X HOLDING: A FLAWED JUDGMENT OR YET ANOTHER LESSON IN CONSISTENCY?

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I. Introduction

On 7 January 2011, the *Hoge Raad der Nederlanden* (Netherlands Supreme Court) held that the Dutch tax unity regime is not incompatible with European Union law, on the footsteps of the judgment of the Court of Justice in *X Holding*[2]. Specifically, the *Hoge Raad* considered that the Dutch rules that disallow a cross-border tax unity with subsidiaries resident for tax purposes in another Member State are compatible with the freedom of establishment[3].

The *X Holding* judgment is one of the latest stocked by a number of academics and authors in the pile of the allegedly most inconsistent decisions of the Court of Justice[4], criticism undoubtedly increased by the relevance of the subject matter and even the timing of the decision[5]. Although it has been noted that criticism of its

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2 ECJ, 25 February 2010, Case C-337/08, *X Holding BV v Staatssecretaris van Financiën* ("*X Holding*"), unreported.

3 The decision (in Dutch) can be accessed in http://www.ntfr.nl/bron/43484bishr.htm.

4 See, among others, Van Thiel, Servaas, and Vascega, Marius, "*X Holding: Why Ulysses Should Stop Listening to the Siren*", European Taxation, IBFD, August 2010, pp. 334 ff., Weber, Dennis, "*X Holding. Refusal of advantage of a cross-border tax consolidation a justified restriction of the freedom of establishment*", Vakstudie Highlights & Insights on European Taxation no. 7, Kluwer, 2010, pp. 66 ff., and de Wilde, Maarten F., "*On* X Holding *and the ECJ's Ambiguous Approach towards the Proportionality Test*", EC Tax Review, 2010-4, pp. 170 ff.

5 See Cordewener, Axel, "*Cross-Border Loss Relief and the 'Effet Utile' of EU Law: Are We Losing It*", EC Tax Review, 2011-2, p. 58.

case-law on direct tax issues has become a "*venerable tradition*" [6] – with the allegations ranging from inability[7] to volatility[8] –, it is indeed a tradition with numerous followers, many of whom are of the highest calibre.

One of the reasons may be that the quality of the decisions of the Court of Justice does not meet the desirable standards. An alternative reason may be that many of those tax academics and authors have thus far analysed the case-law on direct tax issues from a *tax* perspective. Through a tax lens, some of the decisions of the Court on direct tax cases may appear contradictory. For instance, it is difficult to understand why in *Manninen*[9] the Court went to such a great length to prevent economic double taxation but failed to condemn juridical double taxation – hand-in-hand with disrespect for a Double Tax Convention ("**DTC**") by a Member State – in *Kerckhaert-Morres*[10] and its remake *Damseaux*[11].

However, according to Article 19(1) of the Treaty on the European Union ("**TEU**"), it is for the Court of Justice to "*ensure that in the interpretation and application of the Treaties the law is observed*". This means the Court is primarily an "internal market court" – not a tax court – entrusted with the responsibility of guiding the interpretation and application by national courts of the freedoms and principles that constitute the fabric of the common purposes set out in Article 3 TEU and the pillars of EU law. Except for extraordinary circumstances provided for in primary law, such freedoms and principles are incompressible. This means that EU law prevails, even if to the detriment of tax law principles. The concern of the Court must be the consistency of the interpretation of EU law freedoms and principles, not of tax measures adopted by Member States. This paper tries to show that that was exactly what the Court did – yet again – in *X Holding*.

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6 Vanistendael, Frans, "*In Defence of the European Court of Justice*", Bulletin for International Taxation – March 2008, IBFD, p. 90.

7 "*The Court has been performing a balancing act in this area for almost two decades now... it is a breathtaking spectacle, but one keeps wondering what the act would have looked like if the indisputably gifted free-stylists would have rehearsed beforehand*." (Wattel, Peter, *apud* Weber, Dennis (editor), "*The Influence of European Law on Direct Taxation*", Kluwer Law, The Netherlands, 2007, pp. vii-viii).

8 "*Most of the time, the outcome of a case is unpredictable…*" (Brokelind, Cécile, "*The* acte clair *doctrine arising from the Court of Justice's direct tax case law from a Swedish perspective: Use or misuse*", apud Dourado, Ana Paula, and da Palma Borges, Ricardo (editors), "*The Acte Clair in EU Direct Tax Law*", IBFD, The Netherlands, 2008, p. 466).

9 ECJ, 7 September 2004, Case C-319/02, *Petri Manninen* ("*Manninen*"), [2004] ECR I-7477.

10 ECJ, 14 November 2006, Case C-513/04, *Mark Kerckhaert and Bernadette Morres v Belgische Staat* ("*Kerckhaert-Morres*"), [2006] ECR I-10967.

11 ECJ, 16 July 2009, Case C-128/08, *Jacques Damseaux v État Belge* ("*Damseaux*"), [2009] ECR I-06823.

II. Application of structural concepts

a. Structural concepts

The jurisprudence of the Court is built upon common blocks – hereinafter, the "**structural concepts**" – and its decisions, based on a precedential model which ensures an easier congregation of opinions from the various judges, are usually painstakingly drafted with a view to evidencing the origin and consistency of the application of such structural concepts. Those structural concepts – which are not specific to the analysis of the compliance of a domestic tax rule with EU law but are instead a common denominator in all areas and subjects – may be classified as follows:

(i) Comparability;

(ii) Obstacles; and

(iii) Justifications.

The analysis of the decision in *X Holding* evidences that, notwithstanding the natural *evolution* of the jurisprudence, there is no inconsistency, contradiction or disruption as regards the interpretation and application of these structural concepts.

b. Comparability

(i) General remarks

Although the Court is also frequently called to interpret EU law pertinent to domestic cases (e.g., *Leur-Bloem*[12] and *Les Vergers du Vieux Tauves*[13]), a cross-border element is usually involved where an issue arises of possible non-compliance of domestic direct tax rules with EU law, particularly where primary law is at stake. Therefore, the Court first needs to assess whether the situation under analysis is comparable to a purely domestic situation and contrast both for a possible difference in treatment and for a possible restriction in the exercise of any of the freedoms enshrined in the Treaty on

12 ECJ, 17 July 1997, Case C-28/95, *A. Leur-Bloem and Inspecteur der Belastingdienst / Ondernemingen Amsterdam 2*, ("*Leur-Bloem*"), [1997] ECR I-4161.

13 ECJ, 22 December 2008, Case C-48/07, *Service public fédéral Finances v Les Vergers du Vieux Tauves SA.* ("*Les Vergers du Vieux Tauves*"), [2008] ECR I-10627.

the Functioning of the European Union ("**TFEU**")[14]. Neither the TFEU nor any other source of law provide guidance on what features or circumstances may be considered when ascertaining whether a situation is comparable, or not, but the Court has developed a consistent approach in that regard. *X Holding* is yet another landmark decision fitting a consistently woven pattern.

(ii) Comparability level

Comparability should be established at the level of the taxpayer and not by reference to other elements of the situation, as for example subsidiaries (e.g., *Bosal*[15], *Marks & Spencer*[16], *Rewe*[17]). In *Marks & Spencer*, possibly influenced by the arguments made before them, the United Kingdom ("UK") Special Commissioners did not detect a breach of EU law because they compared the position of a foreign subsidiary and a foreign branch of a UK company when they should have compared two UK parent companies, one with foreign subsidiaries and the other with UK subsidiaries. The Court had actually made this point clear in *ICI*[18] several years before.

In *X Holding*, the crux of the matter was whether the possibility granted by Dutch law to resident parent companies and their resident subsidiaries to be taxed under a regime of fiscal unity, i.e., as if they formed a single tax entity, was a breach of EU law considering that such fiscal unity was not available to Dutch resident parent companies and their non-resident subsidiaries. The Netherlands, German and Portuguese Governments tried to bring the

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14 In cases of absolute prohibitions, no difference in treatment exists, because the rule, *per se*, directly prevents the exercise of a TFEU freedom (e.g., ECJ, 15 December 1995, Case C-415/93, *Union royale belge des sociétés de football association ASBL v Jean-Marc Bosman, Royal club liégeois SA v Jean-Marc Bosman and others and Union des associations européennes de football (UEFA) v Jean-Marc Bosman* ("*Bosman*"), [1995] ECR I-4921). This is entirely consistent with the thinking of the Court that "*all measures which prohibit, impede or render less attractive the exercise of* [a] *freedom must be regarded as obstacles*" (ECJ, 28 February 2008, Case C-293/06, *Deutsche Shell GmbH v Finanzamt für Großunternehmen in Hamburg* ("*Deutsche Shell*"), [2008], ECR I-01129, paragraph 28).

15 ECJ, 18 September 2003, Case C-168/01, *Bosal Holding BV v Staatssecretaris van Financiën* ("*Bosal*"), [2003] ECR I-9409, paragraph 39.

16 ECJ, 13 December 2005, Case C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)* ("*Marks & Spencer*"), [2005] ECR I-10837, paragraphs 36 ff.

17 ECJ, 29 March 2007, Case C-347/04, *Rewe Zentralfinanz eG v Finanzamt Köln-Mitte* ("*Rewe*"), [2007] ECR I-02647, paragraph 33.

18 ECJ, 16 July 1998, Case C-264/96, *Imperial Chemical Industries plc (ICI) v Kenneth Hall Colmer* (Her Majesty's Inspector of Taxes), ("*ICI*"), [1998] ECR I-4695, paragraphs 22 and 23.

comparability discussion to the level of the subsidiaries of the taxpayer[19], arguing that "*those two situations are not objectively comparable, as resident subsidiaries and non-resident subsidiaries are not in comparable tax situations with regard to a tax scheme such as that at issue in the main proceedings…* [Specifically], *a subsidiary which is established in another Member State is not subject to the fiscal jurisdiction of the State in which the parent company is established, with the result that it cannot be integrated into a tax entity subject to tax in the latter State*"[20].

The matter may be described from one vantage point, but it is nonetheless surprising that, if not since *ICI*, at least after *Marks & Spencer*, Governments persist in the same flawed approach. When the Court analyses whether a certain domestic tax rule is compatible or not with the TFEU freedoms, it does so by scrutinising the impact of the rule in question on the exercise of such a freedom by the taxpayer subject to the rule. Thus, in *X Holding* the Court had to provide guidance on the interpretation of EU law by reference to the exercise, by a parent company, of its freedom of establishment. The rights of the foreign subsidiaries were not at stake. Therefore, the Court noted that "*a resident parent company wishing to form a single tax entity with a resident subsidiary and the situation of a resident parent company wishing to form a single tax entity with a non-resident subsidiary are objectively comparable with regard to the objective of a tax scheme such as that at issue in the main proceedings*"[21]. The situation of the parent company wishing to form a single tax entity is the framework of the comparability analysis. It is noteworthy that, when remarking that the residence of taxpayers may justify a different treatment, it does so from the perspective of the Member State of establishment[22], whereas in *X Holding* the "defendant" is the origin State. The essential differences between host State and origin State situations appear to not have been apprehended by some Member States.

