# THE CURRENT STATE OF DIRECT TAX HARMONISATION IN THE EUROPEAN UNION

## Introduction

This chapter examines the current state of harmonisation of direct taxes in the European Union (n1) as at August 1999. In Community-speak, this chapter attempts to provide a statement of the *acquis communautaire* on direct taxation as at that date. The chapter considers both the legislative measures that have been adopted so far, the jurisprudence of the European Court of Justice ("ECJ") on direct taxation and further measures currently under consideration.

One point of terminology may be made at the outset. The chapter title refers to tax harmonisation, but the term that it coming into more popular current usage is that of "co-ordination of tax policy" (n2). In general, the term "co-ordination" is intended to imply the guidance of Member States towards the acceptance of a mutually beneficial policy rather than any element of imposition of tax measures from the Commission. Whatever the political dimensions of this change in terminology, certain of the direct tax measures already adopted have been enacted under a provision for harmonisation of laws, and the jurisprudence of the ECJ on direct taxation may be regarded as harmonisation through the back door. This chapter therefore retains the title of harmonisation.

## The Legal Bases for Harmonisation of Direct Taxes in the EU

There is no specific reference to the harmonisation of direct taxes in any of the treaties establishing the European Union. In fact, the only reference to direct taxation in the Treaty of Rome was Article 220 (now Article 293 (n3)) which provides:

> "Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals:
>
> …
>
> - the abolition of double taxation within the Community; …"

The Arbitration Convention (n4) has been adopted on the basis of this Article. The ECJ has recently held that Article 293 is not intended to lay down a legal rule directly applicable, but merely defines topics on which the Member States are to enter into negotiations with each other "so far as is necessary" (n5).

The position with regard to direct taxation may be contrasted with that of turnover taxes, excise duties and other forms of indirect taxation where Article 93 (formerly Article 99) requires the Council to adopt provisions for the harmonisation of legislation concerning these taxes.

The absence of a specific provision in the Treaty of Rome relating to the harmonisation of direct taxes is undoubtedly one of the reasons why so little has been achieved on the legislative front with regard to direct tax harmonisation.

In the absence of a specific warrant for harmonisation, measures relating to direct taxes have generally been adopted under Article 94 (formerly Article 100) on the approximation of laws. This Article provides that the Council, acting unanimously on a proposal from the Commission (and after consulting the Parliament and the Economic and Social Committee) may issue directives for the approximation of laws. Article 94 requires the unanimous agreement of the Council. This may be contrasted with Article 95 (formerly Article 100a) which provides for measures on the approximation of laws to be adopted by qualified majority voting. Article 95(2) states that the provision of qualified majority voting "shall not apply to fiscal provisions". This is the basis for the requirement of unanimity on fiscal matters.

Turning from the bases in the treaties for harmonisation of direct taxation to the role of the ECJ, the Court has now repeated on several occasions the following mantra:

> "Although direct taxation is a matter for the Member States, they must nevertheless exercise their direct taxation powers consistently with Community Law" (n6).

The principles of Community Law that are most generally relevant in the field of direct taxation are, first, the freedoms set out in Title III of the Treaty - free movement of workers (Article 39, formerly 48), freedom of establishment (Article 43, formerly 52), freedom to provide services (Article 49, formerly 59) and free movement of capital (Article 56, formerly 73b). Also relevant - though displaced where there is a more specific provision of the Treaty - is the general prohibition of discrimination on grounds of nationality in Article 12 (formerly Article 6). Within the general principles of Community Law, it is interesting to note that Article 6 (formerly Article F) of the Treaty on European Union provides that the Union shall respect fundamental rights as guaranteed by the European Convention on Human Rights as general principles of

Community Law. The ECJ has at times had regard to provisions of the European Convention on Human Rights when determining the scope of Community Law (n7). These fundamental human rights whose observance the Court has a duty to ensure include: the right not to be discriminated on grounds of sex; and that any administrative decisions should be non-discriminatory, should be justified by some imperative requirement in the general interest, must be suitable for securing the objective pursued and must not go beyond what is necessary to attain that objective (n8).

There is one further group of provisions of the Treaty of Rome under which direct tax measures may come up for consideration before the Commission (and, on an appeal or a reference, the Court). These are the State Aid provisions of Articles 87 and 88 (formerly Articles 92 and 93). Article 87(1) prohibits any aid granted by a Member State or through State resources which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods. The State Aid provisions impose an obligation of prior notification of any potential State Aid. The Commission may also take a State which does not abolish or alter a State Aid direct to the ECJ. Direct tax measures may fall within the scope of the State Aid provisions (n9).

## Legislative Provisions Adopted So Far

Largely for the reasons explained above, there have been few legislative measures adopted in the field of direct taxation.

The earliest measure was the Mutual Assistance Directive (n10) which contains extensive provisions for the exchange of information between Member States for the purposes of making correct assessments of taxes on income and capital. This Directive makes provision for a broader exchange of information than is generally provided for under the exchange of information Article of a bilateral double taxation convention. This broader exchange of information was implemented in UK tax law by FA 1977, s77 and FA 1990, s125.

