, the effect of which is to breach the market access principle.[17]

The distinction between the Treaty freedoms is yet more confusing in the direct tax field. This is because the scope and application of a State's taxing jurisdiction may not correspond to the territory represented by its national borders. In other words, in the taxation field a State frequently exercises an extra-territorial jurisdiction. Movements into and out of the State's taxing jurisdiction may not coincide with movements into and out of its national territory. For this reason, as I shall explain, the principles of market access and nationality non-discrimination can appear to overlap in the direct tax field.[18]

2.4 The essential difference between market access and nationality non-discrimination

Notwithstanding these close and potentially confusing relationships, the essential distinction between the Treaty freedoms is this. In determining whether there is a breach of the market access principle the question is whether *the effect of any measure* is to inhibit or impede the movement of a product or producer *between* markets. Is the product or producer seeking to enter or leave a market and, if so, does this measure impede its entry or exit? As such, discrimination is not a necessary feature of the market access principle. Once a product or producer is *within* a market, the focus shifts to the State's internal market rules. Those internal market rules must not incorporate any form of nationality discrimination.

Nationality discrimination is therefore different from market access discrimination. Nationality discrimination always involves comparing how the internal market rules treat two similar or competing products or producers of different origins or nationalities. All that market access discrimination involves is a difference in the way the State's rules operate according to whether the product or producer stays within its market or moves to another market.

Market access discrimination serves to identify particular measures with movements between markets, leading to an enquiry as to whether their effect is to impede movement. Market access discrimination is not, however, a necessary feature of the market access principle. Thus, the market access principle applies both to market access rules that simply lay down the terms on which products or producers may move between markets and to internal market rules that involve no nationality discrimination but which can be said in fact to impede market access.

In a sense, therefore, the market access principle has priority. The enquiry into whether a particular measure infringes the Treaty freedoms can always be conducted in terms of whether the effect of the measure is to impede market access, on the basis that it will always have that effect if it involves nationality discrimination.[19] Eliding the two aspects of the Treaty freedoms in this way, however, masks differences in the way they apply from the perspective of a Host and an Origin State. Greater clarity is achieved, therefore, if the two principles are dealt with separately while recognising their close relationship. On this basis, covert nationality discrimination concerns the application of the nationality non-discrimination principle to the internal rules of a Member State's market notwithstanding its market access overtones or associations.

2.5 The field of application of the Treaty freedoms

The market access principle poses the question whether the effect of a measure is to impede the movement of the product or producer between markets; the nationality non-discrimination principle poses the question whether the product or producer is discriminated against on grounds of origin or nationality within a market. *Both questions have to be answered by reference to the market of the particular Member State whose measure is said to involve the breach and the rules that it adopts to regulate its market*. The questions cannot be answered by reference to something that is not within that market (and is not seeking to enter it) but is comprised in the market of another Member State or by comparison with how other Member States regulate their markets.[20]

As this suggests, an important preliminary issue is to define the field of application of the Treaty freedoms, i.e. *the market by reference to which the issues of access and nationality discrimination have to be answered*. In other words, what lies within the market and what lies (or has moved) outside it,

a. into or out of which access is sought in the case of the market access principle, or
b. by reference to which nationality discrimination is determined?

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[17] This is presumably one reason why the Court has allowed public interest justifications to extend to both covert nationality discrimination and market access. The only justification for overt nationality discrimination remains one of those specified in the Treaty.
[18] See Section 2.6 below.
[19] See Joined Cases C-267/91 and C-268/91 *Keck* and *Mithouard* [1993] ECR I-6097, paragraph 16 cited in footnote 15 above.
[20] Case C-384/93 *Alpine Investments BV* v *Minister van Financiën* [1995] ECR I-1141, paragraph 27, "A prohibition such as that at issue in the main proceedings does not constitute a restriction on the freedom to provide services within the meaning of Article [49] solely by virtue of the fact that other Member States apply less strict rules to providers of similar services established in their territory (see the judgment in Case C-379/92 *Peralta* [1994] ECR I-3453, paragraph 48)."

2.6 The field of application in tax matters

In the tax field, because they can decide whether and to what extent they should exercise their taxing powers, Member States can in effect define the scope of their markets within which Community law operates by the way in which they choose (or not) to exercise their taxing powers.

This presents little difficulty for taxes on products because a State usually only exercises taxing powers in respect of products within the borders of its national territory.[21] It is different in the case of producers. States usually exercise extra-territorial taxing rights against producers that are based in its territory in respect of what they produce both at home and abroad.[22]

The key to understanding the Court's case law in the direct taxation field is the recognition that direct taxes are taxes on producers in respect of the outcome of their production. The direct tax base, in effect, incorporates both products and producers within it. Indirect taxes, by comparison, only incorporate products and not producers within its tax base.[23]

As a result, an internal market rule with extra-territorial application for a *producer* may be a disguised market access rule when viewed from the perspective of the *product*. In other words, in the direct taxation field, it may be necessary to consider the application of market access and nationality non-discrimination principles from the perspective of both products and producers by reference to the market created by the State's exercise of extra-territorial taxing powers and the impact of its internal market rules on the territorial location of products.

The diagram below reflects the relationship between jurisdiction in direct tax systems and the national territory of Host and Origin States. OS represents the territory of the Origin State from which a product or producer originates. HS and HS/OS represent the territory of a Host State within which the Host State can exercise its taxing jurisdiction over products and producers coming from OS. HS/OS represents that part of the Host State's territory in which the Origin State claims jurisdiction to tax the product of producers that remain based in OS. HS is the territory of the Host State outside the taxing jurisdiction of the Origin State, where the Origin State makes no claim to tax products and producers that originated from its territory.

The diagram illustrates that the tax territory of any Member State (within which it exercises its taxing jurisdiction) need not coincide with the physical borders of its territory.[24] Furthermore, each Member State is free to decide how far (if at all) to extend its taxing jurisdiction beyond its national territory. The existence and size of the area covered by the OS/HS territory accordingly represents the exercise of powers that are within the States' exclusive competence. Community law may say whether an Origin State has exercised its jurisdiction in a valid way but may not dictate that the Origin State reduce or extend the HS/OS area.

It will also be appreciated that the provisions of bilateral tax treaties between OS and any of the four Host States represented in the diagram will affect the way in which any of those States levies tax within the lines of the diagram relative to the territory of the particular State. A bilateral tax treaty between OS and any of HS may have the effect of extending OS's exclusive jurisdiction beyond its territory into HS territory (where HS allows OS *exclusive* taxing rights) or the HS area (where OS allows HS *exclusive* taxing rights). In either case, the HS/OS area of double taxation will be reduced. The Treaty may also affect the way OS or HS apply their tax rules to particular products or producers within the HS/OS area.

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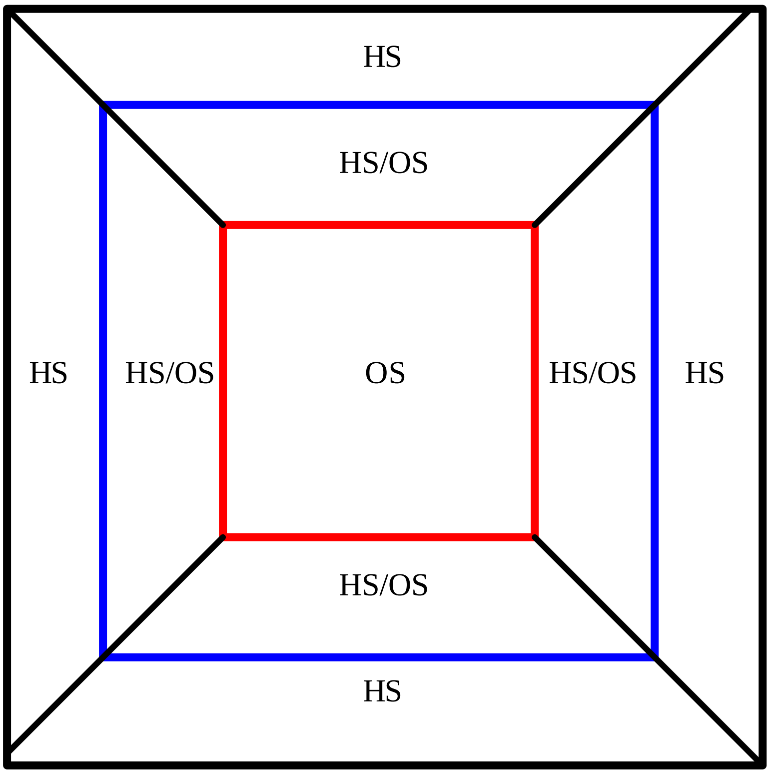
[21] This is because it usually has no practical way in which it can enforce its tax claims while products are abroad.

[22] In practical terms this is usually a great deal easier in the case of natural persons than it is for legal persons, such as companies and other legal entities, whose association with a particular State may be tenuous and easily changed.

[23] There is an important relationship here with the issues of income and consumption taxation. Economic income comprises both consumption and savings (i.e. current and future consumption). The consumption tax base comprises only current consumption and not savings. Accordingly, for every problem encountered in defining and taxing consumption for consumption tax purposes there is a counter-part in the income tax base (which includes consumption). The problems of defining and taxing savings, however, are unique to the income tax base. The difficulties of income taxation internationally derive significantly from the savings component of the tax base and therefore have no counterpart in consumption taxes. In the present context, the territorial jurisdiction exercised by a State represents the common element of both direct and indirect taxation. The extra-territorial taxing jurisdiction exercised by a State represents the unique aspect of direct taxation and corresponds to the savings component of the income tax base.

[24] Thus, although HS/OS and HS can be regarded as representing the national territory of HS, HS may choose not to exercise its taxing rights over products or producers that enter its territory.



It is important to understand that while the agreement of a bilateral tax treaty may reduce or eliminate the HS/OS area *of double taxation* that does not involve redrawing the lines of the diagram in terms of the exercise or not of a State's taxing powers. The agreement of a bilateral treaty represents the exercise by the State of its tax jurisdiction.[25]

To the extent that a State has chosen to exercise its taxing powers, the market access issue is whether, having done so, the consequences of coming within or leaving the State's taxing jurisdiction have the effect of impeding a product's or producer's entry or exit from that State.

The diagram illustrates that, in the case of products, this will be by reference to the tax consequences of the product entering or leaving the territory of the State. In other words, when the product leaves OS and enters either HS or HS/OS even though, while it remains within HS/OS, it remains part of the tax base in the Origin State of a producer based in OS.