The matter may be one of expectations. Some academics appear to expect tax law in an EU context to be not only intricate and complex, which indeed it is, but to have the dense convolution of quantum physics and persist on criticising the Court for not recognising it, claiming for instance that the said paragraph 24 is "*murky as well as over simplistic*"[23]. Others insist on

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19 As it had been tried before in *Bosal* (paragraph 18), *Marks & Spencer* (paragraph 36) and *Rewe* (paragraph 32), for instance.

20 *X Holding*, paragraph 21.

21 *X Holding*, paragraph 24.

22 See *X Holding*, paragraph 23.

23 Almendral, Violeta, "*An Ever Distant Union: the Cross-Border Loss Relief Conundrum in EU Law*", Intertax, Volume 38, Issue 10, 2010, p. 494.

comparing not the taxpayer exercising the freedom of establishment – the parent company – but its subsidiaries[24], demanding a discrimination test that would allegedly be necessary in order to be consistent with previous case-law, without being able, however, to indicate a single case where the Court applied that kind of comparator, because the subsidiaries are not the taxpayer from an origin State standpoint. The point is neither that "*a foreign subsidiary and foreign permanent establishment may be treated differently, provided there is no discrimination compared to a domestic situation*"[25], nor that the Dutch tax unity regime "*discriminates between a domestic subsidiary (which may benefit from group treatment and thus from treatment as a branch) and a foreign subsidiary (which has no access to group treatment)*"[26]. The tax rule potentially in breach of the EU law freedoms is a rule of the origin State (in this case, Netherlands) and neither the subsidiary nor the PE as such that are taxed therein. It is the freedom of establishment of the company resident in the origin State which is affected by the rules of the origin State, not its subsidiary or the profits attributable to the PE in the host State. The point is that: (i) a parent company with a foreign subsidiary cannot be detrimentally treated by its origin State when compared to a parent company with a domestic subsidiary and that (ii) a parent company with a foreign PE cannot be detrimentally treated by its origin State when compared to a parent company with a domestic PE. This is the correct level of comparability because it is the parent company that exercises the freedom of establishment from an origin State standpoint (when it decides to go abroad) and therefore it cannot be restricted in doing so without justification. At the level of the host State, it is either the subsidiary or the foreign company for the portion of its profits imputable to the PE that are taxed, not the foreign company "as a whole", thus the subsidiary and the "portion" of the foreign company that constitutes a PE in the host State are the taxpayer for comparability purposes and there cannot be any discrimination as regards the form they assume because the single term for comparison is in principle a local company[27], although not necessarily so[28].

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24 See Van Thiel and Vascega, "*X Holding…*", cit., p. 347, and Weber, "*X Holding…*", cit., p. 70.

25 Weber, "*X Holding. Refusal…*", cit., p. 70.

26 Van Thiel and Vascega, "*X Holding…*", cit., p.346.

27 See Van Thiel and Vascega, "*X Holding…*", cit., pp. 343 and 344, and Almendral, "*An Ever…*", cit., p. 492.

28 Although the Court has never dealt with such a situation and in practice it may be unlikely, one may venture that in case there is a domestic PE with a special regime (which is however open to PEs of foreign entities, thus not in breach of the non-discrimination principle, including the one enshrined in DTCs), the host State might differentiate between a subsidiary and a PE of a foreign company, provided the PE was not accorded a less favourable treatment than that granted to a domestic PE. One example may, for instance, PEs in free zones. If, for

From the origin State point of view, a restriction on the exercise of the freedom of establishment is ascertained by comparing with the equivalent type of corporate structure in a domestic setting: parent engaging the freedom of establishment by setting up a subsidiary in another Member State and another parent not engaging such freedom by setting up a subsidiary in its own country, on the one side, and a company setting up a PE in another Member State or in its own country, on the other. Disregarding that this has always been the thinking of the Court is the true reason why many of its decisions continue to be allegedly inconsistent, surprising and contradictory, when in fact they are exactly the opposite if the vantage point is EU law, not simply tax law.

It has been remarked that "*the comparator from an origin member state differs from that of a host member state*"[29], but what this means is that, whereas from an origin State standpoint two origin State nationals are compared, in a host State scenario the comparison is between a foreign national and a host State national. From a classification standpoint the comparator remains the "comparable taxpayer". The difference is that for the host State the foreign national is only comparable to a local company to the extent that some of its profits are attributable to a PE (deemed to be a local taxpayer), whereas from the origin State standpoint the company as a whole is compared (engaging, or not, the fundamental freedoms).

(iii) Substance over form

Secondly, the Court of Justice disregards superficial differences and establishes comparability in substance, not in form[30]. The Court is

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instance, the cost deductibility rules applicable to PEs in free zones were more restrictive than those applicable to companies without such PEs, one would expect that, if a free zone PE of a company of another Member State complained about a discriminatory treatment as compared to that of subsidiaries without such type of PE, the Court of Justice would say that a free zone PE and a subsidiary without such PE would not be comparable.

29 O'Shea, Tom, "*Dutch Fiscal Unity Rules Receive Thumbs up From ECJ*", Tax Notes International, Voume 57, no. 10, March 8, 2010, p. 835.

30 It does not appear that the Court of Justice sometimes uses a "factual comparability" approach and in other cases a "legal comparability" approach (see Lang, Michael, "*Recent Case Law of the Court of Justice in Direct Taxation: Trends, Tensions, and Contradictions*", EC Tax Review, Kluwer, 2009-3, pp. 101 ff.). With all due respect, the Court of Justice does not appear to privilege legal comparability when it says that "*By treating the inheritances of those two categories of persons in the same way… the national legislature has in fact admitted that there is no objective difference between them*" (ECJ, 11 September 2008, Case C-43/07, D. M. M. A. Arens-Sikken v Staatssecretaris van Financiën ("*Arens-Sikkens*"), [2008] ECR I-06887). Instead, the Court is simply remarking that the Member State whose legislation is at issue actually acknowledges the comparability in substance. If the so-called "legal comparability" were to take precedence over comparability in substance, the analysis might be manipulated. By focusing on substance rather than form, the Court is able to thwart any attempt to that effect.

relentlessly consistent regarding allegations of non-comparability by Member States in the absence of objective and admissible criteria. More than twenty years apart, the conclusions that "*by treating the two forms of establishment in the same way for the purposes of taxing their profits, the French legislature has in fact admitted that there is no objective difference between their positions*"[31] and that "*the differences between a SICAV governed by Luxembourg law and a share company governed by Finnish law… are not sufficient to create an objective distinction with respect to exemption from withholding tax on dividends received*"[32] showcase the Court's unyielding defence of an objective analysis of comparability.

From a host State standpoint, the Court is able to detect the similarity between a resident and a non-resident who "*obtains the major part of his taxable income from an activity performed in the State of employment*"[33] and reject it otherwise[34]). It is also able to identify the comparability between residents and non-residents as regards the cost of acquisition of shares[35]. The thinking of the Court appears to have developed into the conclusion that, despite the usual statement that "*the situations of residents and of non-residents are not, as a rule, comparable*"[36], "*this is not a significant restriction on the application of the non-discrimination principle as between resident and non-resident taxpayers*"[37] and in practice almost only personal circumstances can prevent comparability between resident and non-resident individuals, although comparability may fail to be established in situations where residence is essential to the purpose of the rule (*Fearon*[38]). Since no

31 ECJ, 28 January 1986, Case C-270/83, *Commission of the European Communities v French Republic* ("*Avoir Fiscal*"), [1986] ECR 273, paragraph 20.

32 ECJ, 18 June 2009, Case C-303/07, *Aberdeen Property Fininvest Alpha Oy* ("*Aberdeen*"), [2009] ECR I-05145, paragraph 55.

33 ECJ, 4 February 1995, Case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker* ("*Schumacker*"), [1995] ECR I-00225, paragraph 36.

34 ECJ, 14 September 1999, Case C-391/91, *Frans Gschwind v Finanzamt Aachen-Außenstadt* ("*Gschwind*"), [1999] ECR I-05451, paragraph 28.

35 See ECJ, 19 January 2006, Case C-265/04, *Margaretha Bouanich v Skatteverket* ("*Bouanich*"), [2006] ECR I-00923, paragraph 40.

36 *Schumacker*, paragraph 36.

37 Gammie, Malcolm, "*The Role of the European Court of Justice in the Development of Direct Taxation in the European Union*", IBFD Bulletin, March 2003, p. 88.

38 ECJ, 6 November 1984, Case C-182/83, *Robert Fearon & Company Limited v Irish Land Commission* ("*Fearon*"), [1984] ECR 03677.

personal circumstances apply to companies[39], comparability between them is almost unavoidable when the host State exercises its taxing powers over a migrant taxpayer, with[40] or without a permanent establishment – "**PE**"[41]. Consistently with the reasoning developed by Advocate-General Geelhoed and adopted in *ACT IV GLO*[42], comparability requires that the State whose legislation is at issue imposes the same charge to tax on both residents and non-residents. In *Truck Center*[43], the charges to tax were different[44] and therefore situations were not objectively comparable, since taxpayers are not in the same situation when the sources of their income differ. In *ACT IV GLO*, it was only because the host State decided to extend its taxing powers to subject non.-residents to the same charge to tax that these became comparable to residents. In *Truck Center*, residents were not subject to withholding tax but non-residents were not subject to corporate income tax either[45]. Nevertheless, this does not mean that Belgium could use this fact to impose a detrimental tax treatment on the foreign lender, since a restriction

39 See Dahlberg, Mattias, "*Direct Taxation in Relation to the Freedom of Establishment and the Free Movement of Capital*", Kluwer Law International, The Netherlands, 2005, pp. 100 to 107).

40 E.g., *Avoir Fiscal*, paragraph 20; ECJ, 29 April 1999, Case C-311/97, *Royal Bank of Scotland plc v Elliniko Dimosio (Greek State)* ("*RBS*"), [1999] ECR I-02651, paragraph 30; and ECJ, 23 February 2006, Case C-253/03, *CLT-UFA SA v Finanzamt Köln-West* ("*CLT-UFA*"), [2006] ECR I-01831, paragraph 30.

41 ECJ, 12 June 2003, Case C-234/01, *Arnoud Gerritse v Finanzamt Neukölln-Nord* ("*Gerritse*"), [2003] ECR I-05933, paragraph 27, and ECJ, 12 December 2006, Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v Commissioners of Inland Revenue* ("*ACT IV GLO*"), [2006] ECR I-11673, paragraph 68.

42 See paragraph 68.

43 ECJ, 22 December 2008, Case C-282/07, *Belgian State - SPF Finances v Truck Center SA* ("*Truck Center*"), [2008] ECR I-10767.

44 See O'Shea, Tom, "*Truck Center: A Lesson in Source vs. Residence Obligations in the EU*", Tax Notes International, Volume 53, Number 7 February 16, 2009, p. 597.

45 Therefore, although this decision is arguably not one of the Court's finest moments, since it is scarcely justified, it does not seem fair to claim that the Court of Justice is "*saying that residents and non-.residents are different because residents and non-residents are different*" (Confédération Fiscale Européenne ("CFE"), "*Opinion Statement of the CFE Court of Justice Taskforce on Truck Center*" (Case C-282/07), paragraph 16). Similarly, see De Broe, Luc, and Bammens, Niels, "*Belgian Withholding Tax on Interest Payments to Non- resident Companies Does Not Violate EC Law: A Critical Look at the ECJ's Judgment in Truck Center*", EC Tax Review, Kluwer, 2009-3, p. 135. "Style" is sometimes a critical factor when assessing the consistency of the case-law of the Court of Justice (see Vanistendael, Frans, "*The Court of Justice at the Crossroads: Balancing Tax Sovereignty against the Imperatives of the Single Market*", European Taxation, IBFD, September 2006, pp. 416 and 417).

might have been deemed to exist even in the absence of discrimination proper[46].