The Mutual Assistance Directive was preceded by a Council Resolution on international tax evasion and avoidance (n11). That resolution emphasised the exchange of information as a means of combating international tax avoidance and evasion.

Two legislative measures contain some matters which have a relevance to direct taxation. The first is the EEIG Regulation (n12) which provides in Article 40 that the profit or losses from the activities of an economic grouping are taxable only in the hands of the members. The second is the Capital Movements Directive (n13) which provides a classification for capital movements subject to the freedom of movement of capital now found in Article 56 of the Treaty.

### The July 1990 Package

The main legislative achievements of the Community in the field of direct taxation came together as a package in July of 1990. This package contained two Directives and a Convention: the Mergers Directive, Parent-Subsidiary Directive, and the Arbitration Convention.

The Mergers Directive (n14) applies to four types of corporate reorganisations - mergers, divisions, transfers of assets and exchanges of shares - (not all of which are possible under the existing corporate laws of all Member States). Where the reorganisation, as defined in the Directive, is possible, the Directive contains rules designed primarily to defer the realisation of chargeable gains on the reorganisation. Insofar as it was necessary to do so, the provisions of the Mergers Directive were implemented in UK domestic law by provisions contained in the F (No.2) A 1992 (n15).

The Parent-Subsidiary Directive (n16) requires that no withholding tax should be imposed on payments of dividends from a subsidiary to its parent where both companies are resident in different Member States: little needed to be done to implement this Directive in UK tax law (n17).

Both the Mergers Directive and the Parent-Subsidiary Directive were adopted under the provisions of Article 94 (formerly Article 100) of the Treaty.

The Arbitration Convention (n18) was adopted under the authority of Article 293 (formerly Article 220) and provides a procedure for the resolution of transfer pricing disputes through a system of ultimately binding arbitration. The Convention contains, in Article 4, a basic, arm's length transfer pricing rule modelled on Article 9 of the OECD Model. The Arbitration Convention was implemented in UK tax law by TA 1988, s815B (n19).

The Arbitration Convention was originally concluded for a period of five years. However, by a Protocol on 25th May 1999 the Convention was amended to provide for automatic renewal for periods of five years at a time unless any Member State informs the Council of its objection to the continuation of the Convention (n20).

The two Directives and the Convention of July 1990 represent - along with the Mutual Assistance Directive - the only significant legislative contributions of the EU to tax harmonisation to date.

There have been two Commission Recommendations in the field of direct taxation prior to the current round of proposals for new directives (which is discussed below). These are the Commission Recommendation on the income of non-residents (n21) (which was the first measure adopted dealing specifically with the direct taxation of individuals), and the Recommendation on small and medium-sized enterprises (SMEs) (n22) which provides a justification for special tax provisions relating to SMEs.

The conclusions of the ECOFIN Council and the proposals for further directives are discussed under the heading of "Current Proposals" below.

## The Jurisprudence of the European Court of Justice on Direct Taxation

While the legislative interventions in the field of direct taxation have been few, there is a growing jurisprudence of the ECJ on direct taxation, some of the cases having a potentially very wide impact (n23).

Most direct tax cases have come to the ECJ under Article 234 (formerly Article 177) through the route of a reference for a preliminary ruling from a court in a Member State faced with resolving a tax dispute. A small number of cases have come to the ECJ in the form of infringement proceedings brought by the Commission under Article 226 (formerly Article 169). The challenge to the tax provision in issue has generally been based upon one of the fundamental freedoms of the Treaty.

The case law so far is analysed below under the sub-headings: cases relevant to the taxation of individuals, and cases relevant to the taxation of enterprises. By way of introduction to this case law, however, it may be helpful to summarise the current state of the ECJ jurisprudence in direct tax matters.

**Summary of the jurisprudence of the ECJ**

At present, the competence in direct taxation rests with the Member States, but they must exercise that competence consistently with the treaties and the general principles of EC law. The treaties and principles contain a prohibition on grounds of nationality which applies not only to direct discrimination but also to indirect discrimination on grounds other than nationality through national measures which make the exercise of Community law rights by non-nationals more difficult. In general, non-residents are more likely to be non-nationals, so discrimination on grounds of residence may constitute indirect discrimination on grounds of nationality. Pausing here, one can see a clash developing between the line which the ECJ has followed and the long established principle of international tax law that different rules should apply to residents and non-residents.

The ECJ has defined discrimination as the application of different rules to the same situation, or the application of the same rules to different situations. The Court has shown, particularly in some recent cases, the necessity of analysing carefully the situations of residents and non-residents to see if they are really in the same situation.

Discrimination may sometimes be justifiable, but on narrow grounds. Many of the tax cases have turned on whether or not a discriminatory provision might be justified. The grounds of justification vary. If there is direct discrimination contrary to the freedom of establishment in Article 43, recent cases have held that this may only be justified within the narrow grounds contained in Article 46 (public policy, public security or public health). On the other hand, if the legislation on its face is indistinctly applicable, discrimination may be justified provided that the legislation pursues a legitimate aim, that the restriction is reasonable, and that the restriction is no greater than that necessary to achieve a legitimate objective (the test of proportionality).