The market access principle will also operate for producers by reference to when they leave or enter the taxing jurisdiction of a State, which will usually involve their moving out of the Origin State's territory. In this case, however, it is not every occasion on which a producer moves across national borders that involves it leaving the taxing jurisdiction of their Origin State or entering the Host State's taxing jurisdiction.[26] And their entry and exit from the taxing jurisdiction of either State, when it occurs, may be unrelated to where their products are located.[27] Thus a move from HS/OS to HS marks a market exit from OS that engages the market access principle.[28] In other

[25] Thus, a branch establishment will be within HS/OS even in those cases in which OS has agreed under a bilateral treaty not to tax its producer in respect of the establishment's profits. For a branch establishment to be outside HS/OS OS must effectively choose not to tax its producers extra-territorially. Similarly, a foreign subsidiary is usually within HS as a national of HS over which OS exercises no taxing powers. Only if OS extends its taxing jurisdiction to foreign subsidiaries will the subsidiary fall within HS/OS. In this respect, the exercise by OS of its taxing jurisdiction over its nationals in their capacity as shareholders does not bring the subsidiary within OS' taxing jurisdiction.
[26] The same point is true for products but it is more apparent in the case of producers because most taxes on products are territorial taxes while those on producers are not.
[27] For example, an individual (producer) resident in OS may already be working (product) in HS/OS when she moves her residence to HS.
[28] This will usually apply to natural persons but may apply to legal persons if they are capable of moving their seat from one State to another, see Article 48 and Case 81/87 *Daily Mail*. This will be possible for the *Societas Europaea* under the European

words, despite the movement between markets, the producer remains within the internal market of OS' tax system being subject at all time to the exercise of its tax jurisdiction.

While it is within the scope of a State's taxing jurisdiction, however, the product or producer is within the internal market rules of that State. At that point, the issue is whether its tax rules involve nationality discrimination, including covert nationality discrimination by not according the producer equal treatment at home and abroad.

Later Sections of this paper consider these issues further. It is implicit in this analysis, however, that the exercise or not of the Member State's taxing power, is outside the scope of Community law. Thus, the definition of tax residence and source (and the resolution of dual residence between States) are not matters that fall within the competence of Community law.[29] Otherwise Community law would be able to dictate what a State can and cannot tax rather than the manner in which it taxes products and producers within the jurisdictional tax market it has chosen.

Once a Member State has determined its jurisdictional tax market, Community law can intervene. As I noted in relation to the diagram, one Member State may agree with another to modify their domestic rules on residence and source through a double taxation convention. The Treaty freedoms then apply by reference to their agreement, which may alter the boundaries of the State's taxing jurisdiction and therefore the application of the market access principle in a particular case. Furthermore, if a State has agreed to surrender its taxing power over a particular product or producer, it cannot devise internal market rules to compensate for what it has given up. Community law in effect holds it to its agreement and the Community law consequences that flow from it.[30]

2.7 Cohesion and comparative advantage in a single market

The Treaty freedoms permit (without the need for justification) any internal market rules that apply without nationality discrimination and without being a disguised market access rule. The essential question, not finally resolved by current case law, is whether in the tax field—

- an internal market rule
- that applies without nationality discrimination
- but which has an extra-territorial territorial application

involves a breach of the market access principle on the basis that its extra-territorial application necessarily impedes the movement of products or producers between markets.

The Court has not had to resolve this issue because every tax case has clearly involved either a disguised market access rule or nationality discrimination. The case that perhaps comes closest to illustrating this issue is *Bachmann,* which concerned an internal market rule (the rules concerning the taxation of Mr Bachmann as a Belgian resident) with extra-territorial application (dealing with his deduction of payments for services sourced outside Belgium).[31]

The decision in *Bachmann* can be approached as a decision that Belgium (as Host State) could justify taxing imported services differently to the equivalent domestic services to ensure equal treatment of those services within its domestic market. Because a Host State does not usually tax imported services,[32] it can only secure equal treatment indirectly by applying a different internal market rule to consumers that choose foreign rather than domestic services.[33] Accordingly, the internal market rule has an extra-territorial application. If, however, the rule does produce a level playing field in the Host State on which the providers of services can compete,[34] is there nevertheless a breach of the market access principle given the extra-territorial effects of the internal market rules?

The tax case law dealing with services should be viewed from a market access perspective rather than from the perspective of equal treatment of domestic consumers. Different taxation of Host State consumers according to whether they buy at home or abroad is a market access issue and not one of nationality discrimination under the internal market rules that apply to consumers.[35]

Company Statute. The conversion of a taxable foreign branch into a non-taxable local subsidiary does not involve the market exit of a producer from OS but the export of its productive capacity from HS/OS to a new producer in HS.

[29] Case C-336/96 *Gilly*.

[30] Case C-80/94 *Wielockx*.

[31] Case C-204/90 *Bachmann* v *Belgian State* [1992] ECR I-249.

[32] It only taxes if the service provider establishes itself in the Host State.

[33] Note that "consumers" may also be producers in the case of financial services, where the product is a savings instrument of some sort.

[34] Or, as the Court decided, any market access effects that arose from the perspective of the product – the supply of services sourced abroad rather than at home – are justified as securing the cohesion of the Host State's tax system from its internal market perspective.

[35] This is clearly reflected in the case law, see Case C-204/90 *Bachmann*; Case C-484/93 *Svensson and Gustavsson*; Case C-118/96 *Safir*; Case C-294/97 *Eurowings*; Case C-55/98 *Bent Vestergaard*; Case C-136/00 *Danner*; Case C-422/01 *Skandia*.

You can understand the rationale for this by reference to the competitive basis for the single market.[36] Consumers should be free to access the cheapest services available in the single market. It is not for the Host State to counteract the comparative advantage enjoyed by foreign goods and services by raising the cost of those services to protect its domestic goods and services. In this context it was unexceptional for the Court to say in *Eurowings* that—

> "Any tax advantage resulting for providers of services from the low taxation to which they are subject in the Member State in which they are established cannot be used by another Member State to justify less favourable treatment in tax matters given to recipients of services established in the latter State."[37]

The same arguments do not necessarily apply from the Origin State's perspective.[38] It is possible to think about the extra-territorial taxation of *producers* (rather than consumers) by an Origin State in terms of nationality discrimination. Thus, from the perspective of a foreign insurance company, bank or lessor, the issue is whether the internal market rules of their Origin State, in order to secure equal treatment in its market, can tax its producers differently in respect of services supplied abroad as compared with services supplied in the domestic market. I return to this issue in Section 3 below.[39]

2.8 Determining what the Treaty freedoms permit

From this discussion, consideration of whether the Treaty freedoms permit particular internal market rules might be approached in five stages —

1. First, identify the market by reference to which the matter is to be determined. In tax terms, this depends on the extent to which the Member State has exercised its taxing powers (including the surrender of those powers by agreement with another Member State).

2. Is the measure a market access rule (explicitly dealing with the terms of entry and exit from that market) or part of the State's internal market rules (defining and regulating the economic activities of products and producers within that market)? In the tax field—

   - a market access rule is one that sets out the terms on which a product or producer comes within or leaves the State's taxing jurisdiction, and
   - an internal market rule is one that determines the liability to tax of those products and producers over which the State exercises its tax jurisdiction otherwise than by reference to the product or producer entering or leaving its tax jurisdiction.

3. Notwithstanding that the rule appears to be part of the internal market rules for determining liability to tax, are its terms such that it is in fact a disguised market access rule?

4. If it is an internal market rule (with or without extra-territorial application), does it in fact apply without giving rise to nationality discrimination?

5. Even if it is an internal market rule with extra-territorial application that is applied without nationality discrimination, does it nevertheless have the effect of impeding the movement of products or producers between markets?

In many cases it is unnecessary to disentangle nationality discrimination and market access in this way. In analytical terms, however, the importance of doing so lies in ascertaining the breach, the justification and the remedy in any particular case. Thus, in the current tax case law most internal market rules with extra-territorial application have been found to constitute disguised market access rules that fall at stage 3. Stage 4 has largely concerned internal market tax rules without extra-territorial application. It is important to understand why the Court has adopted this perspective, if only to understand what is needed to correct the breach and ensure no future breach.

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[36] As represented by the economic theory of comparative advantage.
[37] Case C-294/97 at paragraph 44.
[38] This is not to say that the Origin State can disadvantage its suppliers in respect of their foreign services. Provided, however, the Origin State affords equal treatment to their domestic and foreign services, they cannot complain if that leaves them in an uncompetitive position in the Host State. This is an aspect of reverse discrimination, which is in effect what the Host State is doing when it leaves its producers at a competitive disadvantage to imported goods and services, as the case law cited in footnote 35 effectively requires.
[39] The answer is likely to be that the Origin State cannot apply a different internal market rule in such circumstances where the Host State either does not seek to exercise or has agreed under a Treaty not to exercise any taxing jurisdiction over the services. In those circumstances, the less favourable taxation of services supplied abroad is effectively an export restriction by the Origin State, see Case C-251/98 *Baars*; Case C-35/98 *Verkooijen*.

The issues of breach, justification and remedies stem from the application of each principle according to whether the State concerned is acting in its capacity as importer or exporter. I call an importing State the "**Host State**". The exporting State I call the "**Origin State**", being the State from which products and producers originate.

All States are simultaneously Host and Origin States but this does not affect the importance of analysing in what capacity a State is acting as a means of seeing how the principles affect the exercise of its competences. I therefore analyse nationality discrimination and market access from both perspectives in Sections 3 and 4.

3 – NATIONALITY DISCRIMINATION

3.1 The nationality non-discrimination principle

Nationality discrimination involves the different treatment within a Member State's market of similar or competing products and producers by reason of their origin or nationality. Different treatment arises [40]—

> "… through the application of different rules to comparable situations or the application of the same rule to different situations."

One compares the position of one product or producer with another and asks, "*Am I (or my products) treated in the same way as my competitor?*" or "*Am I disadvantaged by being treated the same way as this product or producer who is different?*"

Those questions have to be asked in the context of the same State's market. You cannot complain that you are treated differently by reference to some other State's market. Nor can you complain of nationality discrimination if, having come into a Host State from another State, the reason why you unable to compete on equal terms in the Host State stems from measures taken by your Origin State. You complaint in that case must be directed to your Origin State.

Accordingly, A is compared with B in the context of *the same State's market*. In doing so, one must always compare like with like: the goods must be similar [41] or be in competition.[42] One taxpayer must be in a similar or competing position to another within that State. In the tax field this comes down to whether you are subject to the same or a comparable exercise by the State of its jurisdiction to tax the particular product or producer in question.

Having identified similar or competing products or producers within the same market and determined that they are not treated alike, the question is why are they not treated alike? The nationality non-discrimination principle is only concerned with discrimination on grounds of origin or nationality and with discrimination *against* the non-national or foreign product or producer. The fact that a State subjects similar or competing products and producers to different tax regimes within the same market – for example different savings products – may distort consumers' choices between them and may be bad policy. The difference in treatment cannot, however, be an infringement of the nationality non-discrimination principle so long as the basis for the different treatment does not depend *in law or in fact* on the origin or nationality of the product or producer concerned. The difference in that case can only be a market access or State aid issue depending on the effect of the measure in question.[43]

Nationality discrimination is concerned with the internal market rules of a State. If the rule depends as a matter of the Member State's *law* on origin (products) or nationality (producers), that will amount to direct or overt nationality discrimination unless the discrimination works only against the State's own products or producers. There is nothing to prevent a Member State placing the home team at a disadvantage.[44] If a non-national or foreign product or producer is less favourably treated, however, there is a breach of the nationality non-discrimination principle subject only to any express justification that the Treaty allows. As express Treaty justifications encompass only public policy, public security or public health, there is in effect no Treaty justification for overt or direct nationality discrimination in the tax field.

