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The “Labyrinth Of Impossibility” in the Tax Cases of the European Court of Justice: Is the Comparability Analysis a Way Out?

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THE “LABYRINTH OF IMPOSSIBILITY” IN THE TAX CASES OF THE EUROPEAN COURT OF JUSTICE: IS THE COMPARABILITY ANALYSIS A WAY OUT?

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1. The state of play of the ECJ decisions concerning direct taxes and the rekindling of the debate on efficiency norms

The Treaty establishing the European Community contains tax provisions that have served as the legal basis for harmonization in the field of indirect taxation, but it does not contain similar provisions in the field of direct taxation. The Treaty however includes a general rule (art. 12) according to which “any discrimination on grounds of nationality shall be prohibited”. This is an equal protection clause that is generally considered as the starting point to reach integration of an internal market where goods, services, work and capital can freely move. Within this scenario the European Court of Justice (hereinafter the “ECJ” or the “Court”) has progressively developed a judicial approach based on the so called “principle of subsidiarity”, i.e. the acknowledgement by the Court that “although direct taxation falls within the competence of the Member States, the latter must none the less exercise that competence consistently with Community Law”.

The principle of subsidiarity is a recognition that although there is no overarching principle to be followed by the Court according to which tax harmonization should be imposed by the Community institutions (including the Court itself), tax sovereignty that falls within the competence of the Member States must nevertheless be exercised consistently with Community law. Thus by relying on the principle of subsidiarity the Court has constructed a broad equal protection clause and held that in the field of direct taxation there are limitations to tax imposed by Member States which

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1 The European Economic Community was created by the Treaty establishing the European Community (hereinafter “TEC” or the “Treaty”, also known as the Treaty of Rome). In 1992, with the Treaty on European Union (“TEU”), the members of the European Economic Community (“EEC”) expanded their cooperation. The TEU renamed the EEC “European Community” (“EC”) and named the political union of Europe as the European Union (“EU”). After the TEU the Treaty of Amsterdam (1999) and the Treaty of Nice (2003) introduced amendments. Finally the Treaty of Lisbon (2009) amended the two treaties which comprise the constitutional basis of the EU, i.e. the TEU and the TEC. In this process, the TEC was renamed to the Treaty on the Functioning of the European Union (“TFEU”) and the articles renumbered. The reference in this article are at the numbering of TEC as most of the extant cases have actually applied those articles.
derive from the principle of non discrimination found in the Treaty (art. 12), as reflected in the so called fundamental freedoms: free movement of goods (art. 23), free movement of workers (art. 39), freedom of establishment (art. 43), free movement of services (art. 49), and free movement of capital (art. 56). This traditional list now includes also the freedom of movement of EU citizens (art. 18 TFEU).

A direct taxation measure potentially impacted by the equal protection clause can be brought before the Court of Justice by the infringement procedure (art. 258 TFEU, previous art. 226 of the Treaty) started by Commission or Member States, or by the preliminary ruling required by national courts of Member States (art. 267 TFEU, previous art. 234 of the Treaty). In these cases the ECJ has the power to decide that a national direct tax measure is in breach of the Treaty if that measure is held to be discriminatory or restrictive of one or more of the fundamental freedoms, and thus in the last couple of decades the ECJ invalidated income tax law provisions of the Member States and exerted a significant impact on direct taxation in the EU.

This jurisprudence of the ECJ has spurred a lively debated that originated in Europe and lately has expanded to the U.S. with a discussion on the standards, if any, adopted by the Court. The initial reactions in Europe to the decisions of the Court revolved around the question whether such decisions unduly restricted the tax sovereignty of Member States, or instead constituted an entirely new approach to EU tax issues. The discussion on those issues lingered until the end of the nineties, but the turning point was the beginning of the last decade when the Court decided landmark cases on dividends and on group taxation. This renewed jurisprudence ignited in Europe a discussion about the role of the ECJ decisions within the EU framework for tax integration


3 In that direction: Frans Vanistendael, The role of the European Court of Justice as the supreme judge in tax cases, 5 EC TAX REV. 114–122 (1996).


about their impact on domestic tax systems. On the other side of the Atlantic a new brand of criticism has been developed in 2006-2008 within American legal thinking that was essentially based on three arguments: (i) the alleged lack of concern by the Court for national tax policies, (ii) the failure by the Court to provide express guidance on how to select comparable situations to apply the equal protection clauses of the Treaty to tax measures, and (iii) a missed evaluation by the Court from an overall EU perspective of justified differences of domestic and cross-border situations.