The same reasoning applies from an origin State standpoint to residents acting in a purely domestic context *vis-à-vis* residents engaging some of the TFEU freedoms. As an example of an origin State comparability analysis, the Court found that "*shareholders who are fully taxable in Finland find themselves in a comparable situation, whether they receive dividends from a company established in that Member State or from a company established in Sweden*"[47], reflecting the reasoning of, *inter alia*, *Baars*[48].

In *X Holding*, the Court notes that the resident parent company not exercising its TFEU freedoms (wishing to form a single tax entity with one or more resident subsidiaries) and the resident parent company exercising such freedoms (wishing to form a tax unity with non-resident subsidiaries) are objectively comparable "*with regard to the objective of a tax scheme such as that at issue in the main proceedings in so far as each seeks to benefit from the advantages of that scheme, which, in particular, allows the profits and losses of the companies constituting the single tax entity to be consolidated at the level of the parent company and the transactions carried out within the group to remain neutral for tax purposes*"[49]. In other words, the Court understands that, where it comes to availing of a beneficial tax regime, the parent company which has exercised its freedom of establishment setting up or acquiring subsidiaries abroad is substantially equivalent to the parent company which has refrained from exercising such freedoms.

(iv) Impact of DTCs

Finally, comparability depends on the taxpayers being on the same footing whenever a DTC is at play. Therefore, and following its findings in non-tax

46 In paragraph 49 the Court clarifies that, although there is no discrimination because the situations are not comparable, there might have been a restriction if there were a detrimental impact to the migrant taxpayer, which implies comparing tax rates and the tax collection procedures: the "*Court determined that there was no such restriction on the freedom of establishment and, for the same reasons, on the free movement of capital. This* ***had to be on the basis that*** *the ''headline'' rate of tax charged under the Belgian corporation tax rules* ***was significantly higher*** *than the headline rate of tax charged under the withholding mechanism* (O'Shea, "*Truck Center*…", cit., p. 601 – emphasis added). Accordingly, if the withholding tax rate exceeded the headline rate of corporate income tax applicable to resident recipients of interest income, a restriction would exist.

47 *Manninen*, paragraph 36.

48 ECJ, 13 April 2000, Case C-251/98, *C. Baars v Inspecteur der Belastingen Particulieren / Ondernemingen Gorinchem* ("*Baars*"), [2000] ECR I-02787, paragraphs 29 ff.

49 *X Holding*, paragraph 24.

jurisprudence (*Matteucci*[50]), the Court concluded that a German resident owning property in the Netherlands was not in an equivalent situation to that of Belgian residents also owning property in the Netherlands with regard to the rights arising to the latter under the Dutch-Belgian DTC[51]. Specifically, the German resident could not claim the application of rights that Netherlands accorded to Belgian residents because Netherlands had done so in the context of the overall balance achieved in the negotiation of the DTC. Therefore, the Court rejected the application of the most-favoured nation principle in a TFEU context[52].

c. Obstacles

(i) Discrimination and restriction

In respect of direct taxation matters, the Court of Justice has to determine whether a certain direct tax treatment represents an obstacle to the exercise of the TFEU freedoms or, more broadly, a breach of the EU law principles in general. The "negative integration" effect of its decisions[53] consists in the removal of such obstacles, which can emerge as *discrimination* or *restriction*.

In very broad terms, there is discrimination proper whenever a member State treats non-nationals less favourably than nationals (i.e., not granting "national treatment") in a comparable position[54]. The significance of

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50 ECJ, 27 September 1988, Case C-235/87, *Annunziata Matteucci v Communauté française of Belgium and Commissariat général aux relations internationales of the Communauté française of Belgium* ("*Matteucci*"), [1988] ECR I-05589.

51 See ECJ, 5 July 2005, Case C-376/03, *D. v Inspecteur van de Belastingdienst / Particulieren / Ondernemingen buitenland te Heerlen* ("*D.*"), [2005] ECR I-05821, paragraphs 58 ff.(see, for a more detailed discussion, O'Shea, Tom, "*The ECJ, the `D' case, double tax conventions and most-favoured nations: comparability and reciprocity*", EC Tax Review, Kluwer, Vol. 14, 2005, pp. 190–201, and Van Thiel, Servaas, "*Why the ECJ Should Interpret Directly Applicable European Law as a Right to Intra-Community Most-Favoured-Nation Treatment*", European Taxation, IBFD, Part 1 (June 2007) and Part 2 (July 2007).

52 This particular issue was not relevant in *X Holding* and therefore this article does not expand further on the subject

53 See Gammie, "*The Role…*", cit., p. 98.

54 There can also be discrimination when different situations are treated equally, in such a fashion that it has a detrimental impact for the migrant taxpayer (see ECJ, 11 August 1995, Case C-80/94, *G. H. E. J. Wielockx v Inspecteur der Directe Belastingen* ("*Wielockx*"), [1995] ECR I-02493, paragraph 17, and ECJ, 6 December 2007, Case C-298/05, *Columbus Container Services BVBA & Co. v Finanzamt Bielefeld-Innenstadt* ("*Columbus Container*"), [2007] ECR I-10451, paragraph 41, among many others. It has been argued that an example is *Deutsche Shell* (see Lang, "*Recent…*", cit., p. 99), although the Court appears to have adopted a restriction approach (see O'Shea, Tom, "*German Currency Loss Rules Incompatible With EU Law, Court of Justice Says*", Tax Notes International, March 5, 2008).

comparability is emphasised by the fact that, ultimately, "*the decision as to whether there is discriminatory treatment depends on the choice of comparator*"[55]. However, in the vast majority of the cases, particularly the more recent ones (as domestic laws are progressively amended to better conform to EU law), the breach of EU law is not so blatant and a discriminatory treatment applies on the ground of residence, not nationality (sometimes prompting "covert discrimination").

Discrimination on the grounds of residence is perhaps more correctly classified as indirect discrimination[56], falling somehow in between the prototypical examples of obstacles: discrimination on grounds of nationality and restriction proper[57]. The Court of Justice has consistently held that both overt and covert discrimination are prohibited by the TFEU. Since the concept of residence is a cornerstone of tax systems, failure to identify indirect discrimination in rules treating comparable residents and non-residents differently would seriously undermine TFEU freedoms and principles. The consistency of the Court of Justice over a decade may be illustrated by *Schumacker*[58] and *Conijn*[59].

In any case, once comparability has been established, any differing treatment in a host State to the detriment of a migrant taxpayer leads inevitably to a finding of an obstacle. In such a scenario, the Court of Justice finds the migrant "*placed at a disadvantage by comparison*"[60] with the non-migrant or "*subject to a tax which is higher than that applied to residents and… consequently in a less favourable position than the latter*"[61]. In this regard, it is important to note that in the host State, a subsidiary of a foreign company will in principle be considered a non-migrant, because it is a

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55 Lang, "*Recent…*", cit., p. 99.

56 See ECJ, 31 March 2011, Case C-450/09, *Ulrich Schröder v Finanzamt Hameln* ("*Schröder*"), [2011], unreported, paragraph 40.

57 See O'Shea, Tom, "*EU Tax Law and Double Tax Conventions*", Avoir Fiscal Limited, London, 2008, p. 33

58 See *Schumacker*, paragraphs 28 ff.

59 See ECJ, 6 July 2006, Case C-346/04, *Robert Hans Conijn v Finanzamt Hamburg-Nord* ("*Conijn*"), [2006] ECR I-06137, paragraph 25.

60 ECJ, 13 July 1993, Case C-330/91, *The Queen v Inland Revenue Commissioners, ex parte Commerzbank AG* ("*Commerzbank*"), [1993] ECR I-04017, paragraph 18.

61 ECJ, 11 October 2007, Case C-443/06, *Erika Waltraud Ilse Hollmann v Fazenda Pública* ("*Hollmann*"), [2007] ECR I-08491, paragraph 37.

creature of national law[62], which is why in the host State there is still a migrant / non-migrant analysis between the foreign company which triggered a PE in such State, but only inasmuch as profits are attributable to such PE, and a local company[63].

Finally, a non-discriminatory treatment can be restrictive, as was found in *Futura*[64], where the obligation of a Luxembourg PE of a French company to keep separate accounts complying with Luxembourg's tax accounting rules could not be held discriminatory *vis-à-vis* Luxembourg companies but was deemed to constitute a restriction on the freedom of establishment of the French company, already subject to similar obligations in France. A restriction approach was also present in *Truck Center*[65], where, having concluded there was no comparability – and therefore no discrimination –, the Court proceeded with a concise restriction analysis. If "*the difference in treatment resulting from the tax legislation at issue in the main proceedings… procure*[d] *an advantage for resident recipient companies*"[66], the Court of Justice would in all likelihood have found a restriction to exist.

From an origin State perspective, once comparability between purely domestic and cross-border situations has been established, a restriction on the exercise of the TFEU freedoms is also inevitable where the latter is subject to a less favourable treatment[67]. This is precisely the type of analysis conducted by the Court of Justice in *X Holding*. First, the Court noted that tax unity allowed "*for the profits and losses of the companies constituting the tax entity to be consolidated at the level of the parent company and for*

62 See ECJ, 16 December 2008, Case C-210/06, *CARTESIO Oktató és Szolgáltató bt* ("*Cartesio*"), [2008] ECR I-09641, paragraph 104 (also referring to ECJ, 27 September 1988, Case C-81/87, *The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc.* ("*Daily Mail*"), [1988] ECR 05483.

63 And not a mere restriction analysis "*instead of establishing a PE-subsidiary comparison or a migrant / non-migrant comparison for the sake of the non-discrimination principle*" (Almendral, "*An Ever…*", cit., p. 492).

64 See ECJ, 15 May 1997, Case C-250/95, *Futura Participations SA and Singer v Administration des contributions* ("*Futura*"), [1997] ECR I-02471, paragraphs 24 to 26.

65 Oppositely, sustaining that "*there is as yet no clear evidence of a 'non-discriminatory restriction approach' in the direct tax case law*", see Zalasinski, Adam, "*The Limits of the EU Concept of 'Direct Tax Restriction on Free Movement Rights', the Principles of Equality and Ability to Pay, and the Interstate Fiscal Equity*", Intertax, Kluwer, Volume 37, Issue 5, 2009, p. 288.

66 *Truck Center*, paragraph 49.