If the rule depends on origin or nationality not as a matter of the Member State's law but as a matter of *fact* and works against the non-national or foreign product or producer, there will be indirect or covert nationality

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[40] Case C-279/93 *Schumacker* at paragraph 30.
[41] E.g. Article 90, paragraph 1.
[42] E.g Article 90, paragraph 2.
[43] See Case C-308/01 *Gil Insurance Ltd* as to whether differential rates of insurance premium tax in the UK could amount to State aid.
[44] I.e. "reverse discrimination". It may be only a matter of time before the Court develops nationality non-discrimination in a manner that prohibits reverse discrimination. At present, however, the concept of reverse discrimination is accepted and applied by the Court.

discrimination.[45] There is a breach subject to any express provision of the Treaty and to any public interest justification accepted by the ECJ as not involving a breach.
The application of the public interest justification to covert discrimination reflects that the measure is, *in law*, a non-discriminatory provision. If *covert* discrimination is treated as nationality discrimination, it may operate to strike down otherwise non-discriminatory internal market rules. Implicitly the Court has recognised this extension of nationality discrimination by allowing Member States to rely on public interest justifications to defend otherwise non-discriminatory internal market rules that by their criteria of differentiation raise issues of market access.[46]

3.2 The scope of nationality discrimination

At first glance the nationality non-discrimination principle appears to be confined to cases in which a State is acting as a Host State. The Host State is the State *within* whose market products and producers compete. In other words, it is dealing with the internal market rules that have <u>no</u> extra-territorial application. The Origin State in contrast is the State from whose market products and producers originate with a view to competing in the Host State market. Both market access and nationality discrimination are issues for a Host State but only market access (or, as I shall occasionally call it, "market exit") issues appear to concern an Origin State.

There are two reasons for this —
1. In most cases products and producers that leave an Origin State to compete in the market of a Host State leave the jurisdiction of the Origin State and enter the jurisdiction of the Host State. Most Origin State measures, therefore, are only relevant so long as the product or producer remains within the jurisdiction of the Origin State. While that is so, Origin State measures have the potential to impede the products or producer's exit from the Origin State – an actual or disguised market access rule. Once the product or producer has left the Origin State, its ability to affect matters is at an end and Community law is solely concerned with the position within the Host State market.[47]
2. Even when an Origin State exercises extra-territorial jurisdiction over products or producers that move outside its territory, those products and producers do not usually acquire a new origin or nationality because they have left the territory of the Origin State and entered the territory of the Host State. So long as the products or producers remain within the jurisdiction of their Origin State they remain Origin State products or producers.

In the circumstances of (2), it is difficult to see how nationality discrimination operates from the perspective of the Origin State when the only products and producers concerned are the Origin State's own products and producers, albeit that some are outside its territory and some within it. The "market" by reference to which breach is established remains the Origin State's market. There is no breach of the Treaty freedoms by comparing how the Origin State treats its products and producers in the Host State market with how the Host State treats those products and producers.

3.3 The scope of nationality discrimination in Origin State taxation

Nevertheless, because direct taxes seek to tax producers in respect of the results of their production, the nationality non-discrimination principle has a particular application when an Origin State exercises extra-territorial taxing powers in respect of its producers. This is because the producer remains within the scope of the Origin State's internal market rules but its products can move outside those rules.

The usual application of the nationality non-discrimination principle is in the context of how the internal market rules of a Host State treat products and producers of different origin or nationality in its *territorial* market. From an Origin State perspective, when an Origin State producer remains within the Origin State but his product moves abroad, his product in effect acquires a different origin or nationality. Nationality discrimination then involves comparing how the Origin State's internal market rules affect those foreign products as compared with their domestic equivalents.

Consistent with the nationality non-discrimination principle, the Origin State should accord equal treatment to its producers in taxing their foreign products – employment income, business profits, service fees and capital – as

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[45] This raises a particular Community law issue for companies, where the company's seat will determine its nationality (see Article 48) but residence (which may or may not depend upon its seat) will determine whether the State exercises extra-territorial taxing rights over the company. If seat and residence coincide the issue will be whether nationality discrimination should be characterised as overt or covert.
[46] See Section 2.3 above.
[47] Hence the nationality discrimination view of the matter in the direct tax field set out in Section 3.5 below. Once the product has left the Origin State, the Origin State can only influence it indirectly by taxing the producer (i.e. applying its internal market rules with extra-territorial application). If its internal rules do not involve any national discrimination for the producer it is difficult to see how those rules will affect the access of the product to the Host State's market.

compared with domestic employment income, business profits, service fees and capital.[48] Equal treatment does not, however, mean the *same* treatment when products or producers are not in the same situation. Accordingly, the key question is whether and to what extent producers subject to extra-territorial taxation are in the same situation in respect of products abroad as compared to those at home.

In deciding whether there is nationality discrimination, it remains important to make the comparison by reference to the *same* not different markets. There is no nationality discrimination under the Origin State's internal market rules by comparing them with the way in which the Host State taxes the Origin State producer or its products in its market. Thus, the Origin State is not bound to accord equal treatment by reference to the Host State's internal market rules nor to refrain from exercising taxing rights because the Host State has also chosen to exercise taxing powers in respect of the same product.[49] The "market" in this context is the Origin State's tax market as established by the internal market rules of its tax system.

3.4 What nationality discrimination demands for tax purposes

The internal market rules of a State in direct taxation are, in effect, the rules of its tax system that deal with the on-going computation of tax liabilities of products and producers that are within the State's tax jurisdiction. The tax rules that apply to compute any tax liability imposed on a product or producer on its entering or leaving the State's taxing jurisdiction are the market access rules of its tax system. Between the two are rules that are either disguised market access rules or internal market rules with extra-territorial application.

Products and producers are necessarily the same to the extent that they are subject to the exercise by the State of the same or a comparable taxing jurisdiction and necessarily different to the extent that they are not. Provided that a different tax rule reflects that difference in the way in which the State has chosen to exercise of its tax jurisdiction, that difference will not involve any nationality discrimination. This will usually mean that if the different rule relates to the exercise of worldwide taxing rights, the exclusion from that rule of products and producers subject only to limited (territorial) discrimination will not be nationality discrimination. The difference reflects a genuine difference *in taxing situation* between the national and non-national and their objectively different position in the State's tax market, i.e. given the way in which the State has chosen to exercise its taxing powers.

Thus an individual who comes into the State to work and who does not derive virtually all his income there, cannot claim the benefit of personal reliefs and allowances reserved to permanent residents who are taxed by reference to their worldwide income.[50] If, on the other hand, an individual from another State or a branch of a foreign enterprise is in reality in the same position under the State's tax laws as a resident individual or local subsidiary, the two will be subject to the exercise of equivalent taxing powers by the State concerned and no difference in its tax rules will be permitted.[51]

Internal market rules with extra-territorial application frequently raise market access issues. Indeed, it is not easy to draw a clear line between a disguised market access rule and an internal market rule with extra-territorial application. The key to understanding where the line between them lies is in understanding what nationality non-discrimination demands.

Section 3.1 described nationality discrimination in relatively conventional terms. You can better appreciate the nature of the principle and what it demands, however, if you express the principle in positive terms rather than in the more usual negative way of what the principle forbids. The principle requires that comparable products and producers of different origins and nationalities are subject to the same internal market rules of a State unless there is some objective difference in their situation unrelated to their origin and nationality that justifies the application of a different rule. In this respect you cannot say that products and producers are not comparable because they are of different origin or nationality. The difference must be something other than that.

Expressing that principle in the context of a producer over which a State exercises extra-territorial taxing powers, the State cannot apply different tax rules according to whether the producer produces in the domestic market or abroad, unless the different rule reflects some objective difference in his situation. In this respect the most obvious

[48] Note, however, that this does not require an Origin State to extend equal treatment to a foreign branch or subsidiary because the subsidiary is outside the Origin State's extended jurisdictional market. The issue is whether the Origin State can apply different rules to foreign branch establishments as compared with domestic branch establishments.
[49] Products and producers that go abroad but remain within the jurisdiction of the Origin State may find themselves within the taxing jurisdiction of two or more Member States. Dual regulation (or double taxation), however, is not a breach of the Treaty freedoms as such, as Article 293 of the Treaty indicates.
[50] Case C-391/97 *Gschwind*.
[51] Case C-279/93 *Schumacker* (individual); Case C-307/97 *St Gobain* (branch of a company).

aspect of differentiation is when the product or producer becomes subject to the exercise of taxing jurisdiction *by another State*.[52]

The existence of double taxation therefore justifies a different rule – that is, the modification of normal internal market rules by the application of an internal market rule with extra-territorial application. That different rule can then deal with the different situation that arises *as a result of the State's exercise of extra-territorial taxing powers*, namely that the product or producer is now subject to the taxing jurisdiction of two or more States.

The italicised words reflect an important qualification, namely that a State is not bound to eliminate double taxation. Double taxation arises through the independent exercise by two or more Member States of their taxing powers. As such, it arises from the existence of separate national taxing markets within the Community. As I noted in Section 3.1, the nationality non-discrimination principle must be applied by reference to the particular State's market to which the internal market rules apply, not by a comparison with another State's market and its internal market rules.

Nevertheless, to the extent that a product or producer subject to an exercise of extra-territorial powers by a State is subject to a different rule when it is abroad rather than at home, that rule is dealing with a genuine difference in situation if it is dealing with the double taxation that arises because the product or producer abroad has fallen within the taxing jurisdiction of another State.

The freedom to apply a different rule in that situation, however, does not alter the basic demand of nationality non-discrimination. It is not that the product or producer has ceased to be the same or comparable. Its situation abroad is different from its situation at home *because of the double taxation* and the State can therefore justify the application of a different rule *to deal with double taxation*. That does not offer the State a licence, however, to apply a different rule that goes beyond dealing with double taxation but has the effect of subjecting the product or producer to a higher effective tax burden *under that State's rules*.

"Under that State's rules" emphasises again that the higher tax burden must arise as a matter of the internal market rules of the State concerned. It does not arise from its failure to relieve in full the double taxation that results from the exercise by two or more States of taxing powers over the product or producer concerned. If it were otherwise, an Origin State could be obliged to give relief for a Host State's tax over and above the tax that the Origin State chooses to levy on its producers.