The argument related to the lack of concern by the Court for national tax policies emphasizes that the ECJ decisions impose constraints on Member States that are “fundamentally inconsistent with the fiscal autonomy retained by the Member States in their right to veto EU taxing provisions”. In that light the ECJ decisions are viewed as limiting the ability of Member States to use tax policy to stimulate their own domestic economies with standard measures such as depreciation allowances, tax credits for new investments in plant and equipment, or tax incentives based on national policy reasons. In a wider sense it has been pointed out that a discussion of political integration is largely absent from ECJ direct tax decisions and that the Court has not used the prohibition on tax discrimination as a means to forge a single polity from the diverse constituencies of Europe.

In a second line of thinking – that relating to the failure by the Court to provide express guidance on how to select comparable situations - the argument focuses on how the Court actually decides tax cases, and addresses two aspects. A claim is raised that the Court does not explicitly state the criteria that are used to adjudicate cases on equal protection and fails to give adequate reasoning for its tax decisions thereby creating legal uncertainty. Viewed from that perspective the Court’s jurisprudence at times turns out to be arbitrary, ungrounded, and overly formalistic, and this reveals that the ECJ has in fact avoided the need to address the underlying tension between national tax autonomy and market integration, thereby leaving Member States and EU nationals with little guidance. This critical appraisal of the sentencing style of the Court is also directed to the comparable internal situation test (“CIST”) according to which the Court compares the complaining cross-border taxpayer to a purely internal taxpayer and checks whether the national treatment disadvantages non-nationals. It is in fact maintained that the use of the CIST methodology tends to focus the Court’s attention on the formal task of selecting an internal and cross-border tax situation for comparison, rather than the important competing policy considerations that ought to motivate the Court’s discrimination judgment.


Income Tax Discrimination at 1225; Internal Consistency Test at 57

Flunking the Test, supra at note 7 at 57.

Flunking the Test, supra at note 7, passim.

Internal Consistency Test, supra at note 7 at 40 and 61.

Flunking the Test, supra at note 7 at 22 – 23.
But the pivotal argument concerning how the Court actually decides the tax cases is that it has never clearly explicated the paramount standards for choosing comparable taxpayers, and in particular that the Court has not offered so far a coherent explanation of which tax attributes should be compared to conclude that tax situations are deemed similar for tax discrimination purposes. According to this criticism the Court would not have replied to important questions, such as “What does it mean for two taxpayers to be comparable? How similar must they be before they warrant equal treatment? With respect to what attributes must they be similar?”

Besides, it is claimed that the analysis of the Court is burdened by a number of attributes that aggravate the comparability with unnecessary complexities, and that the Court has offered no explanation for why, in a particular case, it compares particular attributes while ignoring others.

Finally, in respect to the third point - the complaint about a missed overall EU evaluation of justified differences - it has been noted that the Court does no provide a reliable way to distinguish mere disparities of treatment (that may be accepted) from actual restrictive or discriminatory treatment. For example, to simplify tax compliance, a host state may tax non residents on a gross basis, disallowing deductions for business expenses. This may seem discriminatory in light of the fact that residents pay tax on a net basis, after deducting their business expense, but, on the other hand, non residents may suffer no actual disadvantage from the difference in treatment, which therefore would not amount to a restriction precluded by the Treaty.

In this critical view the outcome of the process is that by eschewing normative analysis, the Court presently avoids its responsibility to decide tax cases. For example, it is argued that in the area of cross-border dividends a flat out preference for domestic parity of treatment has basically suppressed considerations of efficiency, fairness, and administrability that should inform difficult tax policy decisions.

The last chapter of the debate in the U.S. is now on stage and hinges on new issues, namely the search for an overarching canon of efficiency that could inspire the Court in its endeavour. Ruth Mason and Michael Knoll have propounded a particular type of economic efficiency as the guiding principle for judicial decisions regarding tax discrimination. They affirm that the equal protection clause must promote economic efficiency in the form of “competitive neutrality” for taxing labor income, a standard of efficiency that can be transposed to capital income and that is deemed to be superior to other forms of neutrality if the assumption is made that that taxpayers cannot change their state of residence. This competitive neutrality would impose obligations on both origin and destination countries and thus it would provide a comprehensive mechanism for eliminating distortions.