In tax matters, some grounds of justification have been accepted by the ECJ while others have been rejected. The concept of "cohesion" of the tax system was originally accepted by the ECJ, but recent cases suggest that cohesion will seldom be accepted unless there is a direct link between the discrimination and another tax measure which justifies the discrimination. Safeguarding of a State's tax revenue is never accepted as a justification. The difficulty of finding out information about non-residents is not accepted: the Court has frequently referred to the Mutual Assistance Directive as a basis for finding out information about residents of other Member States.

The prevention of tax avoidance may be a valid justification, though recent cases have indicated that this only applies where highly artificial schemes are involved.

The fact that there is no EU harmonisation on an aspect of direct taxation is not a justification for discriminatory measures. Nor is it justification generally to refer to the fact that a matter is regulated by a double taxation convention, though a double taxation convention may be relevant, for example, in defeating an argument based on cohesion.

Finally, it is not a justification for the Member State to show that the discriminatory treatment is counterbalanced by a countervailing advantage otherwise available to the person who is discriminated against.

As examination of the case law will show, attempts by Revenue authorities to justify discriminatory tax provisions have generally failed.

## The Principal Cases Relevant to the Taxation of Individuals

It is interesting to note that no legislative provisions have been adopted so far that relate directly to the taxation of individuals. Perhaps because of this lack of legislative development, a number of cases have been brought to the ECJ concerning the taxation of individuals. Most of these cases have been brought under Article 39 (formerly 48) on the free movement of workers or under Article 43 (formerly 52) on the freedom of establishment in the case of self-employed individuals.

The earliest case that one could put into this category was the case of *Biehl* which was brought under Article 39 on the free movement of workers. Biehl was a German national resident and working in Luxembourg from 1973 to 1983. In 1983 he returned to Germany midway through the tax year. At the end of the year he discovered that his employer had deducted too much tax, and he claimed a repayment from the Luxembourg authorities. Under Luxembourg law, no repayment could be made to a non-resident. Biehl challenged the refusal of the repayment through the Belgian Courts, and the Conseil d'Etat referred the matter to the ECJ for a preliminary ruling under Article 234. The ECJ ruled that Community Law forbids not only overt discrimination on grounds of nationality but also covert discrimination, and that discrimination on grounds of residence is more likely to work against nationals of other Member States (n24). The Luxembourg authorities sought to justify the covert discrimination on grounds of protecting the system of progressive taxation: an individual who moved residence during the course of a tax year might be entitled to personal allowances in both States. The ECJ rejected this ground of justification by showing that an individual is not necessarily better off merely because he has moved during the year and had the possibility of two personal allowances (n25).

In *Bachmann*, a German national moved to work in Belgium in 1972. Before leaving Germany he took out a policy for sickness, invalidity and life insurance, and for a pension with a German company. When in Belgium he wished to deduct his contributions, but this was disallowed because contributions were only deductible if payable to a Belgian insurance company. The taxpayer challenged the disallowance of the deduction on grounds of infringement of Article 39 and also infringement of the freedom to supply services in Article 49. The Belgian Cour de Cassation referred a preliminary question to the ECJ which first determined that the restriction was discriminatory as it was more likely to affect non-nationals. However, the provision could be justified on grounds of cohesion of the tax system: Belgium only permitted a deduction of contributions paid to local insurance companies since it would not otherwise be able to tax payments under the policies to individuals who had once again become non-resident. The ECJ accepted this argument on the grounds of cohesion, as well as accepting that the same result could not have been achieved by less restrictive measures. This case is the high watermark of the justification of cohesion: it is an open question whether *Bachmann* would be similarly decided today.

Perhaps the most important case decided so far on the taxation of individuals was the case of *Schumacker* which was also brought under Article 39. A Belgian national lived in Belgium but worked in Germany and derived more than 90% of his income from that country. Germany applied the possibility of a "splitting tariff" to German residents but not to non-residents. The German Government argued that residents and non-residents were not in comparable circumstances so there could be no discrimination. The ECJ replied that, in relation to direct taxation, the situations of residents and non-residents are not, as a rule, comparable (n26); however, the situation is different where the non-resident obtains the major part of his taxable income from the state of employment (in this case Germany) since his situation is then comparable with that of a German resident (n27). There was, therefore, no objective difference between the situation of Schumacker and a German resident. The question that followed was whether there was any justification for this discrimination. An argument based on cohesion of the tax system was rejected as was an argument on the grounds of difficulties in obtaining information about non-residents (n28).

The *Schumacker* case implies that a Member State must treat a non-resident who earns the majority of his income in that State in the same way as a resident (n29). Part of the response of the Commission to this situation was the Commission Recommendation on the taxation of non-residents (n30).