What this adds up to, therefore, is that the object of the internal market rule with extra-territorial application should be, so far as possible, to secure equal treatment (*i.e. equal taxation or the same tax burden*) of comparable products and producers within its taxing jurisdiction. If the rule goes beyond the objective of securing equal treatment and imposes a higher effective tax burden on the product or producer as a result of its being abroad rather than at home, an internal market rule with extra-territorial application will have acquired disguised market access characteristics and be open to challenge under the market access principle.[53]

The Table at the end of this section summarises the effect of this analysis.

3.5 Remedying nationality discrimination in direct taxation

Where the Treaty breach is established by comparing two products or producers in the same market, the remedy is usually straightforward, namely to adopt the same treatment for those products or producers, irrespective of their origin or nationality. The only issue is whether the State should level up or level down.

The remedy is less straightforward, however, in the case of *competing* products.[54] If products or producers are not the same but are in competition, applying the same treatment might over-compensate for the initial breach. An application of the same treatment to competing but different products or producers could itself give rise to nationality discrimination by applying the same rule to situations that are in fact different.[55]

In such cases the solution lies in adjusting the position between the competing but different products or producers in a targeted manner that is best designed to achieve equal treatment in the market concerned. In other words, the measures must be designed to achieve a non-discriminatory outcome (by reference to origin or nationality) for

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[52] This is related to origin and nationality only in the sense that a product or producer has to do something outside the Origin State's territory to be subject to the possibility of double taxation. It is the exercise by another State of taxing jurisdiction, however, that it the source of the relevant difference, not origin or nationality by itself.
[53] See further Section 4 below.
[54] E.g. Case 170/78 *Commission* v *UK (wine and beer)* [1980] ECR 417.
[55] If the disadvantaged product or producer were the domestic product or producer rather than the foreign product or producer, there would be reverse discrimination but no Treaty breach. Substituting reverse nationality discrimination for nationality discrimination, however, is hardly satisfactory.

competing but different products or producers and must be suitable for the attainment of that objective without going further than is necessary to achieve it.[56]

It is this aspect of nationality discrimination that is particularly problematic in the context of the exercise by an Origin State of extra-territorial taxing powers. In this respect it is the same problem of adjusting internal market rules to deal with products that are in competition as opposed to similar products.

The products of a producer subject to extra-territorial taxation are in the same tax market created by the Origin State's internal market rules and entitled to equal treatment whether at home or abroad. So long as it can exercise exclusive jurisdiction over the producer and its products, the Origin State cannot claim that there is any difference to justify a different rule just because the producer is active in a different territorial market. They are the products of the same producer in the same (tax) market.

Once their products are within another State's territorial market *and subject to taxation there*, however, producers are still in the same tax market but the producers active in other States' markets are no longer similar to those active in the home market but have become competing producers.

It is almost inevitable that the use of internal market rules with extra-territorial application to deal with competing producers will affect the movement of those producers and their products between the *territorial* markets of different Member States. Indeed, if the Origin State imposes more onerous internal market rules on producers who have accessed other markets, it becomes plain that the internal market rule is likely to represent a quantitative restriction on exports.

It is unsurprising, therefore, to find that in the case of internal market rules with extra-territorial effect the Court has largely resorted to market access language. The Court has shifted the emphasis away from comparing two products or producers in the same territorial market, and how similar or competing products or producers may be accorded equal treatment, towards the issue of whether a State can justify different tax treatment of a producer in respect of its product depending on whether it stays at home or goes abroad.

3.6 Equal treatment and market access in direct taxation

Nevertheless, it is important to recognise that equal treatment of competing producers and the elimination of obstacles to movement of products between territorial markets are in reality two sides of the same coin. The objective in any case is to secure a level playing field within a Member State on which home and visiting teams are subject to the same rules and players of either team are free to come and go without hindrance.[57]

Thus, the home country cannot impose less favourable rules on a visiting team than apply to the home team.[58] Similarly, it cannot (without justification) subject the home team to less favourable rules *at home* if it plays abroad,[59] or less favourable rules when it plays abroad as compared to the rules that apply when it plays at home.[60] The effect in either case is likely to deter the home team from accepting foreign fixtures.

There is nothing, however, to prevent the home country requiring its team to play abroad under home rules.[61] That is equivalent to a non-discriminatory internal market rule for the Origin State. On that basis, the rule can only infringe the market access principle, requiring that the rule *in fact* impedes market access. There is no existing case law of the Court applying the market access principle in the context of Origin State rules for the simple reason that this would be to impose Host State rules on an Origin State.[62]

3.7 Taxation and the administrative rules of the tax system

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[56] See Case C-19/92, *Dieter Kraus* [1993] ECR I-1663, paragraph 32.
[57] It is on that basis that one needs to understand the Court's statement in Case C-55/94 *Gebhard* [1995] ECR I-4165 at paragraph 37: "It follows, however, from the Court's case law that national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions: they must be applied in anon-discriminatory manner; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it (see Case C-19/92 *Kraus* v *Land Baden-Wurttemberg* [1993] ECR I-1663, paragraph 32)."
[58] Case C-311/97 *Royal Bank of Scotland*.
[59] Case C264/96 *ICI*; Case C-294/97 *Eurowings*; Case C-141/99 *AMID*; Case C-168/01 *Bosal*.
[60] Case C-251/98 *Baars*; Case C-35/98 *Verkooijen*.
[61] Hence the credit system and capital export neutrality are not inconsistent with the Treaty freedoms although the manner of their implementation in any case may be. See also Case C-439/97 *Sandoz*, in which Austria applied its internal market rules for stamp duty on loan instruments extra-territorially to charge loans to Austrian residents abroad. The vice in that case was that Austria charged foreign loan instruments to stamp duty in circumstances in which it did not charge domestic loan instruments, and it was unable to justify the difference.
[62] See further Section 4 below.

I have been concerned in this Section to consider the application of nationality discrimination in the context of an Origin State that exercises an extra-territorial taxing jurisdiction on its producers. In my view, the effect of that principle is that an Origin State is required to accord equal treatment in the sense of imposing the same effective tax burden on its producers whether the outcome of the production that forms the tax base is at home or abroad. If their producers are subject to taxation in another State, Origin States may devise different rules to deal with that different situation but the imposition of a higher effective tax burden on foreign production is always a breach of the Treaty freedoms, either as a market access restriction on products going abroad or as nationality discrimination by the Origin State against its producer.[63]

None of this prevents States from recognising that they may need to use different administrative rules depending on whether (from the Origin State's perspective) production is at home or abroad and whether (from the Host State's perspective) the producer is a domestic or foreign producer.[64] In this respect because differences in administrative rules tend to be associated closely with the presence of products or producers in other territorial markets, they invariably fall to be considered in market access terms.

3.8 Different Origin State taxation of foreign branches and subsidiaries

The analysis in this Section explains why Community law does not require an *Origin* State to apply the same internal market rules in the taxation of the foreign branches of its producers as compared to their foreign subsidiaries,[65] even though it does require a Host State to apply the same internal (Host State) market rules to branches and subsidiaries.[66] Within the Host State branches and subsidiaries owned by Origin State producers are both within the Host State's taxing jurisdiction. As such it is bound to have internal market rules that do not infringe the nationality non-discrimination principle.

From an Origin State perspective, a foreign branch is a manifestation of a producer over which the Origin State can choose to exercise extra-territorial taxing powers. By contrast, the Origin State usually has no internal rules of application to a foreign subsidiary. The subsidiary is normally outside any exercise of its taxing jurisdiction.[67] To the extent that a foreign subsidiary represents anything from an Origin State perspective, it reflects the Origin State producer's exit – or the export of its productive capacity – from the Origin State. The Origin State's continuing exercise of tax jurisdiction over its producers who establish a branch in the same Host State as its subsidiary is irrelevant. Community law does not require the Origin State to exercise taxing jurisdiction over a Host State national (i.e. company's incorporated there) because it chooses to tax its own nationals on their activities in the same Host State.[68]

The only issue in relation to the establishment of a foreign subsidiary is whether an actual or disguised market access rule impedes its establishment and (on the assumption that the same rule does not impede a branch establishment) denies the producer the right to choose between a foreign branch or subsidiary establishment.[69]

In this respect, a decision *not* to tax a foreign subsidiary – in other words, to permit the export [70] – cannot be an impediment to establishment in another Member State. From an Origin State's perspective, it is the reverse. If an

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[63] And because the higher tax burden is an economic matter, the Origin State will be unable to justify the measure that has that effect. This is why the Court has consistently rejected arguments based on the protection of domestic tax revenues.

[64] This effectively represents the limits of the public interest justification of effective fiscal supervision in direct taxation matters, see Case 120/78 *REWE-Zentrale* ("*Cassis de Dijon*"), paragraph 8. Public interest justifications can only allow different rules to deal with situations in which they are necessary to produce equal taxation. They cannot justify the imposition of a higher absolute taxation burden.

[65] The argument being that any difference in treatment amounts to an infringement of the Origin State producer's freedom to choose between the two. This aspect of Article 43 is a market access issue, not a nationality discrimination issue.

[66] Case C-307/97 *Saint Gobain*. This case helpfully illustrates that what matters is how a State actually exercises its taxing powers. The fact that German companies were subject to an exercise by Germany of its worldwide taxing rights did not suffice to distinguish them from the German branch of St Gobain, in respect of which Germany only exercised limited (territorial) taxing rights. The reality of the internal market rules in question was that Germany exempted German subsidiaries from tax so that its exercise of taxing power in St Gobain's case was as extensive as it was for German subsidiaries. The comparison was by reference to its actual exercise of taxing powers in the particular case.

[67] Clearly different considerations arise if the Origin State does assert taxing rights over the foreign subsidiary, whether generally or under controlled foreign company rules.

[68] In terms of the diagram in Section 2.6, the activities of the branch (representing what is exported) are within HS/OS territory and the activities of the subsidiary are within HS territory. In economic terms, the Origin State may tax any profits that the subsidiary repatriates to Origin State shareholders. In that case, however, there are two producers – the company and its shareholders – not one – the Origin State producer and its branch. The Court has generally respected legal form (see Case C-212/97 *Centros* [1999] ECR I-1459; Case C-168/01 *Bosal*).

[69] The choice being a market access issue, see footnote 14 above.

[70] When the Origin State national establishes a foreign branch, the product represented by the branch activities leaves the Origin State but the producer does not. When an Origin State producer chooses to establish a foreign subsidiary, it creates an entirely new producer (a national of the Host State) so that the producer leaves the Origin State's tax jurisdiction to that extent (and by definition the product of that producer's activities, unless conducted in the Origin State).

issue arises it will be because the effect of the Origin State's tax system is to impede the Origin State national's action of establishing the foreign subsidiary.

The issue, therefore, is solely one of nationality discrimination, i.e. whether the extra-territorial application of the Origin State's internal market rules for determining the producer's on-going tax liabilities involve nationality discrimination by applying less favourably to foreign branch activities as compared with domestic activities.