This claim has elicited a reaction by Michael Graetz and Alvin Warren, who had previously sustained that the ECJ cannot achieve consistent and coherent results by requiring non discrimination in both origin and destination countries for transactions involving the tax systems of more than one Member State. This authors surmise that the Court has entered a “labyrinth of impossibility” in light of the fact that, at the current stage of EU tax evolution, harmonized income tax bases and rates are not attainable. Graetz and Warren convincingly demonstrate that there is no evidence that the proposed canon of competitive neutrality would reduce tax-induced distortions more than competing efficiency norms because the assumption that taxpayers can never change their residences is unrealistic and confines the actual scope of analysis to a small set of cases.

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13 *Flanking the Test*, supra at note 7 at 30 – 32.
14 It is also observed that making a clear-cut distinction between mere disparities and actual discriminations is crucial if the Court is to avoid infringing on Member State tax autonomy: *Flanking the Test*, supra at note 7 at 22 – 23.
15 *Flanking the Test*, supra at note 7 at 42.
16 *Income Tax Discrimination*, supra at note 7 at 1212 and 1226.
involving cross-border workers. Graetz and Warren conclude that the proposed efficiency canon does not provide a way out of the “labyrinth of impossibility” created by a non-discrimination approach to taxation of international transactions. They clarify that there are three ways out of that labyrinth: to impose only the requirements of the origin country, to impose only the requirements of the destination country, or to harmonize the origin and destination countries’ tax laws and rates. For a discussion that demonstrates how this is not feasible at the current state of affairs of EU taxation see infra sections 8 and 9.

Are we back at step one, i.e. to the idea that the jurisprudence of the Court in tax cases cannot be rationally expounded? I am inclined to think that this is not the case because this last chapter of the debate now convincingly suggests that efficiency cannot be the sole normative principle for the Court to decide tax cases. I share Graetz and Warren’s view that the ECJ’s institutional role cannot be linked to an efficiency norm in light of the fact that the Court in tax cases constrains sovereign powers, that no cogent reason is actually found for urging a particular welfare norm, and that there is no actual basis in the Treaty to decide tax cases in accord with competitive neutrality.

This suggests that a more practical strategy to solve, at least in part, the “labyrinth of impossibility” has to be found. In my view such strategy should rely on a bottom-up evolutionary approach. I will pursue this strategy by analyzing a broad sample of the tax cases of the ECJ. These cases are viewed from the perspective of what I call “comparability analysis”, i.e. a process adopted by the Court to compare relevant domestic and cross-border situations to decide whether there are differentiated treatments. The cases of the sample are selected on the basis of a set of criteria aimed at identifying the issues that are the crucible of the decisions of the Court in the taxation of capital, i.e. of companies and their stakeholders.

The sample of tax cases of the Court used here does not include those that discuss application issues of the directives in the area of income taxes because those cases do not apply comparability analysis, and instead focus on other issues, such as, for example, tax avoidance in reorganizations of the “Merger Directive”, interpretation of terms of the “Parent Subsidiary Directive”, or scope of application of the “Interest Royalty Directive” and so on. By contrast, certain cases concerning the tax directives (particularly the Parent Subsidiary Directive) have been included in the sample because they make ample use of the comparability analysis. Furthermore the sample does not

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19 Labyrinth of Impossibility, at 1129, 1142 and 1155.


include cases on direct taxes that discuss issues that exclusively involve individuals and in which corporate issues play a marginal role in the comparability analysis, for example the cases involving the freedom of workers\textsuperscript{23}, or the cases involving freedom of establishment of individuals like professionals or small entrepreneurs\textsuperscript{24}. The cases involving dividends received by individual shareholders have been included in the sample, as the corporate issues connected to the distributing companies play a major role in the comparability analysis. The adoption of these criteria has lead to a sample of cases that represents the vast majority of all the tax cases decided by the Court and that is wide enough to provide reliable insights into the comparability analysis conducted by the Court.

The reliance on a significant sample of cases makes it possible, in the first part (sections 1 through 6), to describe how the Court has established criteria tailored to different cross-border activities and transactions to determine whether two situations are comparable. I will revert to the normative issues at the end of the article, where I will show that, although with a few exceptions, the Court has developed a remarkable set of criteria that enable the perplexed interpreter to untangle the apparent overlapping of canons for comparability. I will claim that this system of comparables provides a way out, albeit a partial one, of the “labyrinth of impossibility” through a gradualistic approach based on a straightforward equal protection principle rather than one or more overarching efficiency principles (sections 7 through 11).