The principle in the *Schumacker* case was applied by the Court in the case of *Asscher* which concerned a Dutch national who moved to live in Belgium but continued to work in the Netherlands and earned the majority of his income from the Netherlands. He was treated as a non-resident in the Netherlands and therefore subject to a higher rate of income tax, though without the obligation to pay social security contributions which fell upon residents. The discrimination was by the Netherlands against one of its own nationals but who was resident abroad. Nevertheless, the ECJ held that a Member State cannot set up barriers to its own nationals exercising the freedoms under the Treaty. The Court went on to hold that the discrimination could not be justified on the grounds that there was a countervailing advantage to a non-resident in not having to pay social security contributions, and that the cohesion of the tax system could not be a justification since there was no direct link between payment of the tax and the obtaining of any benefit.

The most recent case concerning the taxation of individuals is the case of *Gilly*. A couple lived in France where the husband, who was a French national, was a teacher. The wife had dual French and German nationality and taught in Germany. By operation of the France-Germany double taxation convention, her salary was taxable in Germany where it was subject to the rate of tax applicable to a single person without children.

Her salary was also included in the total income of the family subject to tax in France, but subject to a foreign tax credit for the German income: this was an ordinary credit and was less than the total tax payable in Germany. As a result, the income of Mr. and Mrs. Gilly was subject to a higher total tax than if they had been subject to tax in France alone. The ECJ concluded that the higher tax burden arose from the operation of the double taxation convention and that such a convention - based on provisions of the OECD Model - was not incompatible with provisions of the Treaty. Though the challenge in *Gilly* was unsuccessful, the case leaves open the possibility that certain provisions of double taxation conventions might be challenged on the grounds of incompatibility with Community Law.

## The Principal Relevant to the Taxation of Enterprises

Most cases on the taxation of enterprises have arisen under the freedom of establishment (Articles 43 and 48 especially) or under the freedom to provide services (Article 46) and, recently, under the free movement of capital (Article 56). The earliest case here - and the earliest direct tax case before the ECJ - was the *Avoir Fiscal* case. The avoir fiscal - the dividend tax credit - was granted by French law to French enterprises or French subsidiaries of foreign enterprises, but not to French branches of foreign enterprises. Foreign insurance companies complained of this treatment and the Commission brought infringement proceedings against France. The ECJ held that the freedom of establishment means that an enterprise may establish itself in another Member State in whatever form it chooses: to discriminate against an enterprise that establishes itself in the form of a branch would be contrary to Article 43. France sought to justify this difference in treatment on the grounds of the different circumstances of residents and non-residents: this was rejected on the grounds that France computes the taxation of branches in the same way as French enterprises. Finally, an attempt to justify the provision on the grounds of preventing tax evasion was also rejected.

In a number of subsequent cases, the ECJ has rejected purported justifications of discrimination against non-residents operating through branches. These include *Commerzbank* (the UK refusal to make repayment supplement available to non-residents), *Futura Participations* (losses could only be carried forward in a branch if separate accounts were maintained in Luxembourg: the requirement of maintaining separate accounts was covert discrimination and went beyond what was necessary to check the amount of the losses) and the recent *Royal Bank of Scotland* case (Greek banks were taxed at 35%, while branches of foreign banks were taxed at 40% - the ECJ held that there was no objective difference and there were no grounds for justification under the limited provisions of Article 46).

The ECJ has had to decide a small number of cases concerning reliefs for transactions within a group of companies. The first such case was *Halliburton* which concerned a German company transferring a Dutch permanent establishment to a Dutch, sister company. Dutch law provided for an exemption from transfer tax but only where all members of the group are Dutch companies. The ECJ considered that this was covert discrimination and an attempt to justify the rule on the grounds of the difficulty of obtaining information about non-residents was rejected by reference to the Mutual Assistance Directive (n31).

The most recent case concerning groups of companies was *Colmer* which concerned UK consortium relief. Though on the facts the final outcome was not to provide for consortium relief, the ECJ considered that a provision limited to companies resident in the United Kingdom infringed the freedom of establishment and could not be justified on grounds of cohesion or the prevention of tax avoidance - the prevention of tax avoidance only related to artificial tax avoidance schemes - or on grounds of protecting tax revenue (n32).

**Pending Cases**

At the time of writing, there are at least four significant cases pending for judgment before the European Court of Justice. In all these cases an Advocate-General's opinion has been published but not yet a judgment. In connection with the taxation of individuals, the case of *Gschwind v. Finanzamt Aachen-Aussenstadt* (n33) tests whether the German measures adopted to implement the decision of the Court in *Schumacker* were adequate.

With respect to the taxation of enterprises, unquestionably the most important case awaiting judgment is the case of *Compagnie de Saint-Gobain, Zweigniederlassung v. Finanzamt, Aachen-Innenstadt* (n34) which concerns a French company with a German branch. The German branch showed that if it had been a German subsidiary, it would have been subject to more advantageous tax treatment in three ways, including access to Germany's double taxation conventions. The Advocate-General in his Opinion agreed that this discrimination was contrary to Article 48. If the Court confirms the

Opinion of the Advocate-General, then there will have to be a reassessment of the application of double taxation conventions to branches.