Differences in the Origin State's taxation of foreign branches or subsidiaries may influence the form of establishment. The distinction between branches and subsidiaries in national and international tax systems, however, reflect the difference between a single legal person and two such persons. This has Community law implications because a national and its branches are a single producer of a single State with product in two States. A national and its subsidiary are separate producers based in different States, each with their own product.[71] However, the basic reason why different internal market rules for each do not infringe the establishment article of the Treaty stems from the fact that Community law allows Member States to define their tax jurisdiction: a foreign subsidiary is usually outside the Origin State's jurisdiction while a branch often is not.[72]

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[71] This is the reason why a Host State does not infringe Community law by applying different internal market rules to the repatriation of branch profits and the payment of subsidiary dividends, even though it must apply the same rules to the calculation and taxation of the repatriated profits.

[72] How a State chooses to define the tax unit (company or group; husband or wife or family) to which it then applies its internal market rules fro computing tax liabilities is another aspect of its exercise of taxing powers and therefore not within the Community's competence. Community law cannot, for example, require a State to adopt joint rather than separate taxation of married couples. Based on the State's choices, however, it will ensure equal treatment of other State's nationals when they are in a comparable family situation, Case C-87/99 *Zurstrassen*.

ORIGIN STATE	HOST STATE	RELEVANT ORIGIN STATE PRINCIPLE	RELEVANT HOST STATE PRINCIPLE
1. Resident worker (producer) works at home	1. N/A	1. N/A	1. N/A
2. Resident worker (producer) works abroad	2. Employment income (product) not taxed (domestic or treaty rule)	2. Nationality non-discrimination for producer; market exit for product (i.e. higher OS tax on foreign earnings impedes market exit of product and is nationality discrimination of producer);	2. Market access if applies different tax rules to domestic employers for employing foreign labour. Higher tax burden cannot be justified but different compliance burden may be if addresses real differences between domestic and foreign labour and is apt to deal with those differences
3. Resident worker (producer) works abroad (exported product)	3. Employment income (imported product) taxed	3. Nationality non-discrimination for producer; if higher tax burden in OS from working abroad (other than unrelieved double taxation), then breaches both freedoms – impedes market exit of product and nationality discrimination of producer according to source of production	3. Nationality non-discrimination on imported product but no requirement for nationality non-discrimination of producer unless in objectively comparable position to domestic (resident) producers (e.g. where HS employment represents virtually entire income)
4. Resident leaves (exporting producer) to work abroad	4. Foreign worker (importing producer) takes up residence	4. Market exit (may not impose taxation by reference to exit)	3. Market access (may not impose taxation by reference to entry or higher tax burden following entry). Nationality non-discrimination in Host State thereafter
5. Resident self-employed (producer) performs services at home	5. N/A	5. N/A	5. N/A
6. Resident business (individual or company) (producer) performs services abroad	6. Services (imported product) not taxed (domestic or treaty rule)	6. Nationality non-discrimination for producer; market exit for product (i.e. if higher OS tax on foreign profits (other than unrelieved double taxation) impedes market exit of product and is nationality discrimination of producer according to the source of its profits)	6. Market access if applies different tax rule to resident consumers in respect of imported services
7. Resident business (individual or company) (producer) establishes branch abroad	7. Activities (product) taxed via establishment	7. Nationality non-discrimination for producer but may relieve double taxation of foreign profits; if higher tax burden in OS (other than unrelieved double taxation), then market exit for product and nationality discrimination of producer according to the source of its profits)	7. Nationality non-discrimination on domestic profits but no requirement for nationality non-discrimination for foreign producer unless in objectively comparable position to domestic (resident) producers (e.g. where effective Host State taxation of domestic produces limited to territory of Host State)

ORIGIN STATE	HOST STATE	RELEVANT ORIGIN STATE PRINCIPLE	RELEVANT HOST STATE PRINCIPLE
8. Resident individual (producer) leaves to establish abroad	8. Foreign individual (producer) takes up residence to conduct business activity	8. Market exit	8. Market access initially; thereafter nationality non-discrimination
9. Resident individual or company (producer) establishes subsidiary abroad	9. Foreign owned subsidiary (producer) subject to full taxation	9. Market exit on establishment (i.e. tax charge on establishment or higher effective tax burden on producer by reason of establishment)	9. Market access by reference to establishment; thereafter nationality non-discrim ination;
10. Resident (producer) invests capital at home	10. N/A	10. N/A	10. N/A
11. Resident (individual or company) (producer) invests capital abroad	11. Return on investment (product) not taxed	11. Nationality non-discrimination for producer; market exit for product (i.e. if higher OS tax on foreign investment return (other than unrelieved double taxation) impedes market exit of product and is nationality discrimination of producer according to the place of its investment)	11. Market access if applies different tax rules to resident users of foreign capital in respect of that capital or payments abroad
12. Resident (individual or company) (producer) invests capital abroad	12. Return on investment (product) taxed	12. Nationality non-discrimination but may relieve double taxation of foreign investment income; if higher tax burden in OS (other than unrelieved double taxation), then market exit for product and nationality discrimination of producer according to the source of its investment return)	12. Limited nationality non-discrimination on investment return but not comparable in respect of HS tax rules that relate to residents subject to unlimited HS income taxation

SECTION 4 – THE SCOPE OF THE MARKET ACCESS PRINCIPLE

4.1 Discrimination and market access

There is no breach of the nationality non-discrimination principle without nationality discrimination. It is important to recognise, however, that discrimination is not a necessary feature of the market access principle. The breach arises from *the effect of a measure on the movement of products and producers between markets*. Discrimination may be the most common manifestation of a market access issue. It is the difference in treatment accorded by a Member State to foreign and domestic products or producers that highlights the potential movement between markets and raises the issue of market access. However, in such cases it is the *effect* of discrimination on the movement of products and producers between markets, and not the discrimination as such, that is at the heart of the breach.

Thus, a non-discriminatory measure may still breach the market access principle if its *effect* is nevertheless to impede the movement of products and producers between markets. The issue in non-discriminatory cases is to decide, in the absence of any discrimination, whether a market access issue arises, i.e. whether the measure has a Community aspect or is solely internal to the State concerned.

Internal market rules that have no extra-territorial application and do not involve any nationality discrimination fall outside the scope of Community law. Internal market rules (with or without extra-territorial application) that involve nationality discrimination will breach the nationality non-discrimination principle. Measures, whether discriminatory or not, that have the effect of impeding the movement of products and producers between markets will breach the market access principle.

4.2 Market access contrasted with nationality non-discrimination

For the reasons given in Section 3, nationality discrimination is more easily applied in a Host State context, i.e. the State within whose market A and B are competing. Indeed, in many cases, nationality discrimination is irrelevant to an Origin State because products or producers leaving its territory are leaving its jurisdiction. The only relevant principle in that case is the market access principle. In the direct taxation field, however, nationality discrimination can apply to producers who remain within the extra-territorial taxing jurisdiction of the Origin State. As that jurisdiction inevitably relates to products that are moving outside the Origin State, however, there is an overlap with that market exit that makes it more difficult to identify a difference between the Treaty freedoms in this area.

By comparison, for every breach of the market access principle that can be committed by a Host State, it is possible to describe a corresponding breach by an Origin State.[73] A ban on imports corresponds to a ban on exports; quantitative restrictions on imports correspond to quantitative restrictions on exports; measures having equivalent effects on imports correspond to those have equivalent effects on exports.[74]

If you consider the different types of product and producers that the Treaty freedoms cover – goods, persons, services and capital – you can appreciate that the incentive to impede market access – and therefore the relative importance of the market access principle from a Host or Origin State perspective – differs depending on the product or producer in question and the circumstances in which they seek to move between markets. Generally speaking, a Host State has an incentive to impede imports of products where those products may threaten local producers. An Origin State by comparison will usually be happy to export its products. The reverse will apply in the case of producers. A Host State will usually seek to attract producers; an Origin State by comparison will not want to see production move abroad.

For present purposes, however, I am less concerned with where the incentives lie to impede market access than to identify what it is that determines whether and when a Member State – in its capacity either as a Host State or an Origin State – has impeded access *between* markets in a way that gives rise to a breach of the market access principle.

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[73] The reasons for this appear in footnote 18.

[74] See Articles 28 and 29. The fact that a market access rule is easily stated from the perspective of both States provides an indication that it is a market access issue and not one of nationality discrimination. Thus, the fact that the choice of establishment under Article 43 can be expressed from both an Origin and Host State perspective is the clue to the choice being a facet of market access rather than nationality non-discrimination (see footnote 9). Neither Host nor Origin State may have rules that require a producer to establish at home (in the case of the Host State) or abroad (in the case of the Origin State) in one form to the exclusion of the other. Dual regulation is a facet of the market access principle (if it is a breach at all) because it can be expressed in the same terms from both an Origin and a Host State perspective. Assuming different regulation of the same products or producers in Host and Origin States, must Host State regulation defer to Origin State regulation or vice versa? In either case products and producers that move between the two markets face the potential of dual regulation. Should one prevail or do both remain notwithstanding whatever impediment that may create for the free movement of products or producers?

A market access breach may be obvious, for example a straightforward ban on import or export. An outright ban on imports or exports illustrates that a market access rule need not involve any comparison of similar or competing products or producers as such. You just look at the effect of the rule.[75]

This is true for both actual and disguised market access rules. In this respect the tax cases are littered with examples, all of which illustrate that comparison is not at the heart of the matter. Thus, establishment abroad attracted a tax charge for Mr Baars [76] and operated to deny ICI relief for losses at home.[77] Similarly, the French tax rules on the transfer by Mr Lasteyrie du Saillant of his residence abroad were straightforward market access rules.[78] All these tax rules functioned as export restrictions. In this respect, it is noteworthy that in all these appears in terms of the analysis summarised in the Table at the end of Section 3 as cases in which from the Origin State perspective the producer becomes subject to the exclusive taxing jurisdiction of another State, in other words exiting the Origin State's tax market.

The same is true for imports. Thus, Mr Vestergaard. Jesica Safir, Mr Bachmann and Mr Danner all incurred higher tax liabilities by importing services from abroad rather than buying them at home.[79]

Although comparison is not a necessary part of actual or disguised market access rules as it is for a breach of the nationality non-discrimination principle, comparison may nevertheless be relevant in revealing a market access issue. Comparison may show that what appears as an internal market rule in fact relates to the movement of products or producers between markets. More important in the tax field, however, comparison of the effective tax burdens imposed on products and producers according to whether they stay at home or go abroad reveals whether *the effect of the measure* is to impede that movement so as to give rise to a breach of the market access principle. In other words, a State is not entitled to impose a higher tax burden on products or producers depending upon whether they stay at home or go abroad. This is a market access issue rather than a nationality discrimination issue because it goes beyond securing equal treatment in the taxation of domestic and foreign production.