The article is organized as follows. After a preliminary clarification of a few definitions needed to understand comparability analysis I will show that the core of the equal protection clause is constituted by the criteria to define whether two situations are actually comparable (in short the “comparables”), and thus that comparability analysis is really the crux of the matter, the core of the judicial reasoning of the Court in tax cases (sections 2 and 3). After that I will provide a thorough survey of the comparables established by the Court (sections 4, 5 and 6). According to that survey there are in total eighteen comparables used by the Court: each of them will be described in its structure and a brief review of the cases that have used that comparable will be provided. The survey is not a theoretical overlay but an empirical description of the judicial activity of the Court. It does not tell how the comparable ought to be, but how the Court uses the comparables and in what contexts, and shows that there is a specific relationship between each comparable and the situations to which it is applied, so that a canon of comparability can be basically found for all situations.

The final part of the paper (sections 7 through 11) relies on the empirical descriptive work developed in the previous sections and addresses the criticisms that have recently surfaced in the current U.S. legal discourse on the tax cases of the ECJ. In that final part I will show that the Court has established different types of so called “dual” comparables (which can be either “reinforced” or “bilateral”) that account for both inbound and outbound concerns of the two countries involved in the transaction and that have gained a wide scope of application. I will also show that in the cases which were only based on “unilateral” (inbound or outbound) comparables there were material or logical reasons that impeded the use of dual comparables in a two-country setting, or that such an use would have lead to absurd or untenable consequences\textsuperscript{25}.

\textsuperscript{23} The sample of cases used here is relating to the more complex issues of capital income. A test that applies to labor income has been recently developed by Ruth Mason & Michael Knoll, \textit{What Is Tax Discrimination?}, 121 YALE L.J. 1014.

\textsuperscript{24} The reasoning of these cases is included in this paper in so far as it provides canons of comparability that have been extended to corporate cases involving taxation of capital.

\textsuperscript{25} See infra section 10.
At the end of this study a two-step “gradualistic approach” will be proposed. According to this approach one should first check whether in a given situation a dual (bilateral or reinforced) comparable affording full equal protection can be applied (and this occurs in a wide range of situations). Then, in those cases in which a bilateral or reinforced comparable is not available, one should rely on the traditional inbound comparables developed by the Court to achieve a sub-optimal protection. This gradualistic approach shows that the Court expanded the application of the equal protection clause to its broadest extent, and in doing so it paved the way for proactive action by the EU in tax and fiscal integration, possibly based on reinforced cooperation. The equal protection clause thus is the legal basis for levelling the playing field in the EU, but cannot be considered as the tool for actual tax coordination, as political action is needed at EU level to achieve such coordination.

2. Canvassing comparability analysis

The first step in the strategy adopted here is to provide a few working definitions that are needed to consider the importance of comparability analysis in the reasoning of the Court. The main types of economic “freedoms” that are the focus of the tax cases of the ECJ, are protected by the Treaty and therefore there cannot be restrictions or discriminations of a tax nature affecting them. In the parlance of the Court each freedom is “exercised” by a “national of a Member State” in a cross-border dimension. As a result in respect to each exercise of these different freedoms there is a “country of origin” and a “country of destination”. The country of origin (sometimes defined as the home country) is the Member State from where the freedom is exercised, while the country of destination (sometimes defined as the host country) is the Member State to where such a freedom is exercised.

In respect to the exercise of each freedom, therefore, there can be a “discrimination” or a “restriction” in the country of origin or in the country of destination. The ECJ defines a discrimination or restriction as a different treatment of similar situations, or the same treatment of different situations, so that, on the basis of the classical tradition of equal protection clauses, it identifies two categories: the different treatment of persons that are in comparable circumstances, and the similar treatment of persons that are in non-comparable circumstances. In addition to that the Court also elucidates that the Treaty forbids not only discrimination or restriction on the ground of nationality (overt discrimination or restrictions), but also discrimination or restriction based on other criteria (indirect or covert discrimination or restrictions), with the result that all sorts of features have been sorted out by the Court to identify such covert violations of the equal protection clause.