A further case on the taxation of groups of companies is *X AB and Y AB* (n35) which concerns the Swedish rules that apply group treatment only to groups involving non-resident companies in a State with which Sweden has a double taxation convention. The companies concerned have argued that the reliefs should be available in all circumstances and not depend upon the existence of a double taxation convention with the other Member State involved.

Finally, there is an interesting case awaiting judgment in the case of *Eurowings* (n36) which concerns the denial of a deduction for rental payments made by a German company to a company established in the Shannon Airport Zone in Ireland.

### Conclusions on the Jurisprudence of the ECJ

Even from this brief survey of the existing jurisprudence of the Court it is clear that some of these judgments are of far-reaching impact. Whatever is agreed with regard to direct tax harmonisation (or co-ordination of direct tax policies if you will) at the political level, the ECJ is likely to continue to extend the application of the general principles of Community Law and the terms of the treaties to the direct tax field in cases brought to the Court either under references for a preliminary opinion or under infringement proceedings.

## State Aid

Direct tax provisions are subject to the general prohibition on unauthorised State Aids in Articles 87 to 89 (formerly Articles 92 to 94) of the Treaty.

The current position is well summarised in the Commission Notice on the application of the State aid rules to measures relating to direct taxation which was adopted by the Commission on the 11th November 1998 (n37).

**Broader Proposals for Direct Tax Harmonisation**

There has been no lack of reports and Commission documents considering broader proposals for direct tax harmonisation. The history starts with the Neumark Committee in 1962 (n38) through the van den Tempel Report of 1970 (n39) to the last major report on this issue - the Ruding Committee Report of 1992 (n40). The Commission responded to the Ruding Report in 1992 (n41) and no further steps have been taken to implement the recommendations of the Committee.

The current round of proposals for direct tax harmonisation owe their origin to the Commission Reflection Document "Taxation in the European Union" of 20th March 1996.

In April 1996 the ECOFIN Council established a High Level Group on tax policy. This led to the Commission Report "Taxation in the European Union: Report of the Development of Tax Systems" of 22nd October 1996 (n42) which in turn led to the establishment of a permanent group to co-ordinate tax policies within the European Union - the Taxation Policy Group (TPG).

On 1st October 1997 the Commission published a communication "Towards Tax Co-ordination in the European Union" (n43) which was discussed by ECOFIN and finally led to the communication from the Commission "A Package to Tackle Harmful Tax Competition in the European Union" (n44) of 5th November 1997.  This package was discussed at the ECOFIN Council meeting in December 1997, at which the conclusions concerning taxation policy were adopted.

**Proposals Under Current Consideration for Tax Harmonisation (or Co-ordination)**

The proposals currently under discussion for direct tax harmonisation start with the conclusions of the ECOFIN Council of 1st December 1997 concerning taxation policy (n45).  There are three principal measures outlined in those conclusions.

First, the preparation of a Directive on the taxation of savings income on the basis of the principles set out in Annex 2 to the conclusions.

Secondly, the preparation of a draft Directive on interest and royalty payments between associated companies.

Thirdly, the adoption of a Code of Conduct for Business Taxation set out in Annex 1 to the conclusions.

Each of these proposals is discussed in turn below.

The proposal for the Directive on the taxation of savings income adopts a "co-existence model".  Under that model, Member States would have a choice of either imposing a minimum withholding tax (possibly of 20%) on interest income paid to individuals resident in another Member State or, alternatively, to impose no withholding tax but to supply information about the beneficial owner of the interest to that individual's state of residence.

The Commission presented proposals for a draft Directive on the taxation of savings income on 20th May 1998 (n46). The proposal has proved to be highly controversial, particularly with regard to its application to Eurobonds and the involvement of non-Member States. At the time of writing, it appears that a compromise is being sought to exclude some or all Eurobonds. It is by no means certain that the proposal will eventually result in the adoption of a Directive.

The Commission also prepared a draft Directive on interest and royalty payments between associated companies which it submitted on 6th March 1998 (n47). This draft Directive provides for payments to be made of interest and royalties between associated companies without withholding tax. The proposal is generally uncontroversial, but, unfortunately, some Member States have indicated that they will not support the adoption of this Directive unless the Savings Income Directive is also adopted at the same time.

Before turning to the Code of Conduct on Business Taxation, it might be noted that one provision of the Code of Conduct required the Commission to prepare a Notice on the application of State Aid rules to measures relating to direct business taxation. This was adopted in November 1998 (n48).

**The Code of Conduct for Business Taxation**

The Code of Conduct for Business Taxation has as its goal the elimination of harmful tax competition within the Community. Its targets are measures which affect or may affect in a significant way the location of business activity in the Community and which provide for a significantly lower effective level of taxation than the level which generally applies in the Member State in question. Any such measures are regarded as potentially harmful: the measure then has to be assessed to determine whether it is actually harmful or not.