For this reason, the term "discrimination" in a market access context is used in a wider sense than just nationality discrimination.[80] Market access discrimination encompasses any difference in treatment by a State (whether as Host or Origin State) of a particular product or producer according to whether it remains where it is or moves into or out of the State in question.

This is both a different comparison and a different function to that involved in establishing a breach of the nationality non-discrimination principle.[81] In the case of market access discrimination, it is not just a comparison of two products or producers within the same market but a comparison of alternative courses of action open to a single product or producer in a cross-border context. *Shall I sell my goods or supply my services here or abroad? Shall I work here or abroad? Shall I set up business here or abroad? Shall I invest here or abroad?* Inevitably, if a State's tax rules subject you to a higher effective tax burden if you go abroad than if you stay at home, those rules will impede market access.

4.3 Market access in the context of the single market

Answering these questions to decide whether there is a breach of the market access principle is not always straightforward. Most people find it more natural (and easier) to conduct their economic lives in their domestic market. Going abroad is inherently more difficult and presents more obstacles. Different markets discourage exports and place imports at a disadvantage. How does one judge in such circumstances whether the problem is merely one of different markets or something that breaches the market access principle?

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[75] The relevant example in the tax case law is Case 81/87 *Daily Mail* [1988] ECR 5483.
[76] Case C-251/98 *Baars*.
[77] Case C-264/96 *ICI*.
[78] Case C-9/02 *Lasteyrie du Saillant*.
[79] From the perspective of the foreign provider of the services to the Host State market. This can be analysed in nationality non-discrimination terms as unequal taxation of the consumer according to whether he or she buys at home or abroad. Where the consumer is a producer (as e.g. in Case C-294/97 *Eurowings*) it is certainly possible to consider the matter as nationality discrimination terms. As soon as you conclude that the effect is to impose a higher tax burden, rather than secure equal tax treatment, the emphasis shifts to one of market access. See also Section 2.7 above as to why from the consumers' perspective this should be seen as a market access issue rather than nationality non-discrimination.
[80] While recognising that discrimination as such is not required for a breach of the market access principle, the *effect* of the measure in impeding movement between market being the key rather than discrimination as such.
[81] It also leads to a different approach by the Court. Because nationality discrimination involves comparing A with B under certain conditions, the conclusion that A is different from B determines that there is no breach. With the market access principle, the Court treats the market access rule or internal market rule identified with a movement between markets is *prima facie* giving rise to an obstacle. The Court then gives detailed consideration to the effect of the rule through the justifications put forward by the Member States.

The market access principle is concerned with the ability of products and producers to move *between* markets rather than to how they are treated once they are within a market. As I have noted, in the context of direct taxation there is an overlap between the two. From the producer's perspective (i.e. that of the Origin State), the extra-territorial exercise of taxing powers can be examined in terms of nationality discrimination, requiring one to compare the taxation of a producer in the same *tax* market by reference to his domestic and foreign production.

The exercise of extra-territorial taxing powers may, however, well affect the movement of products between *territorial* markets. At the very least, it identifies an internal market rule of extra-territorial application as relating to the movement of products and producers between territorial markets. The question then is whether the difference in treatment creates a disadvantage or additional burden that is likely to impede that movement.

In virtually all tax cases to date, the Court has regarded the breach as obvious because the effect of the measure has been to disadvantage a product or producer in some way or subject it to some additional tax burden or to deprive it of some relief as a result of it moving between markets.[82]

Because, however, the Community comprises 25 markets rather than one single market, *differences that exist between the markets of two or more Member States* may be impediments to cross-border movement but do not amount to a breach of the market access principle. In essence, a breach of the market access principle is a sin of a single Member State – whether as Origin or Host State – by reference to how it regulates its market and not the sin of the Member States collectively by failing to establish a genuine single market throughout the Community.

4.4 Negative integration versus positive harmonisation

The simple explanation of this point is that the Treaty freedoms are part of a process of negative integration rather than an instrument of positive harmonisation.

Unless the Treaty or legislative acts under the Treaty have established common rules throughout the Community, Member States remain free to make their own rules within their own market, subject only to complying with the Treaty freedoms. Those principles do not require Member States to adopt common rules. This would allow the tail of the Treaty freedoms to wag the Community dog. The Court can lay down what Member States may not do – negative integration – but it cannot tell them what common rules they should adopt in place of national measures.[83] The development of common rules is a matter for the agreement of Member States through the legislative acts permitted by the Treaty.

Accordingly, a Member State, in those matters in which it retains national competence, must not exercise its powers so as to impede producers and their products from moving into or out of that Member State. In the exercise of that freedom, products and producers may move *from* State A that has chosen to impose more stringent regulation *to* State B with less stringent regulation. Inevitably, the more stringent regulation of State A may inhibit the producers or products of State B from moving to State A. If that involved a breach of the market access principle, the Treaty would have the effect of imposing State B's regulations on State A, leading to the harmonisation of regulation – or if you prefer, of tax systems – throughout the Community.

It is not the differences in markets within the Community that leads to a breach of the market access principle, even though those differences may impede the movement of products and producers between markets and therefore detract from the creation of a genuine single market. The creation of a genuine single market can only derive from the legislative acts of the Member States and not from the negative impact of the Court's case law.

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[82] Note that in Case C-141/99 *AMID*, paragraph 24, the Belgian Government sought to limit the application of the market access principle by distinguishing between the position when the movement occurred and the operation of its internal market rules thereafter: "In reality, the Government argues, that system does not influence the choice of undertakings whether or not to create a foreign establishment. Bearing in mind that, when an undertaking decides to open a permanent establishment in another Member State, it does not know whether it will consistently make losses or profits, and that, moreover, it certainly does not know whether the losses will occur in the new permanent establishment or at the main seat of the business, that system does not create a hindrance contrary to the Treaty." That argument was of no avail. Belgium had agreed by Treaty to exempt AMID's Luxembourg branch from Belgian tax. Thus any Belgian internal market rule that purported to restrict loss relief within its tax market by reference to something that Belgium had agreed was outside its tax market could only be view as a measure designed to impede the export of the productive activities to another State. For the same reason, the Commissioners concluded in *Marks & Spencer* v *Halsey* that the UK parent company could not claim the benefit of losses of subsidiaries that it established outside the UK's tax market just because it could claim the benefit of losses of subsidiaries within that market, see footnote 8 above and [2003] STC (SCD) 70 at 92 – 95, paragraphs 79 – 89. See also footnote 85 below.

[83] See, for example, the Court's answer to the second question posed in Case C-385/00 *de Groot* at paragraph 114. The Court may obviously indicate how it has identified a breach and thereby what the solution would be for a State to remedy its breach, see for example Case C-234/01 *Gerritse* at paragraph 55 where the Court had to indicate how to determine whether a 25% flat rate tax applied to gross earnings amounted to nationality discrimination in a Host State context.

It follows that the different choices that Member States make as to how to exercise their remaining competence in particular areas – such as their choices as to what to tax and what not to tax – does not of itself involve any breach of the market access principle. The differences in markets within the Community are the consequence of the different choices that Member States have made.

What matters is how (not whether) they exercise their remaining competences. In particular, the issue is whether the *effect* of their internal market rules does more than create different markets but impedes the movement of products and producers between those markets.

4.5 Market access in the presence of different markets

It is not every difference in treatment that has the effect of impeding movement between markets nor every impediment on movement that represents a breach of the market access principle. In particular, it is not possible for the *internal market rules* of a particular State that involve no nationality discrimination to lead to a breach of the market access principle merely because Member State A has chosen a different set of internal market rules to Member State B, even though its rules (when compared with the choices made by other Member States) have the effect of impeding movement of products into or out of that Member State A.

The essential point is that the effect of the internal market rules of a State can only be judged by reference to how they deal with the products and producers *in that State's market, not by comparison with other States' markets*. Thus, in relation to an Origin State, you cannot compare something within its market (e.g. within the scope of its taxation rules) with something that lies outside it (i.e. outside the scope of those taxation rules) or within the scope of another Member State's market (e.g. within the scope of its choice of tax rules).

To the extent, however, that a Member State seeks to regulate products or producers that have accessed another Member State's market, there is an inevitable conflict between the market access effects of such regulation and the principle that differences in markets do not involve any market access breach even though those differences may have a market access effect.

This is particularly relevant in a tax context, where Member States exercise worldwide taxing rights over producers based in their territory and therefore tax the outcome of their production at home and abroad. Even though a Member State's internal market tax rules do not involve any nationality discrimination, can they nevertheless breach the market access principle on the basis that their effect is to impede movement between markets? In particular, can an Origin State (OR) impede access to a Host State's market (HR) by seeking to impose its tax rules on the outcome of an Origin State producer's production in another Member State (HR/OR)?[84]

In this respect, what matters is whether the effect of the Origin State measure is to disadvantage the product or producer or subject it to a higher effective tax burden *in the Origin State's market*, not whether there is a difference in treatment as such. The product or producer may be dealt with differently because it is in another market rather than with a view to discouraging it to go to another market.[85] In considering whether the effect of a measure is to impede market access in a relevant way, the measure has to be judged by reference to how the product or producer is dealt with State's market. Has the Member State provided a level playing field and is it running the game on an even-handed basis according to rules that it has devised. The matter is not judged by reference to whether there is a level playing field and a single set of rules across the Community.

4.6 The exercise of extra-territorial jurisdiction and market access

It is possible from this analysis to see why market access is more of an issue for Origin States in dealing with producers rather than with products. Once a product has been exported it leaves the jurisdiction of the Origin State, which has no further concerned with it. It becomes a matter for the internal market rules of the Host State.

A producer, however, may remain within the Origin State while serving the markets of other States. The Origin State may then have to deal differently with producer's activities in another market. That difference in treatment serves to identify particular measures with a cross-border of Community element. Community law has no competence if the Origin State does not seek to exercise any taxing rights over it. Community competence is engaged, however, if the State taxes the producer in both markets but the relevant question for market access is whether the difference in treatment has the effect of discouraging the producer from accessing the foreign market. This will only be the case if the difference in treatm ent reflects a difference in the effective tax burden in the Origin

[84] See the diagram in Section 2.6.
[85] In particular, some differences may be anticipated in the administrative compliance burdens that are imposed. These must, however, be apt to deal with the issue and not go beyond what is necessary, see case C-250/95 *Futura*.

State rather than what amounts to the creation of a level playing field between producers who stay at home and those that go abroad.

This means that there is no automatic breach of the market access principle by an Origin State just because a product or producer has gone to another market. Having accessed another market, the relevant question is whether the Origin State subjects the product or the producer to a higher effective tax burden *at home* because it has gone abroad.[86] The fact that Origin State regulation according to its home rules places the producer at a disadvantage in the market of other Member States is not a breach of the market access principle but a reflection of the different markets in the Community.