67 See ECJ, 6 June 2000, Case C-35/98, *Staatssecretaris van Financiën v B.G.M. Verkooijen* ("*Verkooijen*"), [2000] ECR I-04071, paragraph 36, and ECJ, 23 February 2006, Case C-471/04, *Finanzamt Offenbach am Main-Land v Keller Holding GmbH* ("*Keller Holding*"), [2006] ECR I-02107, paragraph 37.

the transactions carried out within the group to remain neutral for tax purposes"[68]. Then, it concluded that "*The exclusion of such an advantage for a parent company which owns a subsidiary established in another Member State is liable to render less attractive the exercise by that parent company of its freedom of establishment by deterring it from setting up subsidiaries in other Member States*"[69]. This is nothing less than the repetition, twelve years down the road, of the migrant and non-migrant comparative test that the Court of Justice had already applied, in an origin State scenario, in *ICI*[70]. The Court is not concerned about the scope or the severity of the disadvantage; it is sufficient that the exercise of a TFEU freedom is rendered "less attractive". There is therefore no such thing as a minimal breach threshold[71]. It is not necessary that the taxpayer is actually or significantly hindered in the legitimate exercise of TFEU freedoms. Any harmful consequence of the application of the tax legislation at issue, even if it is merely potential[72] or minimal[73], suffices for these purposes. This is in all likelihood one of the reasons why the Court of Justice focused on the offsetting of losses and almost disregarded entirely the other advantages or features of the tax unity scheme. Although some authors critically pointed out that "*there was no factual indication of any losses in the X Holding case*"[74], their existence was necessarily irrelevant for purposes of the Court's analysis, since it is not its role to solve individual cases but to provide authoritative guidance on the interpretation of EU law. The truth is that despite the allegation that "*the failure to address the other disadvantages… can easily be viewed by the parties as a denial of due process (insufficient statement of reasons) and a denial of justice…* [and that the]*… question thus arises whether the referring judge in X Holding should now feel obliged to refer a request for a preliminary ruling back to the ECJ due to the fact that the decision of the Second Chamber of the Court displays numerous violations of procedural and substantive law*"[75], the *Hoge Raad* did nothing of the kind.

68 *X Holding*, paragraph 18.

69 *X Holding*, paragraph 19.

70 See *ICI*, paragraphs 20 ff.

71 See *Avoir Fiscal*, paragraph 21.

72 See ECJ, 14 December 2000, Case C-141/99, *Algemene Maatschappij voor Investering en Dienstverlening NV (AMID) v Belgische Staat* ("*AMID*"), [2000] ECR I-11619, paragraph 27.

73 See ECJ, 11 March 2004, Case C-9/02, Hughes *de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie* ("*Lasteyrie du Saillant*"), [2004] ECR I-02409, paragraph 43.

74 Van Thiel and Vascega, "*X Holding…*", cit., p. 342.

75 Van Thiel and Vascega, "*X Holding…*", cit., pp. 337 and 338.

(ii) Acceptance of disparities[76]

The Court of Justice only finds an obstacle where the detrimental impact to the migrant taxpayer (be it inbound or outbound) results from the exercise of taxing powers by a single Member State. Disparities arising "*from the exercise in parallel by two Member States of their fiscal sovereignty*"[77] do not represent hindrances forbidden by the TFEU, as the Court of Justice would reiterate in *Orange Smallcap*[78], and it is irrelevant whether they assume the form of juridical or economic double taxation, if the Member State in question does not treat migrant and non-migrant taxpayers differently. Therefore, "*the overall approach of looking at double burdens in two jurisdictions in order to decide which jurisdiction is responsible for removing the restriction seems to be a road that has been closed*"[79].

The consistency is emphasised by the application of the reasoning that "*the Treaty offers no guarantee to a worker that extending his activities into more than one Member State or transferring them to another Member State will be neutral as regards social security*"[80] to the tax arena[81]. In this light, it is understandable that the Court accepts cross-border double juridical

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76 Despite his elegant defence, the Court of Justice has never accepted the concept of "dislocation". See Wattel, Peter, "*Corporate tax jurisdiction in the EU with respect to branches and subsidiaries; dislocation distinguished from discrimination and disparity; a plea for territoriality*", EC Tax Review, Kluwer, 2003-4, pp. 194 ff.

77 *Kerckhaert-Morres*, paragraph 20. This decision is not inconsistent with ECJ, 6 March 2007, Case C-292/04, *Wienand Meilicke, Heidi Christa Weyde and Marina Stöffler v Finanzamt Bonn-Innenstadt* ("*Meilicke*"), [2007] ECR I-01835., where allegedly the Court of Justice held that "*the shareholder's Member State of residence must recognize the (level of) taxation applied in the company's source Member State (the principle of mutual recognition)*" (Bizioli, Gianluigi, "*Balancing the Fundamental Freedoms and Tax Sovereignty: Some Thoughts on Recent Court of Justice Case Law on Direct Taxation*", European Taxation, IBFD, March 2008, p. 136. Member States must only take into consideration the tax status of a company distributing dividends from another Member State when such status is also taken into consideration in a domestic situation (as not only in *Melicke* but also *Manninen*). If in a domestic context that element is not relevant, it is not relevant in a cross-border situation either, as was the case in *Kerckhaert-Morres*.

78 See ECJ, 20 May 2008, Case C-194/06, *Staatssecretaris van Financiën v Orange European Smallcap Fund NV* ("*Orange Smallcap*"), [2008] ECR I-03747, paragraph 37.

79 Vanistendael, Frans, "*Denkavit Internationaal: The Balance between Fiscal Sovereignty and the Fundamental Freedoms?*", European Taxation, IBFD, May 2007, p. 213.

80 ECJ, 19 March 2002, Joined Cases C-393/99, *Institut national d'assurances sociales pour travailleurs indépendants (Inasti) v Claude Hervein and Hervillier SA*, and C-394/99, *Guy Lorthiois and Comtexbel SA* ("*Hervein and Lorthiois*"), [2002] ECR I-02829, paragraph 51.

81 See ECJ, 15 July 2004, Case C-365/02, *Marie Lindfors* ("*Lindfors*"), [2004] ECR I-07183, paragraph 34, and ECJ, 12 July 2005, Case C-403/03, *Egon Schempp v Finanzamt München V* ("*Schempp*"), [2005] ECR I-06421, paragraph 45.

taxation where a country does not eliminate it domestically (*Damseaux*, upholding *Kerckhaert-Morres*) but rejects cross-border double economic taxation "*where a Member State has a system for preventing or mitigating… economic double taxation for dividends paid to residents by resident companies*"[82]. This analysis is consistent with *Manninen*[83], before, but also with *Les Vergers du Vieux Tauves*[84] more recently.

This reasoning also explains why it is not correct to state that "*cash-flow disadvantages seem to no longer be of concern to the Court*"[85]. Cash-flow disadvantages such as those found in joined cases *Metallgesellschaft* and *Hoechst*[86] arise due to the legislation of one Member State alone and are therefore unacceptable. Conversely, those that result from the inability to immediately deduct losses which may in due course be deducted in the host State derive from the interplay of origin and host State rules and the Court implicitly accepted them in *Marks & Spencer* and *Lidl Belgium*[87] as a tolerable consequence of the exercise of the TFEU freedoms. As mentioned above, none of the Member States involved can ensure neutrality of such exercise[88].

Accordingly, in *X Holding*, the Court of Justice did not delve into any possible cash-flow disadvantages arising from the inability to form a fiscal unity in the Netherlands. Some commentators have fiercely criticised this stance of the Court, even alluding to a concern (at least of the Advocate-General) with a cash-flow disadvantage for the Member-State[89], when in fact there is no reference or indication in the judgment that there was such consideration. Actually, it is quite clear from the Court's direct tax case-law that any kind of "mercy" based on the relevance of the tax revenue generated by a defective domestic provision is absent in the Court's agenda.

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82 *ACT IV GLO*, paragraph 55.

83 See *Manninen*, paragraph 33.

84 See *Les Vergers du Vieux Tauves*, paragraph 47.

85 Lang, "*Recent…*", cit., p. 112.

86 ECJ, 8 March 2001, Joined Cases C-397/98, *Metallgesellschaft Ltd and Others v Commissioners of Inland Revenue and HM Attorney General*, and C-410/98, *Hoechst AG and Hoechst (UK) Ltd v Commissioners of Inland Revenue and HM Attorney General* ("*Metallgesellschaft and Hoechst*"), [2001] ECR I-01727.

87 ECJ, 15 May 2008, Case C-414/06, *Lidl Belgium GmbH & Co. KG v Finanzamt Heilbronn* ("*Lidl Belgium*"), [2008] ECR I-03601.

88 See O'Shea, Tom, "*Court of Justice Rejects Advocate General's Advice in Case on German Loss Relief*", World Tax Daily, 123-2, June 25, 2008.

89 See Van Thiel and Vascega, "*X Holding…*", cit., pp. 341 ff.

It is respectfully submitted that the analysis should be reversed, i.e., the Court detected a potential breach of EU law consisting in a restriction of the freedom of establishment and proceeded to ascertain whether any justification was available to legitimise it. Such justification was not, as examined below, a cash-flow disadvantage for the Netherlands. It was because the Netherlands was found to be justified in the regime adopted that, in combination with Belgium rules, a cash-flow disadvantage might arise to the taxpayer. That, however, is not contrary to EU law: it merely represents the unfortunate but understandable result of the exercise in parallel by two Member States of their fiscal sovereignty (one of them in a "potentially-breaching-but-justified-manner").

(iii) Impact of DTCs

Finally, the Court of Justice has developed the consistent view that DTCs form part of the domestic framework and that, as such, whereas a Member State "*cannot rely on the existence of a tax advantage granted unilaterally by another Member State in order to escape its obligations under the Treaty*"[90], it may overcome an obstacle triggered by its own domestic law by negotiating appropriate remedies in a DTC. Contrary to what has been argued, this does not appear to imply "*that the object of comparison should be transferred from the domestic legal order to the Community legal order or to the Internal Market legal order*" [91], but instead that a restriction can be healed vicariously by the treatment provided for by another Member State as a result of a DTC that the Member State creating the restriction was able to enter into: "*a Member State may succeed in ensuring compliance with its obligations under the Treaty through the conclusion of a convention for the avoidance of double taxation with another Member State*"[92].
It should be emphasised that the application of the DTC has to effectively "*overcome the effects of the restriction*"[93] and therefore it is necessary "*to determine whether it enables the effects of the restriction… to be neutralised*"[94]. A potential remedy is not sufficient in the eyes of the Court.

90 ECJ, 8 November 2007, Case C-379/05, *Amurta SGPS v Inspecteur van de Belastingdienst / Amsterdam* ("*Amurta*"), [2007] ECR I-09569, paragraph 78.

91 Bizioli, "*Balancing*…", cit., p. 136.

92 *Amurta*, paragraph 79. This had been made clear in *Bouanich*, paragraphs 50 ff., and reiterated, among others, in *ACT IV GLO*, paragraph 71.

93 ECJ, 14 December 2006, Case C-170/05, *Denkavit Internationaal BV and Denkavit France SARL v Ministre de l'Économie, des Finances et de l'Industrie* ("*Denkavit Internationaal*"), [2006] ECR I-11949, paragraph 47.

94 *Amurta*, paragraph 84.

d. Justifications

(i) General remarks

The most disputed feature about the *X Holding* decision is undoubtedly its conclusions on justifications and more precisely the proportionality analysis carried out by the Court[95]. However, it is respectfully submitted that, once again, the Court of Justice did nothing but maintain its usual thinking on the subject (although admittedly in a relatively circuitous way).

In very broad terms, discriminatory treatment on grounds of nationality can be justified only, under the TFEU, by public security, public health[96] and public policy reasons. In this respect, there has been little impact to date in the direct tax field[97].