With respect to measures that are determined to be actually harmful, by adopting the Code Member States have undertaken a political (though not legally binding) commitment to "roll back" those measures within a period which should normally be completed within five years from 1st January 1998. In addition, Member States commit themselves to the policy of "standstill" under which they are not to introduce any new harmful tax measures within the context of the Code.

The Code of Conduct makes provision for a review process under which potentially harmful tax measures are to be assessed to determine whether or not they are harmful. To implement that process, a Code of Conduct Group was established by the Council on 9th March 1998 (n49) under the chairmanship of the then Economic Secretary to the Treasury, Dawn Primarolo. The Group is to complete its initial work by the end of this year.

The first annual report of the Code of Conduct Group was presented to the Council in November 1998 (n50) but said relatively little about the work of the Group. A second interim report was presented to the ECOFIN Council on 25th May 1999 but has not yet been published. The Minutes of the ECOFIN Council indicate that the Group has called for the preparation of short discussion papers on timing differences, small and medium-sized enterprises, shipping, small economies, and regional developments and that the Group is waiting for the result of two Commission studies - on administrative practices and on holding companies. The Group is to present its final report to the ECOFIN Council in November 1999.

A certain amount is known about the way that the Code of Conduct Group has gone about its business. An initial list of potentially harmful tax measures falling within the scope of the Code was prepared. This list contained 85 potentially harmful tax practices grouped under five headings: intra-group services, financial services and offshore companies, other sector-specific measures, regional incentives, and other measures. So far as the United Kingdom is concerned, five measures were originally placed on this list: the foreign income dividend scheme for international headquarter companies, special measures for the film industry, enterprise zones, 100% capital allowances for SMEs in Northern Ireland, special capital allowances for small and medium-sized businesses. In addition, two further measures were added: 40% first-year allowances for small and medium-sized businesses and independent investment managers (n51). Not surprisingly, the United Kingdom Government's assessment of these measures is that none of them is harmful.

The initial list of 85 measures for consideration by the Code of Conduct Group was prepared by self-assessment by each of the Member States identifying which of its own tax provisions might fall within the scope of the Code. In addition, the Dutch Ministry of Finance commissioned two independent reports to identify potentially harmful tax practices (n52). As a result of these reports, over a hundred further measures were added to the list for consideration by the Code of Conduct Group.

The Code of Conduct Group is expected to complete its review of these potentially harmful tax measures by November this year.

**Draft Directive on the Enforcement of Tax Debts**

There is one other proposal for a Directive relating to direct taxation which is currently on the table in the European Union. This is a proposal to extend the existing Directive on mutual assistance in the recovery of tax debts to cover most direct taxes (n53).

There has been a Directive in force since 1976 for mutual administrative assistance in the enforcement of tax claims. Initially, this Directive applied only to matters such as agricultural levies and Customs' duties but was extended to VAT in 1979. If adopted, the proposed amendment will extend this system to taxes on income and capital (defined as those to which the Mutual Assistance Directive applies. For the United Kingdom, these are: income tax, corporation tax, capital gains tax, petroleum revenue tax, and (insofar as it is still relevant) development land tax.

The proposal to amend the Directive on assistance in the recovery of tax claims has been endorsed by the Economic and Social Committee and by the European Parliament (which suggested certain amendments). The proposal is independent of the other proposals under discussion which arise out of the conclusions on taxation policy of December 1997. The only controversial issues that have arisen are whether the adoption of the amending Directive would require unanimity as a fiscal measure and whether the Directive has been given an inaccurate and inappropriate title.

## Concluding Remarks

More attention has been paid to issues of harmonisation and direct taxation in the EU during the last twelve months than perhaps at any time in the previous twenty. This has opened debate on whether or not harmonisation of direct taxes is desirable, and, if it is, what approaches should be adopted and what procedures should be followed to adopt those measures.

Even if the draft Directives on the taxation of saving income and on interest and royalty payments fail, other aspects of the work on EU tax harmonisation will continue. The Code of Conduct Group is to produce its report by November, though one would then have to wait to see how different Member States interpret the political obligation to adopt rollback. Meanwhile, judgments of the ECJ continue to appear on various matters relating to direct taxation. Whatever happens, the issue of direct taxation within the European Union will not disappear and practitioners will need to be aware of the on-going developments.