The exact distinction between “discrimination” and “restriction” has not been explained in detail by the Court, and opinions of scholars still diverge on this matter. The semantic content of the term “discrimination” as unjust differentiated treatment, and the term “restriction” as a limiting measure, is not disputed, but the ECJ has used discrimination and restriction language interchangeably, so

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26 See in general: Peter Oliver & Wulf-Henning Roth, The internal market and the four freedoms, 41 COMMON MKT. LAW REV. 407–441 (2004); RUTH MASON, PRIMER ON DIRECT TAXATION IN THE EUROPEAN UNION 1-3 (2005).
27 See e.g.: Case C-311/97 Royal Bank of Scotland, 1999 E.C.R. I-2651 at ¶¶ 25 -27, which states that discrimination consists of the application of different rules to comparable situations or in the application of the same rule to different situations.
28 See e.g. Case C-330/91 Commerzbank, 1993 E.C.R. I-4017, ¶ 14 and basically all the dividend cases discussed infra at section 5.
that it is really difficult to make a clear-cut distinction\textsuperscript{30}, and therefore, for expediency the term “restriction” or “restrictions” is used here to cover all possible cases of violations of the equal protection clause.

The ECJ, to determine whether there is a restriction, adopts the perspective of a single Member State, i.e. either the country of origin or a country of destination of the actual exercise of a freedom by a national of a Member State. This starting point is compelled by the very nature of the judgement at the ECJ level: once a preliminary ruling is requested by a national judge initiating a case the ECJ in principle must give a decision\textsuperscript{31} since the submitted questions pertains to the interpretation of Community law.\textsuperscript{32} In this respect the ECJ differs from the Supreme Court of the U.S., which has the power to select the cases and to address wide policy issues. Thus, depending on the questions raised by the national court, there can be (i) cases of restriction in the country of destination (“inbound restriction” cases), as well as (ii) cases of restriction in the country of origin (“outbound restriction” cases), but please note that an inbound restriction case brought to the Court from the perspective of a country of destination could in theory be also an outbound restriction case from the perspective of the country of origin and decided accordingly (we will see that in certain situations the Court indeed adopts a two-country view).

Given the fact that there are four freedoms protected by the Treaty, there can be, in turn, four types on inbound cases and four types on outbound case. The inbound cases involve restrictions in the country of destination of either freedom of workers, freedom of establishment, freedom of services or freedom of capital. By contrast the outbound cases involve restrictions in the country of destination of either freedom of workers, freedom of establishment, freedom of services or freedom of capital. In conclusion there can be basically eight types of restriction cases, i.e. either inbound or outbound cases involving restrictions of the freedom of workers, freedom of establishment, freedom of services or freedom of capital. Variations of these basic eight types of restriction cases are found when the Court decides that the exercise of a freedom can be protected by more than one of the Treaty provisions. So for example there can be combined cases in which the Court decides on the basis of arts. 49 and 56, or art. 43 and 49, or arts. 39, 43 and 49, and so on.

The case law of the ECJ over the last three decades has covered an extensive array of cross-border activities. The Court addresses either individual or corporate taxpayers (hereinafter “companies”) as “nationals of a Member State”\textsuperscript{33}. Individuals with a controlling participation in a company or who directly carry out business activities may be equated, for the purposes of comparability, to corporate entities and their activities analyzed in the light of freedom of establishment. By contrast, a certain transaction by a company may be encompassed under the freedom of capital, depending on certain features of its activities\textsuperscript{34}. For example a certain case can be molded by the Court into an inbound case that demands protection under the freedom of establishment clause, while another case can be


\textsuperscript{31} There are a few strict derogations to such an obligations, as the Court may refuse to rule on a question referred by a national court only in the set of very specific circumstances that have been identified by the Court itself; see e.g. Leur Bloem, supra note 18, ¶¶ 16-29.

\textsuperscript{32} See e.g. Case C-200/98 X AB et Y AB vs Riksskatteverk 1999 E.C.R. I-8264, ¶ 19; Leur Bloem, supra note 18, ¶¶ 30-34.

\textsuperscript{33} In general see: MATHIAS DAHLBERG, DIRECT TAXATION IN RELATION TO THE FREEDOM OF ESTABLISHMENT AND THE FREE MOVEMENT OF CAPITAL 71-83 (2005).