On the other hand, discrimination on the grounds of residence (in a host State scenario) or a restriction (in an origin State case) may potentially be justified, provided that the principle of proportionality is respected[98].

(ii) General Interest Justifications

With respect to the general interest justifications, "*the Court has accepted a number of public interests not listed in the Treaty as [being] sufficiently vital*"[99]. These include some fundamental socio-economic reasons, related not to the protection of tax revenue but with the safeguarding of the best interests of people and economic agents involved (e.g., preservation of jobs in *Geurts and Vogten*[100] and *Jäger*[101]).

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95 See, among others, the "*Opinion Statement of the CFE on X Holding (C-337/08)*".

96 Not in respect of the free movement of capital.

97 This does not mean that Member States do not try to claim such a defence, as in ECJ, 11 September 2007, C-76/05 *Herbert Schwarz and Marga Gootjes-Schwarz v Finanzamt Bergisch Gladbach* ("*Schwarz*"), [2007] ECR I-06849, where Germany unsuccessfully employed education policy arguments, among others (paragraph 50 ff.). See also ECJ, 6 October 2009, C-153/08, *Commission of the European Communities v Kingdom of Spain* ("*Commission v Spain*"), [2009] ECR I-09735, paragraphs 37 ff.

98 See II.d(iii) below.

99 Terra, Ben, and Wattel, Peter, "*European Tax Law*", 5th edition, Kluwer Law International, The Netherlands, 2008, p. 50.

100 See ECJ, 25 October 2007, Case C-464/05, *Maria Geurts and Dennis Vogten v Administratie van de BTW, registratie en domeinen and Belgische Staat* ("*Geurts and Vogten*"), [2007] ECR I-09325, paragraph 26.

101 See ECJ, 17 January 2008, Case C-256/06, *Theodor Jäger v Finanzamt Kusel-Landstuhl* ("*Jäger*"), [2008] ECR I-00123, paragraph 50.

As regards tax-specific grounds, they may be classified and organised in several different ways and there is abundant literature – and fierce discussion – on taxonomy and nomenclature, which sometimes adds little to an insightful understanding of the thinking of the Court on this subject. A simplified approach, for the purposes of the discussion of this article, may perhaps reduce those grounds, in the direct tax field, to a common denominator[102], the *integrity of the tax system* from several different angles of observation, including, and again citing examples of case-law over a decade or more:

- its intrinsic structuring and coherence[103];

- its territorial application in the form of fiscal territoriality or balanced allocation of taxing powers[104];

- its pre-emptive approach translated in the need to prevent tax avoidance in one or more of its several forms[105]), but only if the rules in question have the "*specific purpose of preventing wholly artificial arrangements, designed to circumvent... tax legislation*"[106]; and,

- from a surveillance and control perspective, its "fiscal supervision" manifestation, present at least in indirect taxation since *Cassis de Dijon*[107], and increasingly irrelevant due to the increasing scope of mutual assistance in the recovery of debt (particularly since

102 A common denominator was instead found in the concept of "*national fiscal interest*" in Bizioli, "*Balancing…*", cit., pp. 139 and 140.

103 See ECJ, 28 January 1992, Case C-300/90, *Commission of the European Communities v Kingdom of Belgium* ("*Commission v. Belgium*"), [1992] ECR I-00305, paragraphs 14 ff., and ECJ, 23 October 2008, Case C-157/07, *Finanzamt für Körperschaften III in Berlin v Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt GmbH* ("*Krankenheim*"), [2008] ECR I-08061, paragraphs 40 ff.

104 See *Futura*, paragraphs 18 ff., and *Marks & Spencer*, paragraphs 43 ff.

105 See *ICI*, paragraph 26, *a contrario sensu, Marks & Spencer,* paragraph 57, and ECJ, 18 July 2007, Case C-231/05, *Oy AA* ("*Oy AA*"), [2007] ECR I-06373, paragraph 60.

106 ECJ, 12 December 2002, Case C-324/00, *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt* ("*Lankhorst-Hohorst*"), [2002] ECR I-11779, paragraph 37. There is similar language in ECJ, 11 October 2007, Case C-451/05, *Européenne et Luxembourgeoise d'investissements SA (ELISA) v Directeur général des impôts and Ministère public* ("*ELISA*"), [2007] ECR I-08251, paragraph 91, and ECJ, 17 January 2008, Case C-105/07, *Lammers & Van Cleeff NV v Belgische Staat* ("*Lammers & Van Cleef*"), [2008] ECR I-00173, paragraph 33.

107 See ECJ, 20 February 1979, Case C-120/78, *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein* ("*Cassis de Dijon*"), [1979] ECR 00649, paragraph 8.

Directive 2001/44/EU, of 15 June), except for when third countries are involved[108], and in any case with a relatively recent example being the decision in joined cases *X* and *E.H.A. Passenheim-van Schoot*[109].

In *X Holding*, the governments which submitted observations argued that the restriction adopted by the Dutch legislation was "*justified **in particular** on the ground of safeguarding the allocation of the power to impose taxes between the Member States*"[110]. Following that road, the Court invoked *Marks & Spencer* and *Lidl Belgium* to conclude that "*the preservation of the allocation of the power to impose taxes between Member States may make it necessary to apply to the economic activities of companies established in one of those States only the tax rules of that State in respect of both profits and losses*"[111].

Therefore, there was a concern about the potential to "manipulate" losses, namely that taxpayers would be able to move losses from another Member State to the Netherlands, thus potentially avoiding taxes by means of illegitimate/abusive tax planning. The intention to prevent tax avoidance underlies the statement of the Court states that "*To give companies the option of having their losses taken into account in the Member State in which they are established or in another Member State would seriously undermine a balanced allocation of the power to impose taxes between the Member States, since the tax base would be increased in the first Member State, and reduced in the second, by the amount of the losses transferred*"[112]. Naturally, this statement has to be read very carefully as it does not apply to every possible way of taking losses into account in a Member State different than that in which those losses have been generated. For instance, the interaction between rules of one country and another could give rise to a situation where both would take the losses into consideration. The fact that the Member State where those losses had not been generated also accepted their deductibility did not necessarily mean that there would be an increase of the tax base in the Member State where the losses had been generated,

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108 See ECJ, 18 December 2007, Case C-101/05, *Skatteverket v A.* ("*A.*"), [2007] ECR I-11531, paragraph 63, and ECJ, 19 November 2009, Case C-540/07, *Commission of the European Communities v Italian Republic* ("*Commission v. Italy*"), [2009] ECR I-10983, paragraphs 68 ff.

109 ECJ, 11 June 2009, Joined Cases C-155/08 *X v Staatssecretaris van Financiën* and 157/08, *E. H. A. Passenheim-van Schoot v Staatssecretaris van Financiën* ("*X and Passenheim*"), [2009] ECR I-05093.

110 *X Holding*, paragraph 27, with emphasis added by the author.

111 *X Holding*, paragraph 28.

112 *X Holding*, paragraph 29.

unless the latter had some sort of recapture rule to prevent double dipping. Notwithstanding the above, the judgment is entirely correct because the Court uses the disjunctive "or", meaning that it is considering only situations (e.g., a transfer proper) where using the losses in another Member State would free the Member State where they been generated from the obligation to recognise them (hence the reference to "*losses transferred*"). This is why the Court alludes to the possibility of the taxable base of the subsidiary increasing[113].

One might wonder whether the Court fully understood either the intricacies of the Dutch system or the intent of the taxpayer, because the transfer as such was not necessarily involved [114] (apparently it did, unless the conclusion is that the *Hoge Raad* itself does not understand them either). However, the author believes that such question would be unfair to the Court. The following paragraph – "*The same applies with regard to a tax integration scheme such as that at issue in the main proceedings*"[115] – clarifies that the Court is not affirming that the above statement relates to the case at hand, it is simply establishing an analogy, which is very frequent in its decisions [116]. The relevant operative segments of the judgment are therefore in the following paragraphs. First, the Court considers that, "*Since the parent company is at liberty to decide to form a tax entity with its subsidiary and, with equal liberty, to dissolve such an entity from one year to the next, the possibility of including a non-resident subsidiary in the single tax entity would be tantamount to granting the parent company the freedom to choose the tax scheme applicable to the losses of that subsidiary and the place where those losses are taken into account*"[117]. It has been remarked that the Court was particularly impressed by the degree of liberty granted to the taxpayer not only to opt for applying the tax unity regime but also to shape and reshape the tax unity in the most favourable way, on a yearly basis[118]. Specifically, "*Since the dimensions of the tax entity can therefore be altered, acceptance of the possibility of including a non-resident subsidiary in such an entity would have the consequence of allowing the parent company to choose freely the Member State in which the*

113 See Weber, "*X Holding. Refusal…*", cit., p. 68.

114 It has even been claimed that "*the CJ (and an AG)… could no longer cope with the complexity of tax law*" (Weber, "*X Holding. Refusal…*", cit., p. 73).

115 *X Holding*, paragraph 30.

116 As well as fully understandable considering its tradition of cross-reference to previous judgments, a form of ensuring consistency and saving time in internal discussions.

117 *X Holding*, paragraph 31.

118 Panayi, Christiana, "*Reverse subsidiarity and EU tax law: can Member States be left to their own devices?*", British Tax Review, 2010, no. 3, pp. 284 and 285.

losses of that subsidiary are to be taken into account"[119]. This is precisely the type of manipulation, if not outright illegitimate tax avoidance, the Court accepts that the Netherlands can prevent and which leads to the conclusion that the Dutch rules are appropriate to achieve the objective of safeguarding the allocation of taxing rights[120]. In other words, "*Although the preservation of the allocation of taxing rights seems to be the only overriding reason in the Court's ruling, another second reason also looms in the text, which is the fear of abuse*"[121]. It is respectfully submitted that this fear, which relates to the risk of loss trafficking, is not evidenced "*only in passing*"[122], but is instead at the core of the reasoning of the judgment. Indeed, the Court was perfectly conscious that "*simply arguing that balance in the allocation of taxing rights might be affected is not enough. The threat to the balanced allocation of the power to impose taxes must be demonstrated. Here, the problem related to loss trafficking or loss tax planning*"[123].

It is therefore unintelligible how it can be claimed that "*the Court thus seem to focus on "balanced allocation" almost as a sole justification, which is contrary to Marks & Spencer, where the additional grounds of loss trafficking and double dipping played a key role*"[124]. It is true that the word "*almost*" smoothens the sentence, but the suggestion that loss trafficking and double dipping were not at the very heart of the *X Holding* judgment is astonishing, particularly when the Court explicitly alludes to the "*freedom to choose… the place where those losses are taken into account*" [125]. Nevertheless, since more than one commentator sees things "*only in passing*", one should acknowledge that the Court should be more careful in the structuring and writing of its judgments, namely by adopting a more straightforward description (e.g., the freedom to traffic losses or to set up double dip schemes, instead of "*choose… the place where those losses are taken into account*").

It should also be noted that it is not relevant that in this particular case there were no losses in dispute[126]: the Court did not decide the case of *X Holding*,

119 *X Holding*, paragraph 32.