4.6 The extension of market access to non-discriminatory rules

I have defined the market access principle in the direct tax field according to whether particular measures impose a higher effective tax burden on a producer in respect of his foreign production. It seems unlikely that a State can ever justify a breach of the market access principle that can be expressed in those terms.
The market access principle, however, can encompass any difference in treatment that leads to a disadvantage or additional burden as a result of accessing other markets within the Community. Where a difference in treatment does not involve an additional tax burden as such but, for example, involves higher compliance or administrative burdens, those differences may be justified if they reflect a real difference in situation between domestic and foreign production arising from factors other than just the fact of being at home or abroad.

Because origin and nationality are not the essence of the market access principle but movement between markets is, there can be measures that impede that movement that nevertheless apply to products and producers generally, and are not dependent either upon origin and nationality or upon differences in markets as such. There may be measures that impede movement between markets notwithstanding that the measures apply to all products or producers irrespective of origin or nationality. If the effect of the measure is to constrain the exercise of particular freedoms – to sell goods or to supply labour, services or capital – within Community markets generally, it may involve a market access breach.

In other words, the measure in question functions to impede the free movement of the particular product or producer anywhere within the Community in circumstances in which such a general constraint on the exercise of a fundamental freedom guaranteed by the Treaty cannot be justified.[87]

The *Daily Mail and General Trust* case[88] can be used to illustrate this wider ranging application of the market access principle in the direct taxation field. As the Court noted, Daily Mail could have re-located its primary establishment to The Netherlands by going into liquidation and transferring its assets to a new Dutch company. Daily Mail did not choose that option because it would have created the very tax liabilities it was seeking to avoid. Those tax liabilities, however, were the UK's internal market rules of general application to any liquidation.[89] Could Daily Mail nevertheless have argued that the imposition of a general tax charge on liquidations would have the effect of impeding market access? In my view, such an argument would not succeed.[90]

4.7 Dual regulation within the single market

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[86] Thus, there is no disadvantage to being unable to deduct the losses of foreign subsidiaries over which an Origin State has never exercised any taxing powers. The subsidiary is a producer of another State. The Origin State only ever exercises taxing powers over its parent in its capacity as a shareholder rather than as the person conducting the activities that give rise to the losses, see *Marks & Spencer* v *Halsey*, *supra* footnote 4, at pages 97 – 99, paragraphs 101 – 106. As the UK National Reporter for the IFA Vienna Congress 2004 has pointed out, the parent company's disadvantage cannot stem from the UK taxation of foreign dividends with credit because UK subsidiary's dividends are exempt from tax. The exemption of foreign dividends (which under current litigation is being claimed by certain other UK taxpayers) would therefore not dispose of the issue of deducting foreign losses. The simple answer, as the Commissioners decided, is that Community law does not require the UK to give relief for the losses.
[87] See Case C-415/93 *Bosman*. The distinguishing feature of this case was the Community application of the rule. Thus UEFA argued that the dispute concerned a purely internal Belgian situation but the Court concluded that it was impossible to view the matter as a purely internal one. Given the freedom of States over their choice of taxing jurisdiction, it is difficult to envisage a similar tax situation to the one that concerned the Court in *Bosman*.
[88] Case 81/87 *Daily Mail*.
[89] In fact, this is not correct within a group of companies where assets may be transferred without immediate tax charge provided they are transferred to a group company within the UK tax charge. Daily Mail would presumably argue today that the Treaty freedoms allow a transfer to a Dutch group company without immediate tax charge.
[90] And did not succeed in *R (on the application of Professional Contractors Group)* v *IRC* [2001] EWCA Civ 1945, [2002] STC 165. In that case, taxpayers argued unsuccessfully that non-discriminatory tax rules applying to services rendered by individuals using personal service companies had the effect if impeding access to the UK's market by foreign contractors.

The single market envisaged by the Treaty is a Community within which each Member State must maintain a level playing field within its jurisdiction. Twenty-five level playing fields, however, do not necessarily create a single level playing field across the Community, save as Member States choose to create such a Community playing field through legislative acts under the Treaty. Member States may therefore choose different internal market rules to regulate their own market.

This does not completely answer the question whether one Member State must defer to another in cases in which each seeks to apply its rules to the same product or producer, i.e. in cases of dual regulation. In this respect direct taxation is an obvious example of permitted self-regulation, where the jurisdiction and power to tax is within the exclusive competence of Member States, and one in which dual regulation (i.e. double taxation) regularly arises given the extra-territorial application of the Origin State's internal market rules.

A football analogy is particularly apt, given the case law, to illustrate the issues of dual regulation. The natural advantage of playing at home is not an aspect of nationality discrimination. The host pitch and its facilities may be better or worse than those available to the visiting team in its State but that does not matter. Provided the host pitch is not tilted against the visiting team or the home team's goal posts more narrowly spaced, there will be no nationality discrimination. From the home country's perspective, the natural disadvantage of playing away from home on an unfamiliar pitch is not an issue of market access.

But what if the game is played in each State with different equipment, to different standards and according to different rules? Here it is not just the different conditions of the two markets within which the game is played but a matter of the terms on which and standards to which the game is played in each market.

If each State retains competence to set its own rules, a visiting team has no option to play according to the home State's rules, provided those rules apply equally to both home and visiting teams. In that case there is no nationality discrimination and if the home State's competence to set the rules of the game when played on its pitch is to have any meaning, there is nothing in Community law to force it to adopt any less stringent rules used elsewhere. There is no automatic breach of the market access principle by a home State because its rules are *less favourable* than those to which the visiting team is subject in its State of origin, even if that deters visiting teams coming to play. What the home State cannot do is to prevent its own players leaving to play abroad under the less stringent rules that apply there.

But what if the visiting team's equipment meets the standards set by the Origin State but not the standards set by the Host State? Can the Host State insist that the visiting team's equipment should meet whatever standards it sets? Again, if to play the game both teams must have the same equipment manufactured to the same Host State standards, there is no nationality discrimination. On the other hand, if the Host State can apply its own standards to the visiting team's equipment that will raise market access issues if it means that the equipment must comply with the standards set by both Host and Origin States.

In this case, the issue is not whether the Host State's standards are more or less favourable than the Origin State's standards. It is the fact of *dual regulation* as compared to *single regulation* that matters, not the relative burden of each set of regulations when you compare one with the other. Dual regulation is capable of being presented as an issue for either the market access principle or the nationality non-discrimination principle. From one perspective dual regulation may impede the movement of products and producers between markets. From another perspective, the Host State's decision to impose its own regulation on products or producers that originate in another Member State imposes an additional burden on those products or producers as compared with Host State products and producers that need only comply with Host State rules.

Dual regulation is, however, an issue of market access not of nationality discrimination. If the *fact* of dual regulation (as contrasted with the *content* of the Host State's regulations) amounted to nationality discrimination, Host State rules would always have to defer to Origin State rules. The Host State would have to justify its internal market rules in every case in which Member States retained competence to act. It is apparent, however, that dual regulation is a market access issue because it can be expressed from the perspective of either Origin or Host State. It is also clear that it is not every occasion of dual regulation that involves a breach of the market access principle.

If every occasion of dual regulation were a potential breach, one State or another would always have to justify its measures. In essence, Member States' competence in matters would be limited to regulating products and producers within their domestic market. In other words, the Treaty would deny Member States the right to any extra-territorial jurisdiction, at least where the exercise of extra-territorial jurisdiction extended to the market of another Member State, except to the extent that the Origin State could justify the exercise of an extra-territorial jurisdiction.

The Court's case law does not go so far as to strike down every case of dual regulation that cannot be justified. In the direct tax field in particular the Court has never questioned the competence of an Origin State to impose worldwide taxation on its producers. Furthermore, as Article 293 indicates, the elimination of double taxation is a matter for agreement between Member States and not a matter of Community law.[91]

The issue in cases of dual regulation is whether dual regulation in the circumstances impedes market access or whether it represents a distortion in the Community single market that only Member States collectively can correct by legislative action. Accordingly, what determines the cases of dual regulation that impede market access and, in those cases, which State – Origin or Host – must justify its measures or defer to the rules imposed by another State? The starting point in answering this question is the Treaty provisions on the free movement of goods and the Court's case law on this subject.

SECTION 5: THE SCOPE OF *DASSONVILLE* IN DIRECTION TAXATION

5.1 The Treaty Articles dealing with Goods

The removal of customs duties or other taxes levied at national borders on goods and the removal of measures having equivalent effect are the least that is required in any move towards a single market. The Treaty Articles dealing with the freedom of movement of goods are therefore the most detailed in terms of setting out the fundamental requirements of the Treaty in respect of the free movement of goods and what the market access principle envisages for each Member State.

What these Articles require is the removal of such measures at national borders – so that goods may move freely between markets. As such they do not demand uniformity of markets, save in so far as the Member States choose to adopt a common system. Article 23 provides for the adoption of a common customs tariff with third countries, so eliminating the competition for third country imports that would otherwise exist between Member States as the cheapest point of entry to the single market. Beyond that, however, the positive integration of the single market for goods requires the adoption of specific legislative measures, in the case of indirect taxes, under Articles 93.

The focus of the free movement of goods provisions of the Treaty is therefore primarily on the rules that regulate the basis upon which goods enter the Community and cross national borders within the Community. As such the Articles address both fiscal and other measures and deal with Origin State export rules and Host State import rules. Thus, Article 25 prohibits the imposition of customs duties on imports and exports and charges having equivalent effect. Articles 28 and 29 prohibit quantitative restrictions on imports and exports and all measures having equivalent effect.

Articles 28 and 29 recognise that import and export quotas operate in the same way to restrict movement between markets. In applying these Articles, however, the Court has had to address two particular questions —
(1) What are "measures having equivalent effect" to quotas?
(2) If markets are not uniform, when (if at all) do differences in Member States' markets impede the free movement of goods between different markets?

5.2 The Dassonville formulation

In *Dassonville*,[92] the Court formulated its test of equivalent measures in these terms—
"All trading rules enacted by Member States which are capable of hindering, directly or indirectly, actually or potentially, intra-Community trade are to be considered as measures having an effect equivalent to quantitative restrictions."

This formulation suggests that every Member State is bound to allow market operators an unfettered freedom to trade within its market. In other words, it impinges on a Member State's freedom to define its own market – the size and shape of its pitch and the rules according to which the game is played, rather than just whether players from other Member States can come onto the pitch and play according to local rules.

As we have seen, a Member State cannot determine the size, shape or layout of its pitch or devise its rules so as to favour the home side, whether overtly or covertly. An unlimited application of the *Dassonville* formulation, however, could place an absolute limitation on the ability of a Member State to define its internal market rules even if it did so even-handedly. The offside rule might not be allowed, for example, on the basis that it limited the freedom to play the game in a particular way even though the rule applied without distinction to home and visiting teams.

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[91] Article 293 does not have direct effect to enable taxpayers to rely upon it, see Case C-336/96 *Gilly*.
[92] Case 8/74 *Dassonville* [1974] ECR 837 paragraph 5.