\textsuperscript{34} On these distinctions see: Fabrizio Amatucci, Limited tax liability of non-resident companies and freedom of establishment, 12 EC TAX Revie\textsuperscript{2}w 202–207 (2003); Ana Paula Dourado, Free Movement of Capital and Capital income Taxation within the European Union, 3 EC TAX Rev. 176–185 (1994).
constructed as an outbound case involving economic activities that demands protection under the freedom of capital clause, and so on.\textsuperscript{35}

The type of activities carried out by taxpayers has a fundamental impact on the selection by the Court of the applicable comparable (see infra section 3). These activities can be classified into three major classes: cross-border economic activities, cross-border flows of dividends, and activities of group of companies. Cross-border economic activities encompass all kinds of activities with an economic nature that are conducted by nationals of Member States on a cross-border basis either directly (this is particular the cases of services such as insurance or similar services), or relying on branches, or using corporate vehicles located in another country such as subsidiaries. In certain cases these activities are carried out without the use of a fixed place of business and yet they retain their economic value (for example they may involve itinerant or artistic activities and the like).\textsuperscript{36}

Cross-border flows of dividends include payments of dividends between distributing companies and shareholders that are resident in different Member States. So, differently from cross-border economic activities, the cross-border flows of dividends always imply a company that is participated by a shareholder, and this entails a complex multi-dimensional analysis that must account for several factors such as: the type of shareholder (individual or corporate), the type of participation (controlling or non-controlling), the types of charges in the country of residence of the distributing company (both at the level of that company in terms of mechanisms for the relief of economic double taxation on dividends, and at the level of the recipient shareholder in terms of withholding taxes). Finally the activities of group of companies encompass all kinds of intra-group interactions that have an interdependent impact on the tax positions of individual companies resident in different Member States.\textsuperscript{37}

3. The defining role of comparability analysis: from unilateral to dual comparables

After having explained the basic terminological distinctions needed for a fruitful discussion of the ECJ tax cases, one can advance an essential framework of the building blocks that make up the structure of these cases. There are four of these building blocks: (i) the qualification of facts and the determination of the freedom at stake in a specific case, (ii) the comparability analysis that follows from that determination and aimed at identifying which are the comparable situations, (iii) the analysis under which the Court decides whether there is an actual restriction in respect to those comparable situations, and (iv) the evaluation of justifications and/or potential third country issues. A brief analysis of these building blocks is provided here to show that the second of them - comparability analysis - is central in so far as it bears on the analysis of restrictions and the ensuing holding in virtually all tax cases, both those in which a violation of the Treaty is found and those in which no such a violation is found.

In the first building block of the tax cases (qualification of facts) the Court, on the basis of the activities carried out by the parties, decides which is the freedom involved, and therefore identifies the legal basis of the case to be decided. Given the fact that there are basically three kinds of situations considered by the Court (cross-border activities, cross-border flows of dividends, and group cases) a case is initially canvassed by the Court as either a cross-border activities case, a

\textsuperscript{35} On that point see: Steven Den Boer, Freedom of Establishment versus Free Movement of Capital: Ongoing Confusion at the ECJ and in the National Courts?, 50 EUR. TAX’N 250-258 (2010).

\textsuperscript{36} When those cross-border economic activities involve corporate vehicles they may also imply either cross-border flows of dividends or more complex group situations, but for dividends and those situations the Court has developed specific comparables discussed infra respectively at section 5 and 6.

\textsuperscript{37} These situations often involve also participations that trigger cross-border flows of dividends, but this aspect is not considered by the Court when it looks at the actual relationships between affiliated companies.
cross-border dividend case, or a group case, and the actual provisions of the Treaty that are applied by the Court vary on a case-by-case basis depending on the fact patterns.

In the second building block of the tax cases (comparability analysis) the Court defines the actual comparable of the case, i.e. identifies what are the relevant domestic and cross-border situations that should be considered to decide whether there is a differential treatment that is precluded by the Treaty. This process through which the Court decides whether two situations are, in its own jargon “objectively comparable” is defined here as the “establishment of a comparable”. This process is a constitutive judicial activity that abides at the core of the equal protection clause developed by the Court. In establishing a comparable the Court conducts an autonomous analysis based on the factual and legal issues of the case at hand, but also relies on the indications of the parties, and the role of advocacy is relevant. Thus situations are not intrinsically “comparable” as suggested by the term artfully used by the Court, but become comparable on the basis of the criteria advanced by the parties and selected by the Court in its comparability analysis.