# NOTES

1. There is a technical difference between the European Union and the European Community which is quite difficult to express. In general, the European Union represents the interests and policies of the Member States with respect to the rest of the world, while the European Community represents the network of rules which have been adopted within the Member State to achieve the objectives established by the various treaties. In principle, therefore, matters concerning direct tax harmonisation ought to come under the heading of European Community Tax Law. However, there is some simplification if one refers to the territories of the Member States as the European Union.
2. See, for example, the evidence of Commissioner Mario Monti to the Select Committee on the European Communities (Sub-Committee A) of the House of Lords on the 13th May 1999 (15th Report of the Select Committee, Session 1998/99 entitled "Taxes in the EU: Can Co-ordination and Competition Co-exist?" HL Paper 92, pages 81 to 90).
3. Following the entry into force of the Treaty of Amsterdam, Articles of the Treaty establishing the European Community have been renumbered. This chapter generally uses the new numbering but with a reference to the previous number.
4. Discussed further below.
5. *Gilly*, paragraph 15.
6. *Colmer*, paragraph 19 referring to *Schumacker,* paragraph 21, *Wielockx*, paragraph 16, *Asscher*, paragraph 36 and *Futura Participations*, paragraph 19.
7. There is a well-established jurisprudence of the Court that fundamental human rights are part of the general principles of Community Law protected by the Court: see *Stauder v. City of Ulm* (Case 29/69) [1969] ECR 419 at page 425, paragraph 7; *Internationale Handelsgesellschaft* (Case 11/70) [1970] ECR 1125 at page 1134, paragraphs 3 and 4; *Nold* (Case 4/73) [1974] ECR 491 at page 507, paragraphs 12 and 13; *Prais* (Case 130/75) [1976] ECR 1589 at page 1597, paragraph 8; *ERT* (Case C-260/89) [1991] ECR I-2925 at pages 2963-2964, at paragraphs 41 to 44; and *P v. S and Cornwall County Council* (Case C-13/94) [1996] ECR I-2143 at pages 2164-2165, paragraphs 16 to 19.
8. On this see *R. v. Human Fertilisation and Embryology Authority ex parte Diane Blood* [1997] 2 All ER 687, in the context of a decision of the Fertilisation and Embryology Authority.
9. See, in particular, the Commission Notice on the application of the State aid rules to measures related to direct business taxation discussed further below, and see the judgement in *Banco Exterior de España* (Case C-387/92) [1994] ECR I-877 at page 908, paragraph 14.
10. Council Directive 77/799/EEC of 19th December 1997 concerning mutual assistance by the competent authorities of the Member States in the fields of direct and indirect taxation, OJ L336, 27.12.1977, page 15 as amended by Council Directive 92/12/EEC of 25th February 1992, OJ L76, 23.3.1992, page 1.
11. Council Resolution of 10th February 1975 on the measures to be taken by the Community in order to combat international tax evasion and avoidance, OJ C35, 14.02.75, pages 1 to 2.

12. Council Regulation 2137/85/EEC of 25th July 1985 on the european economic interest grouping, OJ L199, 31.7.85, page 1.

13. Council Directive 88/361/EEC of 24th June 1988 for the implementation of Article 67 of the Treaty, OJ L 185, 8.7.88, page5.

14. Council Directive 90/434/EEC of 23rd July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, OJ L 225, 23.7.90, page 1.

15. Sections 44 to 49: on the implementation of the EC direct tax measures in UK tax law, see the Inland Revenue Consultative Document "EC Direct Tax Measures" of December 1991.

16. Council Directive 90/435/EEC of 23rd July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L225, 20.8.90, page 10.

17. Only amendments to TA 1988, s123 by F(No.2)A 1992, s30 - since repealed.

18. EC Convention 90/436/EEC of 23rd July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, OJ C 225, 23.7.90, page 10.

19. Inserted by F(No.2)A 1992, s51.

20. Protocol amending the Convention of the 23rd July 1990, OJ C202, 16.7.99, page 1.

21. Commission Recommendation 94/79/EC on 21st December 1993 on the taxation of certain items of income received by non-residents in a Member State other than that in which they are resident, OJ L39, 10.2.94, page 22.

22. Commission Recommendation 94/390/EC of 25th May 1994 concerning the taxation of small and medium-sized enterprises, OJ L177, 9.7.94, page 1.

23. The Appendix contain a list of the principal decisions of the ECJ in the filed of direct taxation, with the full citation of the cases.

24. See paragraphs 13 and 14 of the judgement.

25. In a subsequent case, *Commission v. Luxembourg*, the Commission brought infringement proceedings under Article 226 (formerly 169) against Luxembourg which had not changed the rule which was found to be discriminatory in *Biehl.*

26. See paragraph 31 of the judgement.

27. See paragraph 36 of the judgement.

28. See paragraphs 42 and 45 of the judgement, in particular the reference to the Mutual Assistance Directive in paragraph 45.

29. There was a similar decision reached in the case of *Wielockx*

30. Commission Recommendation of 21st December 1993 mentioned above.

31. See paragraph 22 of the judgement.

32. See paragraphs 26 and 29 of the judgement.

33. Case C-391/97, Opinion of Advocate-General Colomer presented on 11th March 1999.

34. Case C-307/97, Opinion of Advocate-General Mischo presented on 2nd March 1999.

35. Case C-200/98, Opinion of Advocate-General Saggio presented on 3rd June 1999 - this Opinion may possibly have been withdrawn.

36. *Eurowings Luftverkehrs AG v. Finanzamt Dortmund-Unman*, Case C-294/97, Opinion of Advocate General Mischo delivered on 26th January 1999.