The *Dassonville* formulation could also suggest that if markets are not uniform, any difference in market rules can impede the free movement of goods between them. Thus, if a visiting team used a different version of the offside rule at home, it might demand to play the game with its version of the offside rule. Alternatively, if a visiting team played the game at home with a ball of different weight, size and shape to that used in the Host State, could it demand to use its ball rather than one supplied by the home team?

The offside rule and size of football are good illustrations of where the Court should not go. Allowing a visiting team to use its offside rule or its football goes beyond allowing the visiting team the right to compete in the Host State but imposes the rules chosen by the Origin State on the Host State. The home team is forced to play at home on the visiting team's terms.

5.3 "Certain selling arrangements"

Accordingly, the Court revisited its *Dassonville* formulation in *Keck* to exclude "certain selling arrangements" – the rules of the game – from the scope of measures having equivalent effect to quantitative restrictions. It said [93]—

> "By contrast, contrary to what has previously been decided, the application to products from other Member States of national provisions restricting or prohibiting certain selling arrangements is not such as to hinder directly or indirectly, actually or potentially, trade between Member States within the meaning of the *Dassonville* judgment (Case 8/74 [1974] ECR 837), so long as those provisions apply to all relevant traders operating within the national territory and so long as they affect in the same manner, in law and in fact, the marketing of domestic products and of those from other Member States."

But what if the Host State measure does not relate to the rules of the game but to the equipment that the teams use to play it? Thus, the Origin State allows its teams to play the game using boots with a particular type of spikes that are banned in the Host State. Must the visiting team use Host State boots or may it play the game using its usual boots? In this case the effect of allowing the visiting team to use its usual boots does not impose Origin State rules on the home team. The Host State remains free to decide what rules it should apply to its team. If as a result its home team suffers a disadvantage in competing against visiting teams that is no more than a reflection of the competition that the Community requires.

The Court in *Cassis de Dijon* answered this issue against the Host State. It said [94]—

> "In the absence of common rules relating to the production and marketing of alcohol … it is for the Member States to regulate all matters relating to the production and marketing of alcohol and alcoholic beverages on their own territory. Obstacles to movement within the Community resulting from disparities between national laws relating to the marketing of the products in question must be accepted in so far as those provisions may be recognised as being necessary in order to satisfy mandatory requirements relating in particular to the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defence of the consumer."

In other words, the Host State must be able to justify why it requires a visiting team to use boots of its specification rather than those permitted in the Origin State.

In *Keck*, the Court reaffirmed its conclusion in Cassis de Dijon. It said[95]—

> "It is established by the case-law beginning with 'Cassis de Dijon' (Case 120/78 *Rewe-Zentral* v *Bundesmonopolverwaltung fur Branntwein* [1979] ECR 649) that, in the absence of harmonisation of legislation, obstacles to free movement of goods which are the consequence of applying, to goods coming from other Member States where they are lawfully manufactured and marketed, rules that lay down requirements to be met by such goods (such as those relating to designation, form, size, weight, composition, presentation, labelling, packaging) constitute measures of equivalent effect prohibited by Article [28]. This is so even if those rules apply without distinction to all products unless their application can be justified by a public-interest objective taking precedence over the free movements of goods.

The focus, therefore, is on rules that define and regulate the goods that are to be sold (their quantity, how they are packaged, etc) rather than those that define and regulate the market within which they are sold (how the goods can be advertised, when and where they can be sold, etc), subject always to the requirement that both goods and

[93] Joined Cases C-267/91 and C-268/91 *Keck and Mithouard* [1993] ECR I-6097 paragraph 16.
[94] Case 120/78 *Rewe-Zentral* v *Bundesmonopolverwaltung fur Branntwein* [1979] ECR 649 at paragraph 8.
[95] *Supra* paragraph 15

market must always be defined and regulated so as not to provide any advantage to domestically produced goods or producers.

5.4 The scope of Dassonville in direct taxation matters

The key words used by the Court in *Keck* are, "*goods coming from other Member States where they are lawfully manufactured and marketed*". This reflects the provisions of Article 23(2) [96] and Article 24 [97] of the Treaty, allowing goods to move freely within the internal market once they are in free circulation. In other words the principle established by the Treaty in the case of goods is that once they are in free circulation in any Member State, another Member State may not impede their access to its market by imposing additional requirements with which those goods must comply if they are to enter the Host State's market to compete with local goods.[98]

The question is whether a similar principle to "free circulation" can apply to the free movement of products and producers other than goods and, if so, whether the "free circulation principle" can extend into the direct tax field. The outcome of such an application might then be that Origin States may have to defer to Host State tax rules or *vice versa*.

The preference given to Origin State regulation of goods – so that any Host State attempt to set its own rules regulating those goods will give rise to a market access breach unless the attempt can be justified in the national interest – flows naturally from the principle of free circulation for goods as contemplated by the Treaty. Once goods have entered and are in free circulation in any market within the Community, anything that impedes their ability to move to another market is a potential breach.

This presumption in favour of single State regulation – whether by Origin or Host State – does not necessarily exist for other factors and producers. To the extent that the Court has moved in that direction in terms of the freedom of movement of natural persons,[99] this movement is not reflected in the case law in direct taxation matters. That case law, after allowing for the particular extra-territorial application of direct taxation, falls firmly within the Court's established principles relating to market access and nationality non-discrimination as expressed by the Court in *Keck*.

Indeed, for the Court to move towards a broader *Dassonville* formulation of market access in the direct taxation field would imply a departure from the language of virtually every tax case to date, involving in particular the Court's description of where the boundaries lie between Community and Member State competence in direct taxation, its acceptance of the Member States' right of worldwide taxation its reference to the source principle, and its acceptance that taxpayers subject to limited taxation (by reference to source) are not immediately comparable to those who are subject to worldwide taxation.

In the absence of agreement among Member States on common tax rules, it is likely that taxpayers will continue to press the Court to extend its case law towards an unrestricted application of the *Dassonville* formulation. Given that Member States; national tax systems are based on their ability to recognise national tax boundaries and to differentiate in the taxation of what is at home and what is abroad, the Court in fact has little need to extend its case law further for it to impose significant change on national tax systems.

As I have noted previously,[100] to the extent that Member States wish to exercise an extra-territorial taxing jurisdiction the Treaty freedoms in effect require them to accord domestic tax treatment under their tax systems to products and producers throughout the Community over which they exercise that jurisdiction. What Community law cannot do, in the Court's current formulation, is to require them to extend their taxing jurisdiction further than they choose.

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[96] "The provisions of Article 25 and of Chapter 2 of this Title shall apply to products originating in Member States and to products coming from third countries which are in free circulation in Member States."

[97] "Products coming from a third country shall be considered to be in free circulation in a member State if the import formalities have been complied with and any customs duties or charges having equivalent effect which are payable have been levied in that Member State, and if they have not benefited from a total or partial drawback of such charges or duties."

[98] There are interesting comparisons to be made in the application of this principle relating to the free circulation of goods to the rules that protect intellectual property rights under Member States' national laws.

[99] See e.g. Case C-76/90 *Säger* [1991] ECR I-4221; Case C-19/92 *Kraus* [1993] ECR I-1663; Case C-55/94 *Gebhard* [1995] ECR I-4165; Case C-415/93 *Bosman* [1995] ECR I-4921; Case C-60/00 *Carpenter* [2002] ECR I-6279;

[100] Gammie, *The role of the European Court of Justice in the development of direct taxation in the European Union*, IBFD Bulletin [2003] Volume 57 Number 3 pages 86 – 98.

SECTION 6 – THE ANSWERS TO THE QUESTIONS 4 AND 5

I shall answer these questions in reverse order.

6.1 The use of qualified majority voting (QMV) in tax matters

Would in your opinion a wider application of qualified majority voting in tax matters help in establishing a balance between the fully integrated market and the legitimate fiscal interests of the Member States?

By definition it should be easier to obtain agreement on common tax measures with QMV than it is to obtain unanimous agreement. Discussion of QMV, however, merely masks the true nature of the problem. The Treaty requires unanimity for VAT measures and yet a great deal more progress has been made in establishing common VAT rules than has been made in the direct tax field.

Indeed, the unilateral adoption of general consumption taxes by States across the world over a relative few years illustrates that one hardly needs a system of agreement (by QMV or otherwise) in the VAT field. The reality is that most people have a clear view of the basic elements of such general consumption taxes. The areas of difficult and disagreement are on the periphery of such taxes rather than at their heart. The same can be said for taxes on earnings (in the form of income and social security taxes).

Taxes on general consumption (VAT/GST) and taxes on earnings form the bulk of tax revenues for most developed countries. The simple reason for this is that such taxes reflect less mobile factors (i.e. they have a territorial base); they depend upon easily identified and readily valued cash transactions; they are broadly neutral in their effects; and their administration has been greatly assisted by advances in computer technology.

None of these things are true of taxes on capital, including company taxes. There is no common understanding of the tax base, which is why there are 25 versions of the company tax within the single market alone; taxes on capital are not based on cash transactions (or indeed on transactions at all) but depend significantly on judgement and valuation, for which computer technology is of little assistance; taxes on capital are not neutral in their effects; and, finally, capital is a highly mobile tax base, which means that it can be difficult to identify the tax base with any particular territory and when identified it can often more elsewhere to secure lower taxation.

Accordingly, agreement is difficult where taxes raise difficult issues. Difficult issues are central to taxes on capital and company taxes and hence agreement is difficult, with or without QMV.

6.2 The need for agreement or co-ordination in direct taxation

Do you think that it would make a difference in the application of the basic economic freedoms by the ECJ if the European legislature would be more successful in establishing European tax rules or if the national legislatures would respond to the challenge by the ECJ in a more coordinated way?

Where several States seek to tax the same factors, or factors that can easily move between different taxing jurisdictions, they are likely to be relatively unsuccessful in their attempts to raise significant tax revenues based on those factors. As noted above, general consumption taxes and taxes on earnings reflect the less mobile and more easily identified parts of Member State's tax bases, certainly in comparison with taxes on capital and company taxes. In the face of those problems, there are really only two satisfactory solutions – to agree on common measures or to rely for your tax revenues on other, less mobile and more territorially-based taxes.

There is no reason to think that agreement on common measures would cause the Court to modify its approach to the Treaty freedoms. As I have outlined in this paper, the parameters and application of those principles are fairly well established by the Court and I would expect the Court to continue to develop them to reflect changes in the EC Treaty and, eventually, the adoption of a European Constitution.

The main impact, however, of an agreement on common European tax rules or more co-ordinated action by Member States – assuming they are satisfactory and in basic accord with the Treaty freedoms – is likely to be a reduction in the number of tax cases being referred to the Court. It is the failure by Member States to agree in the past that has driven taxpayers increasingly to challenge the tax rules adopted by Member States. That is unlikely to stop, and the pressure on Member States created by the Court's decisions is unlikely to diminish.