120 See *X Holding*, paragraphs 33 and 34.

121 Almendral, "*An Ever…*", cit., p. 494.

122 CFE, "*Opinion…*", cit., p. 3, and Van Thiel and Vascega, "*X Holding…*", cit., 338.

123 O'Shea, "*Dutch…*", cit., p. 835.

124 Van Thiel and Vascega, "*X Holding…*", cit., p. 338.

125 *X Holding*, paragraph 31.

126 See Weber, "*X Holding. Refusal…*", cit., p. 68.

it interpreted EU law. Consequently, it did not dwell on other consequences of the fiscal unity, as it felt that this risk of loss trafficking was enough as a justification. In other words, it concluded that the ability to prevent taxpayers from "cherry picking" – freely deciding whether to use jurisdiction A or jurisdiction B to make use of tax losses – was legitimate, which is in line with the conclusion of the Advocate-General of the *Hoge Raad*, Peter Wattel[127].

The balanced allocation of tax jurisdiction is naturally the framework where such a fear is expressed: preventing taxpayers from availing of a system which would allow them to manipulate losses and to choose where they prefer to have them recognised goes beyond mere "revenue concerns". It is amazing that commentators found this surprising or even inconsistent, when, for instance, the Court had stated that "*In circumstances such as those of the main proceedings, to accept that the losses of a non-resident permanent establishment might be deducted from the taxable income of the principal company would result in allowing that company to choose freely the Member State in which those losses could be deducted*"[128].

Against this reasoning, one could argue that tax consolidation should not be considered as providing an advantage but merely remedying distortions[129]. Tax consolidation would simply remove the distortion created by the fact that an enterprise opted for carrying on its activities through separate legal entities instead of branches. This is certainly one way of looking at the issue. Alternatively, one can also consider that having separate legal entities represents, in itself, an advantage for the enterprise, namely as regards the limitation of liability that an enterprise operating through branches cannot avail of. Therefore, the perspective according to which tax consolidation merely remedies distortions – as if the lawmaker were almost required to create some sort of tax consolidation scheme one way or the other – appears to overlook the fact that there are other, not strictly economic factors, to consider as well, and that such distortions are voluntarily adopted by taxpayers in exchange for other, non-tax, advantages (namely, the limitation to corporate liability). In any case, the fact that the *Hoge Raad* has confirmed the position of the Court of Justice may be an indication that the understanding of the Dutch tax system of the latter was not as blatantly wrong as claimed by some authors...[130]

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127 See Weber, Dennis, "*X Holding. Cross-border tax consolidation. Additional Opinion. AG Wattel of the Netherlands Supreme Court*", Vakstudie Highlights & Insights on European Taxation no. 9, Kluwer, 2010, pp. 66 ff.

128 *Lidl Belgium*, paragraph 34. Similar statements are to be found in *Marks & Spencer* (paragraphs 46 and 49), *Oy AA* (paragraph 56) and *Rewe* (paragraph 42)

129 Wilde, "*On X Holding...*", cit., p. 172.

130 For instance, Weber, "*X Holding. Refusal...*", cit., p. 66.

It has also been claimed that "*unequal tax treatment simply cannot be justified by pointing to the differences in tax treatment*"[131]. However, it should be noted that in reality any tax treatment is a shape comprising a complex of features, some of which may compensate others. Where there are differences in tax treatment on one of the facets (e.g., an exemption), the Court has accepted differences on another (e.g., non-deductibility), if that is what coherence requires. It did so in *Bachmann*[132] and again in *Krankenheim*. These cases are the perfect example that an unequal tax treatment can be justified because an advantageous feature of such treatment is capable of directly compensating a disadvantage. The fact is that when the Court moves from the comparability analysis to the justification analysis, it cannot focus solely on one of the facets but instead on the outcome of the tax treatment as a whole. At that point, symmetry, which on a comparability level is not a tenet, emerges as focal point of the reasoning of the Court on proportionality, precisely because proportionality appeals to balance and fairness. However, in *X Holding* it was not a matter of coherence, but of appropriate allocation of taxing rights and prevention of manipulation by taxpayers that were the crux of the matter.

(iii) Proportionality

Having concluded that a legitimate justification was at stake, the Court proceeded to examine whether the Dutch rules were proportional or, instead, exceeded what was required to attain the envisaged safeguard of the allocation of taxing rights.

In broad terms, when a general interest objective is at stake (such as "*professional rules justified by the general good*"[133]), discrimination on the grounds of residence (in a host State scenario) or restrictions (in an origin State case) may be justified provided that the limitation "*is effected without discrimination*"[134]. It is further required that "*the interests which such rules are designed to safeguard are protected*"[135] and "*that the same result cannot be achieved by less restrictive rules*"[136], so they should not go beyond what

131 Wilde, "*On X Holding...*", cit., p. 181.

132 ECJ, 28 January 1992, Case C-204/90, *Hanns-Martin Bachmann v Belgian State* ("*Bachmann*"), [1992] ECR I-00249.

133 ECJ, 28 April 1977, Case 71/76, *Jean Thieffry v Conseil de l'ordre des avocats à la cour de Paris* ("*Thieffry*"), [1977] ECR 765, paragraph 12.

134 *Thieffry*, paragraph 12.

135 ECJ, 4 December 1986, Case C-205/84, *Commission of the European Communities v Federal Republic of Germany* ("*Commission v. Germany*"), [1986] ECR 03755, paragraph 27.

136 ECJ, 20 May 1992, Case C-106/91, *Claus Ramrath v Ministre de la Justice, and l'Institut des réviseurs d'entreprises* ("*Ramrath*"), [1992] ECR I-03351, paragraph 31.

is strictly necessary. These requirements were consistently developed throughout the years by the Court of Justice in several decisions and finally compiled in *Kraus*[137]. Curiously, this synthesis became known in the literature as the *Gebhard* formula[138], but the *Kraus* decision precedes it by almost three years.

Therefore, unless a difference in situation objectively justifies a distinct treatment, discrimination on the grounds of residence and restrictions *stricto sensu* are only justifiable if they pursue a general interest purpose and they are applied in a non-discriminatory (with respect to nationality), appropriate and proportional manner. It is herein submitted that the Court of Justice has applied this general EU law principle in direct taxation matters with striking consistency and that *X Holding* is no exception, its deficiencies residing in some lack of clarity rather than in technical inconsistency. One of the reasons may be that the Court of Justice applies the proportionality test in a very objective manner, as a simple comparison of degrees of restrictiveness, with a view to ensuring that the restriction "*does not to go beyond what is necessary*"[139]. Therefore, the Court of Justice does not refrain itself from ruling that, for instance, fiscal supervision may be ensured by means other than those provided for by the law of a certain Member State[140]. Conversely, certain restrictions may be deemed proportional if no less restrictive alternatives appear to be available[141].

Proportionality is particularly relevant in respect of restrictions allegedly aimed at combating tax avoidance. In most cases where Member States have claimed that a certain restriction to TFEU freedoms was necessary to prevent abusive conduct, the Court of Justice did not refrain from finding a rule to "*greatly exceed[…] what is necessary in order to achieve the aim which it pursues*"[142] and from considering a rule to be in breach of EU law if, "*despite the absence of objective evidence such as to indicate the existence of an arrangement of that nature*"[143], a certain domestic rule operates as if a

137 See ECJ, 31 March 1993, Case C-19/92, *Dieter Kraus v Land Baden-Württemberg* ("*Kraus*"), [1993] ECR I-01663, paragraph 32.

138 See ECJ, 30 November 1995, Case C-55/94, *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* ("*Gebhard*"), [1995] ECR I-04165, paragraph 37.

139 *Kraus*, paragraph 32.

140 See *Futura*, paragraph 40.

141 See *Oy AA*, paragraph 65.

142 *Lasteyrie du Saillant*, paragraph 52.

143 ECJ, 12 September 2006, Case C-196/04, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* ("*Cadbury-Schweppes*"), [2006] ECR I-07995, paragraph 72.

wholly artificial arrangement were in place in a certain cross-border structure[144].

In *X Holding*, the Court starts by noting that the taxpayer and the European Commission suggest that applying an arrangement equivalent to that foreseen in the Dutch legislation for PEs abroad "*might constitute a less onerous means to achieve the relevant objective than prohibiting a resident parent company from forming a single tax entity with a non-resident subsidiary*"[145]. However, prompted by the argument of the taxpayer and of the European Commission that "*by way of analogy, non-resident subsidiaries could, in the context of a cross-border tax entity, be treated in the same way as foreign permanent establishments*"[146], the Court states that foreign PEs and foreign subsidiaries "*are not in a comparable situation with regard to the allocation of the power of taxation*"[147]. It then proceeds to affirm that "*the Member State of origin remains at liberty to determine the conditions and level of taxation for different types of establishments chosen by national companies operating abroad, on condition that those companies are not treated in a manner that is discriminatory in comparison with comparable national establishments*"[148], which means that provided that foreign PEs are not treated detrimentally *vis-à-vis* domestic PEs, they can be accorded a treatment which differs from that which applies to foreign subsidiaries.

This point is absolutely crucial to understand the reasoning of the Court. In all fairness, one has to acknowledge that there is nothing new about it: the conclusion that the origin State and the host State have different obligations is absolutely clear since at least *ACT IV GLO*[149] and has been restated in

144 Another example being that a transaction with a non-resident party (e.g., a loan) "*cannot be the basis of a general presumption of abusive practices and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty*" (ECJ, 13 March 2007, Case C-524/04, *Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue* ("*Thin Cap Group*"), [2007] ECR I-02107, paragraph 73, and consistently reiterated in C‑105/07 *Lammers & Van Cleef*, paragraph 27, and ECJ, 4 December 2008, Case C-330/07, *Jobra Vermögensverwaltungs-Gesellschaft mbH v Finanzamt Amstetten Melk Scheibbs* ("*Jobra*"), [2008] ECR I-09099, paragraph 37).

145 *X Holding*, paragraph 35.

146 *X Holding*, paragraph 35.

147 *X Holding*, paragraph 38.

148 *X Holding*, paragraph 40.

149 See Almendral, "*An Ever…*", cit., p. 492.

Truck Center[150], for instance[151]. This is why it is hard to see any form of inconsistency with settled case law as regards the scope and ambit of the freedom of establishment. Specifically, it is true that the Court has upheld the freedom "*to choose the appropriate form in which to pursue their activities in another Member State and that this freedom of choice must not be limited in the host state by discriminatory tax provisions*"[152], according to the long standing *Avoir Fiscal* doctrine, but in *X Holding* the rule challenged was a provision of the origin State. As the Court has made clear in *Columbus Container*[153] and joined cases *KBC Bank* and *Beleggen*[154], that freedom of choice is not deemed limited by the origin State if it treats two of those forms of exercising activities in the host State differently, as long as neither is treated in a detrimental fashion *vis-à-vis* the comparable exercise in the origin State[155].

At this stage, two issues may be raised. One is whether it is true, as has been claimed, that by concluding that the inclusion in the tax unity may be denied to foreign subsidiaries because they are not subject to the same tax regime the Court is not coherent with its judgment in *STEKO*[156]. The reply is that the Court did not reach its conclusion on the basis of such argument. The statement in *STEKO* that "*The application of different taxation systems to a*

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150 See O'Shea, "*Truck Center...*", cit., p. 596.