37. SEC (1998) 1800 Final, OJ C384, 10.12.98, pages 3 to 9

38. See H Thrust, The EEC Reports on Tax Harmonisation (IBFD, Amsterdam, 1963).

39. Corporation Tax and Individual Income Tax in the European Communities (European Commission, Brussels, 1970).

40. Report of the Committee of Independent Experts on Company Taxation (European Commission, Brussels, 1992).

41. Commission Communication of 26th June 1992, SEC (92) 118.

42. COM (96) 546 Final.

43. COM (97) 495.

44. COM (97) 564 Final.

45. OJ C98/2, 6.1.98, pages 1 to 6.

46. Proposal for a Council Directive to ensure a minimum of effective taxation of savings income in the form of interest payments within the Community, COM (98) 295 Final - 98/0193 (CNS).

47. Proposal for a Council Directive on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, COM (98) 67 Final - 98/0087 (CNS), OJ C123, 22.4.98, pages 9 to 13.

48. See the discussion above.

49. Council Conclusions of the 9th March 1998 concerning the establishment of the Code of Conduct Group (Business Taxation), OJ C.99, 1.4.98, pages 1 to 2.

50. COM (98) 595 Final of 25th November 1998.

51. This list of measures and the UK Government analysis of these measures is set out at Annex 1 to the Minutes of Evidence given by the Economic Secretary to the Treasury and the Paymaster General to the House of Commons Select Committee on the Treasury on 22nd July 1999.

52. These reports - from PricewaterhouseCoopers and from Baker & McKenzie - are now available on the Internet at: http:\\www.minfin.nl\uk\taxation\TaxCompetition\taxcomp.htm and the documents attached.

53. Proposal for a European Parliament and Council Directive amending Council Directive 76/308/EEC on mutual assistance for the recovery of claims …, COM (98) 364 Final - 98/0206 (COD) of 25th June 1998, and amended proposal for a European Parliament and Council Directive, COM (99) 183 Final - 98/0206 (COD) of 7th May 1999.

# APPENDIX

## The Principal Direct Tax Cases of the ECJ

*Avoir Fiscal:*

*EC Commission v. France* (Case 270/83), 28 January 1986 [1986] ECR 273

*Daily Mail:*

*R v HM Treasury and IRC, ex p Daily Mail and General Trust plc* (Case 81/87), 27 September 1988 [1988] ECR 5505

*Biehl:*

*Klaus Biehl v Administration des Contributions du Grand-duché de Luxembourg* (Case C-175/88), 8 May 1990 [1990] ECR I - 1779

*Commerzbank:*

*R v IRC, ex p Commerzbank AG* (Case C-330/91), 13 July 1993 [1993] ECR I - 4017

*Halliburton:*

*Halliburton Services BV v Staatssecretaris van Financiën* (Case C-1/93), 12 April 1994 [1994] ECR I - 1137

*Bachmann:*

*Hanns-Martin Bachmann v Belgium* (Case C-204/90), 28 January 1992 [1992] ECR I - 249

*Werner:*

*Hans Werner v. Finanzamt Aachen-Innenstadt* (Case C -112/91), 26 January 1993 [1993] ECR I - 429

*Schumacker*

*Finanzamt Köln-Altstadt v Roland Schumacker* (Case C-279/93), 14 February 1995 [1995] ECR I - 225

*Wielockx:*

*GHEJ Wielockx v Inspecteur der Directe Belastingen* (Case C-80/94), 11 August 1995 [1995] ECR I - 2493

*Asscher:*

*PH Asscher v Staatssecretaris van Financiën* (Case C-107/94), 27 June 1996 [1996] ECR I - 3089

*Futura Participations:*

*Futura Participations SA v Adminstrations des Contributions* (case C-250/95), 15 May 1997 [1997] ECR I -

*Safir:*

*Jessica Safir v. Skattemyndighten i Dalarnas Län* (Case C-118/96), 28 April 1998 [1998] ECR I - 1897

*Colmer:*

*Imperial Chemical Industries plc v. Kenneth Hall Colmer (HM Inspector of Taxes)* (Case C-264/96), 16 July 1998 [1998] ECR I - 4695

*Gilly:*

*Mr and Mrs Robert Gilly v Directeur des Services Fiscaux du Bas-Rhin* (Case C-336/96), 12 May 1998 [1998] ECR I - 2793

*Royal Bank of Scotland:*

*Royal Bank of Scotland plc v Elliniko Dimosio (Greek State)* (Case C-311/97), 29 April 1999 [1999] ECR I -

*St Gobain:*

*Compagnie de Saint-Gobain, Zweigniederlassung v Finanzamt, Aachen-Innenstadt* (Case C-307/97)

*Eurowings:*

*Eurowings Luftverkehrs AG v. Finanzamt Dortmund-Unman* (Case C-294/97)

*Gschwind:*

*Gschwind v. Finanzamt Aachen-Aussenstadt* (Case C-391/97)

*X AB and Y AB:*

*X AB and Y AB v Sweden* (Case C-200/98)