151 The Court is also accused of "*accept*[ing] *that the denial of group treatment is proportional, first, because the less restrictive "temporary transfer of losses" would cause a cash flow disadvantage for Member States and would for that reason itself be justified by the need to ensure a balanced allocation of tax jurisdiction*" (CFE, "*Opinion…*", cit., p. 4). However, it is not possible to find any reference in the judgment to considerations of cash-flow disadvantages. It is not uncommon to find criticism to the Court partially based on disagreement with statements or arguments of the Advocate-General that the Court did not second, upheld or even agreed with.

152 CFE, "*Opinion…*", cit., pp. 5 and 6.

153 See *Columbus Container*, paragraphs 51 and 53.

154 See ECJ, 4 June 2009, Joined Cases C-439/07, *Belgische Staat v KBC Bank NV*, and C-499/07, *Beleggen, Risicokapitaal, Beheer NV v Belgische Staat* ("*KBC* and *Beleggen*"), [2009] ECR I-04409, paragraph 80.

155 See, however, Englisch, Joachim, "*Taxation of Cross-Border Dividends and EC Fundamental Freedoms*", Intertax, Volume 38, Issue 4, p. 213 (footnote 149), and Van Thiel and Vascega, "*X Holding…*", cit., pp. 345-347. The latter hold that the "*comparison with comparable domestic establishments*" (*Columbus Container*, paragraph 53) would require a comparison between subsidiaries, when in fact the taxpayer is the company exercising the freedom of establishment (and the reason why the Court alludes to "*those companies*" and not to the foreign establishments).

156 ECJ, 22 January 2009, Case C-377/07, *Finanzamt Speyer-Germersheim v STEKO Industriemontage GmbH* ("*STEKO*), [2009] ECR I-00299. See Almendral, "*An Ever…*", cit., p. 494.

resident company depending on whether it has holdings in resident or non-resident companies cannot be a valid criterion for assessing the objective comparability of their situations and, therefore, for identifying an objective difference between them"[157] could have been transposed to the *X Holding* case almost word for word. It is entirely consistent with the statement in *X Holding* that "*the situation of a resident parent company wishing to form a single tax entity with a resident subsidiary and the situation of a resident parent company wishing to form a single tax entity with a non-resident subsidiary are objectively comparable*"[158]. The difference between the two cases arose not from the comparability but from the justification analysis. In this regard, it is very suggestive that in *STEKO* Germany did not even raise the possible justification of the balanced allocation of taxing rights. The fact is that such a justification would not apply: whereas the loss in the write-down of a subsidiary is intrinsically a loss for the parent company, tax unity, tax grouping and tax consolidation cases deal with losses of the subsidiaries. The market price of the shares could have fallen – as it often does – for reasons that are not exclusively related to the inherent value of the company – an increase in the interest rate payable on bonds can be enough to depreciate shares, even of profitable and well-managed companies. German law actually recognised this, because whether or not the write-down was deductible had to do not with the liability for the subsidiary to be taxed in Germany but with the fact that a possible capital gain could avail, or not, from a tax exemption (which the Court found not to be sufficient to represent the essential link that legitimises the justification of tax coherence). Therefore, there was nothing in *STEKO* that could jeopardise Germany's taxing rights in favour of those of any other country. This last remark is also significant: tax coherence is, *de rerum natura*, assessed by reference to the tax system of the country in question, ignoring any other (which is what the Court did in *STEKO*), unless the former country is able to cure a defect of its tax system by means of a DTC with another country (the provisions of which become part of its legal framework[159]). Conversely, the balanced allocation of taxing rights entails ascertaining whether the country in question is encroached in its tax sovereignty, which inevitably means that another country is able to exercise taxing rights in an "excessively favourable" fashion, potentially deriving a "collateral benefit" from the exercise by a taxpayer of one or more fundamental freedoms (this may occur precisely with loss trafficking cases, since taxpayers may be able to use them in the most "convenient" State and end up paying more in the less "tax expensive" State). Commentators who see in the acceptance of this

157 *STEKO*, paragraph 33.

158 *X Holding*, paragraph 24.

159 See Lang, Michael, "*ECJ case law on cross-border dividend taxation – recent developments*", EC Tax Review 2008-2, p. 69.

justification by the Court a way of giving in to concerns about the protection of tax revenue of the States (or an example of insufficient protection of the fundamental freedoms) do not appear to take into consideration that the allocation of taxing rights is assessed *vis-à-vis* other States (as noted, for instance, in *Lasteyrie du Saillant*[160]), not the taxpayer. Indeed, the concern about the appropriate allocation of taxing rights implies ensuring that the legitimate taxing rights of one country are safeguarded. However, that is not achieved "at the expense" of the taxpayers but instead by preventing the taxing rights of other States from encroaching on the tax sovereignty of the former country. In *X Holding*, the Court was concerned that taxpayers might abusively transfer around and use their losses where it was more convenient, which in substance meant that whereas the Netherlands might have its taxing rights unduly restricted, other countries might be benefiting from not having to recognise tax losses that would more adequately be deducted therein. Therefore, the advantage for the taxpayer would for instance consist of the difference between tax rates or the ability to circumvent the statute of limitation for the utilisation of tax losses in those countries which enforce such a deadline, but that is not the underlying reason for the concern of the Court. The concern arises from the fact that in the absence of the Dutch rules in question the taxpayer might not only adopt a course of action which could affect the Dutch tax revenue – which in itself might be entirely legitimate – but also "prey" on the appropriate allocation of taxing rights between the Netherlands and other States.

Another issue is that one may wonder whether the Court is indeed addressing proportionality or whether the analysis of the latter is instead "*replaced by an incorrect justification and discrimination reasoning*"[161], thus restating its comparability analysis. Considering the *Gebhard* formula, and having established that the purpose (safeguarding the allocation of taxing rights) was protected in a non-discriminatory fashion, the Court should in principle be concerned about the restrictiveness of the rules, more precisely about whether it was possible, or not, to achieve the same result with less burden for the taxpayer. This is why commentators allude to a dislocation of the subject matter, with the Court focusing again on comparability instead of on proportionality *stricto sensu*[162].

It is respectfully submitted that the Court was not repeating its comparability analysis. The latter referred to the comparison between *parents with domestic subsidiaries* and *parents with foreign subsidiaries* and was

160 See *Lasteyrie du Saillant*, paragraph 68.

161 Van Thiel and Vascega, "*X Holding…*", cit., p. 341.

162 See, for all, CFE, "*Opinion…*", cit., pp. 4 and 5.

concluded decisively[163], as mentioned above. Here, the Court is addressing the comparison between *foreign PEs and foreign subsidiaries* because that is the comparison drawn by the taxpayer and the European Commission, which claimed that the safeguard of the allocation of taxing powers could be secured by less restrictive rules, arguing that "*by way of analogy, non-resident subsidiaries could, in the context of a cross-border tax entity, be treated in the same way as foreign permanent establishments*" [164] . Commentators who state that the Court is simply repeating its comparability analysis disregard that there cannot be a repetition of a comparability analysis when (i) the term of comparison is not the same and (ii) the comparison is not for the same purposes.

The Court, although admittedly in an obscure fashion, is precisely pondering whether such less restrictive rules – allowing the "*temporary transfer of losses linked to a recovery arrangement in subsequent financial years*" [165] – would be adequate to the situation at hand. In that regard, it concludes that extending "*the possibility granted to resident parent companies and their resident subsidiaries to be taxed as if they formed a single tax entity… would… have the effect of allowing parent companies to choose freely the Member State in which the losses of their non-resident subsidiary are to be taken into account*" [166]. In other words, having decided that the Dutch law was justified in denying parent companies the freedom to choose where to have the losses of its subsidiaries taken into consideration, the recapture system suggested by the taxpayer and the European Commission could not be considered an acceptable alternative. It was not a matter of how well the recovery arrangements would safeguard the allocation of taxing rights but instead of how free the taxpayer was to decide where the losses of foreign entities could be taken into account, at that taxpayer's discretion. Hence, the Court decided that the restriction enshrined in the Dutch legislation "*must be regarded as being proportionate to the objectives which it pursues*" [167], because the alternative system proposed did not allay the fears of the Court regarding the possibility of manipulation and loss trafficking.

Although it may be claimed that the Court's thinking is not entirely explicit, one can infer from this conclusion that the Court believes that allowing the "*temporary transfer of losses linked to a recovery arrangement in*

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163 See *X Holding*, paragraph 24.

164 *X Holding*, paragraph 35.

165 *X Holding*, paragraph 35.

166 *X Holding*, paragraph 41.

167 *X Holding*, paragraph 43.

subsequent financial years"[168] might not be sufficient to ensure the legitimate safeguard of the allocation of taxing powers, which is why it concluded that an outright denial of the tax unity scheme was proportionate to such objective. In other words, the alternative system was not sufficient to substantiate the justification that the Court had accepted in the preceding paragraphs. A clue may perhaps be found in the statement that:

> "*Articles 43 EC and 48 EC do not preclude legislation of a Member State which makes it possible for a parent company to form a single tax entity with its resident subsidiary, but which prevents the formation of such a single tax entity with a non-resident subsidiary, in that the profits of that non-resident subsidiary are not subject to the fiscal legislation of that Member State*"[169].

At a first glance, the reference to the profits of the non-resident subsidiaries not being subject to the fiscal legislation of the Member State the legislation of which is under analysis could be understood as a reference to comparability. However, on closer scrutiny the interpreter is reminded that, first, comparability is established at the level of the taxpayer – the parent company – and, second, that the fact that the profits of the non-resident subsidiaries are not subject to the fiscal legislation of the Member State of which the parent company is a tax resident did not prevent the Court from reaching the conclusion that parents with resident and non-resident subsidiaries are in a comparable position[170]. Actually, if those profits were subject to such legislation, comparability would be even less disputable. Therefore, the fact that the profits of the non-resident subsidiaries are not subject to the fiscal legislation of the Member State of which the parent company is a tax resident is valued by the Court from an entirely different perspective, not simply in the sense that they are not comparable but instead in the sense that a State cannot be required to extend to them a rule which it has devised for PEs only.

Above all, it appears that it is the "free choice" that worries the Court to the point of imposing on Member States the obligation to allow parent companies to include foreign subsidiaries in their tax unity perimeter. It certainly worries the Court much more than considerations on the economic efficiency of the measures adopted by the Netherlands, in the sense that such

168 *X Holding*, paragraph 35.

169 *X Holding*, paragraph 35.

170 See *X Holding*, paragraph 24.

efficiency is not something that the Court deems particularly significant when assessing the proportionality of the regime[171].

Admittedly, this reasoning opens up two rather different but nonetheless significant questions. The first is whether the decision of the Court would have been the same if, instead of a choice, the tax unity scheme was structured as an obligation for companies meeting certain criteria (e.g., whenever a parent company held at least 75% of the share capital, voting rights and rights to distributed and liquidation profits of its subsidiaries for a full tax year, the tax unity scheme would automatically apply in that tax year). In other words, one can consider "*whether or not the Dutch government could have ensured a balanced allocation of tax jurisdiction itself by abolishing the provision that allows companies to enter and exit the single tax entity at will*"[172], i.e., whether "*the abolition of this choice would, in fact, be a less restrictive way to prevent loss trafficking from undermining the balanced allocation of tax jurisdiction*"[173]. However, the Court never reasons on the basis of rules that do not exist. One Member State may be required to extend to taxpayers engaging a fundamental freedom the rules that such Member State applies to a taxpayer that does not exercise such freedom. That does mean being required to create rules *ex novo*, or even making suggestions on how to address the issue.

The second question is, naturally, whether the weight placed on the freedom of choice is reasonable, Considering that the recovery arrangement suggested by the taxpayer and the European Commission could eliminate the consequences of such freedom of choice (disregarding, just for the sake of the argument, its financial impact), why could not the Court simply accept that a recapture system would address its concerns about the ability of taxpayers to decide where tax losses are to be taken into consideration? A possible explanation is that when the Court finds the rules of Member States to be disproportionate, it does so by reference to less restrictive rules which could apply instead. In *Lasteyrie du Saillant*, for instance, the Court found that the objectives pursued by the French legislation at stake could be secured if the individual leaving the French territory had his or her capital gains tax liability deferred until the date when he or she disposed of the

171 See Wilde, "*On X Holding...*", cit., pp. 177 ff. Market neutrality and market equality are cornerstones of the internal market which according to this author should have precedence over the justification presented by the Netherlands and accepted by the Court, as they are allegedly affected by "*unilaterally imposed obstacles*", in the shape of an inefficient expression of territoriality. It is respectfully submitted that the alleged "*unilaterally imposed obstacles*" are actually the expression of legitimate taxing rights, which in the eyes of the Court cannot be excessively compressed, lest a balanced allocation will be jeopardised.

172 Van Thiel and Vascega, "*X Holding…*", cit., p. 342.

173 Van Thiel and Vascega, idem.

appreciated shares[174]. However, in that case there was comparability between the taxpayer the treatment of which was under analysis – the individual exercising his or her EU freedoms – and the taxpayer not exercising such freedoms, the treatment of which could inspire the one to be accorded to the migrant taxpayer (if the individual moved within the French territory, no taxable event would be deemed to have occurred and liability for tax only arose upon the disposal of the shares). Conversely, in *X Holding* the treatment which according to the European Commission and the taxpayer itself might represent a less restrictive but nonetheless effective rule was the treatment reserved to companies with foreign PEs, which the Court noted not to be comparable to companies with foreign subsidiaries. Hence, the Netherlands could not be required to extend its application to what the Court concluded to be a non-comparable situation[175]. The appropriate comparison was between parent companies with domestic and foreign subsidiaries and the regime which the European Commission and the taxpayer wished to see extended to the situation under analysis was that applicable to a company with foreign PEs.

Additionally, the Court of Justice by no means indicated that its decision overruled any of the past judgments, which means that, if final or terminal losses were at stake, the taxpayer could still find refuge in the doctrine of *Marks & Spencer*[176]. At the end of the day, despite allegations of inconsistency with this decision[177], the Court fundamentally decides the same as it had in *Marks & Spencer*: (i) rejecting the use of foreign losses by a parent company or head-office is, in principle, a restriction to the freedom of establishment; (ii) a balanced allocation of taxing rights and the need to prevent one or more forms of manipulation of losses, however, may justify such restriction; (iii) however, this may or may not be proportional: in *Marks & Spencer*, losses were final, so the rejection was disproportionate, whereas in *X Holding* the Court is not considering the particular issue of final losses and therefore accepted the measure as proportionate, not making any comment on final losses. Although there is literature that derives from the Court's silence an indication that "*the court conceptually seems to move away from its earlier approaches in its Bosal and Marks & Spencer II*

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174 See *Lasteyrie du Saillant*, paragraph 54.

175 *Contra*, see Weber, "*X Holding. Refusal…*", cit., pp. 68 ff.

176 See O'Shea, "*Dutch…*", cit., p. 835. That the final losses exception should apply but noting the problems it raises under Dutch law, see Weber, "*X Holding. Refusal…*", cit., pp. 71 and 72. Assuming that Member States with a tax consolidation would not have to accept final losses of foreign subsidiaries, see Kok, Reinout, "*Domestic and Cross-Border Loss Relief in the European Union*", Intertax, Volume 38, Issue 12, 2010, p. 671.

177 Van Thiel and Vascega, "*X Holding…*", cit., p. 347.

> *rulings*"[178], even spotting an alleged inconsistency because the Court did "*not consider whether the losses of the non-resident subsidiary were terminal losses*"[179] (whereas the facts of the case and the arguments of the taxpayer point to the conclusion that they were not), in reality it is at least highly debatable that the Court has ever "moved away" from its jurisprudence explicitly and thus it seems a giant leap to deduce so from… its silence.

III. Conclusions

Most Court of Justice judgments on direct taxation matters rely on criteria and reasoning developed in previous decisions on both tax and non-tax related matters and those where an original piece of thinking is required are nonetheless aligned with prior decisions. In the author's opinion, although criticism may be justified regarding the lack of clarity in various decisions, sometimes it becomes unintelligible in light of the actual wording of the Court's decisions and this is precisely what happens with *X Holding*. It has been argued, for instance, that

> "*Amazingly,* [*Marks & Spencer*], *although explicitly mentioned by the referring court and by the Advocate General at least 15 times throughout her Opinion, is not followed by her, or by the ECJ, in respect of all its crucial points, i.e.*:
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> - *that the different treatment constitutes discrimination (and thus different treatment of comparable situations)*" – but the Court actually states that indeed the situations are comparable[180], that there is a difference of treatment[181] and that such difference "*is liable to render less attractive the exercise by that parent company of its freedom of establishment by deterring it from setting up subsidiaries in other Member States*"[182];
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> - *that this discrimination can be justified only exceptionally on a combination of grounds including that the possibility of loss trafficking and a double dip could jeopardize the balanced allocation of tax jurisdiction*" – but the Court noted that "*the preservation of the allocation of the power to impose taxes between*

178 de Wilde, "*On X Holding...*", cit., p. 177.

179 Panayi, "*Reverse…*", cit., p. 286. See also Van Thiel and Vascega, "*X Holding…*" cit., p. 342.

180 See *X Holding*, paragraph 24.

181 See *X Holding*, paragraphs 20 and 25.

182 See *X Holding*, paragraph 19.

Member States"[183] was at stake and that Member States could not be required to grant "*the parent company the freedom to choose the tax scheme applicable to the losses of that subsidiary and the place where those losses are taken into account*[184];

- *and that a priori ignoring all foreign losses, without taking into account final losses and without allowing the taxpayer to prove that his situation is "comparable" to the domestic situation, would be disproportionate*"[185] – but the Court neither addressed final losses at all, nor gave any indication that it was abandoning the course set by *Marks & Spencer*.

On the one hand, with all due respect, it is not that "*the Court of Justice has recently been more willing to accept justifications for different treatment*"[186], but that the most blatant manifestations of discriminatory treatment are increasingly rare, notably due to the work of the Court of Justice. Therefore, modern cases are evermore complex and nuanced, with justifications playing a role of rising importance. On the other hand, commentators sometimes believe to have found a change in trajectory but the Court has a very good memory and old decisions cast long shadows. For instance, not much after the prediction that "*instances where* [coherence] *is accepted are diminishing as the Court of Justice becomes more concerned with the discriminatory behaviour of Member States*" and that "*In time, the coherence exception will weaken*"[187], the Court decided to clearly reiterate the validity of such justification in *Krankenheim*.

A prosaic reason that may help illuminate the consistency of the jurisprudence of the Court of Justice may be that by transposing full sentences and even paragraphs to new judgments, the *rapporteurs* reduce the scope for discussion while simultaneously enhancing the consistency of the Court's thinking on the most fundamental subjects. In practice, the Court of Justice adopts a *de facto* precedent rule and consistency has been perhaps its most valuable by-product.

The conclusion appears to be that the Court does not try to be consistent regarding direct taxation matters, but instead considering the internal market objectives and the fulfilment of TFEU freedoms. Trying to analyse cases where tax rules were under

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183 See *X Holding*, paragraph 28.

184 See *X Holding*, paragraph 31.

185 Van Thiel and Vascega, "*X Holding…*", cit., p. 348.

186 Lang, "*Recent…*", cit., p. 110.

187 Verdoner, Louan, "*The Coherence Principle under EU Tax Law*", European Taxation, IBFD, May 2009, pp. 274 and 282, respectively.

analysis as tax cases or even discern, for instance, "*a policy for dividend taxation*"[188] is in all likelihood an ineffectual exercise. It is impossible to find a consistent policy for dividend taxation because the Court neither has nor is required to have any policy for dividend taxation whatsoever. The same can be said in respect about the remark that "*it is at present particularly difficult to infer a sound and coherent doctrine on cross-border loss relief from the ECJ's case-law, as it is growingly complicated, as are as well the systems granting loss relief*"[189], because the Court is not supposed to develop a "doctrine" on cross-border loss relief. The policy and the doctrine of the Court are to protect the treaty freedoms and other EU law principles, without any particular concession to tax or any other matters. That is why the Court has accepted juridical double taxation in certain cases and rejected economic double taxation in others: where tax experts see a tax issue and tend to be more "tolerant" towards economic double taxation than juridical double taxation[190], the Court simply sees a country treating migrants and non-migrants in the same fashion. If that leads to juridical double taxation, it is the unfortunate consequence of a disparity for which EU law has no solution yet. If there is no such national treatment – and whether that triggers economic double taxation, detrimental financial impacts or simply more burdensome compliance requirements is irrelevant –, then it is unacceptable, unless properly justified.

Therefore, through a tax lens it may appear that "*Some judgments on intra-Community situations give the impression that the Court today is willing to give Member States more room to implement national tax policies than it did a few years ago. Other judgments, however, give a different impression*"[191]. It is not more than an impression, though. The Court of Justice is not prone to give Member States anything but unyielding opposition to unjustified obstacles to the exercise of TFEU freedoms. It is by reference to those freedoms that the Court needs to be consistent and it appears it has been doing a fine job at that[192].

X Holding is another landmark in the long and winding road the Court of Justice is building with its decisions. The judgment is consistent with the case-law of the Court as regards its fundamental building blocks, i.e., comparability, obstacles and justifications. It has attracted severe criticism in respect of the proportionality analysis which appears to be highly exaggerated, since the Court, although

188 Lang, "*ECJ case law…*", cit., p. 77.

189 Almendral, "*An Ever…*", cit., p. 491.

190 See, as an example, the discussion on *Kerckhaert-Morres* and *Damseaux*, in Camacho Palma, Rui, "*The Opinion of Heraclitus on C-128/08 Damseaux and C-307/08 Commission v. Belgium*", in International Tax Report, International Tax Report, Informa, (I) July /August 2009 and (II) September 2009.

191 Lang, "*ECJ case law…*", cit., p. 77.

192 Those claiming otherwise may find an interesting list of suggestions of amendments to the Court of Justice's case law in Lang, "*Recent…*", cit., p. 113.

admittedly in a rather circuitous and perhaps even obscure way did not deviate from the usual course of its thinking in this regard. Additionally, the fact that the *Hoge Raad* abided by the decision also appears to demonstrate that the Court did not display a blatant ignorance of the Dutch regime. Therefore, the only discernible "trend" in the most recent case law of the Court in the area of direct taxation seems to be that its decisions are an appealing target for unfair criticism.