The essential feature of the comparability analysis – and this is a description of how the Court decides, rather that a prescription on how it ought decide – is that when the ECJ adjudicates a tax case the exercise of a specific freedom by a national of a Member State is viewed from the perspective of that specific Member State. The Court is not a policy-maker, but an adjudicative body and must hold fast to the complaints that arise from the national judge from the perspective of a given Member State. This is an implicit assumption on which the entire case is decided. Thus in the tax cases there are no overarching policy or efficiency concerns that dictate the outcome of the case, but the Court analyzes the situation from a certain visual angle that it is demanded by the questions raised by the national judge and decides the case on that basis.

There are two basic types of comparability analysis. In the inbound cases the comparability analysis is developed by the Court from the perspective of the country of destination of the cross-border exercise of the relevant freedom by a taxpayer not resident in that country. By contrast, in the outbound cases the comparability analysis is developed by the Court from the perspective of the country of origin of the cross-border exercise of the relevant freedom by the taxpayer resident in that country. These comparables are “unilateral comparables” because they adopt either an inbound or outbound approach from the perspective of just one country and so compare only two situations from the perspective of that very country. The inbound unilateral comparable uses an internal situation test and includes, from the perspective of the country of destination, (i) a domestic situation and (ii) an inbound cross-border situation. By contrast the outbound unilateral comparable uses an external situation test and includes, from the perspective of the country of origin, (i) a domestic situation and (ii) an outbound cross-border situation.

In certain situations the Court however has established another type of comparables, defined here as “dual comparable”, that adopt both an inbound and an outbound approach from the perspective of two countries (the country of destination and the country of origin). There are two types of dual comparables, i.e. reinforced and bilateral comparables.

The Court has used reinforced comparables for cross-border services and sale of shares\(^\text{38}\) and cross-border dividends\(^\text{39}\). This reinforced comparable is employed by the Court in the cases in which, in the country of residence of the relevant taxpayer (the recipient of foreign-source services, the seller of shares transferred to a foreign purchaser, or the shareholder receiving foreign in-coming dividends) there is outbound protection of that taxpayer that is supplemented in its country of residence by inbound protection (respectively in respect to the foreign service provider, the foreign

\(^{38}\) For details see infra the discussion on comparable n. 3, at ….

\(^{39}\) For details see infra the discussion on comparable n. 9, at ....
purchaser of shares, or the foreign company distributing the dividends). The reinforced comparable combines from the perspective of a single country (country A) both an outbound and an inbound comparable because it uses an external situation test that includes from the perspective of country A acting as the country of origin (i) a domestic situation and (ii) an outbound cross-border situation, together with an internal situation test that includes from the perspective of country A acting as the country of destination (i) a domestic situation and (ii) an inbound cross-border situation.

A reinforced comparable thus includes four situations that do not have to be equalized simultaneously, because only pairs of situation have to be equalized. For example in the case of cross-border services, country A is at the same time the country of origin of the recipient of services who seeks services abroad and the country of destination of the services provided locally by a foreign entity. In such a reinforced comparable country A must afford, as the country of origin of such services, outbound equal protection to (i) a domestic situation (recipient seeking services from a provider of services resident in that same country), and (ii) an outbound situation (recipient seeking services from a provider of services not resident in that same country). In addition, in this reinforced comparable country A, as the country of destination of services, must afford equal protection to (i) a domestic situation (provider rendering services to a recipient resident in country A), and (ii) an inbound situation (provider not resident in country A rendering services to a recipient resident in country A).

The Court has also used a stronger form of dual comparable, denominated here bilateral comparable, for the transfer of residence by individuals and consolidation by the parent company of the final losses of foreign controlled companies. This bilateral comparable includes three situations that must be simultaneously equalized (a domestic situation in the country of origin, an outbound situation in the country of origin, and a domestic situation in the country of destination). For example in the case of consolidation by the parent company of the final losses of foreign subsidiaries (for details see infra at …). Country A is the country of origin of the business activities that are carried out in Country B through a subsidiary, so that in Country B is the country of destination of those activities. In this case there are three situations that are included in the comparable: (i) in Country A, a parent company with a domestic subsidiary reporting final losses (domestic situation in the country of origin); (ii) in Country A, a parent company with a foreign subsidiary reporting final losses (outbound situation in the country of origin; and (iii) in Country B, a parent company with a domestic subsidiary reporting final losses (domestic situation in the country of destination). Under that comparable the three situations must be simultaneously equalized so that all the final losses of the subsidiaries must be treated alike (i.e. are consolidated with the profits of the parent company).

A central point that is made here is that in the sentencing style of the Court, the comparable (i) is context-oriented, i.e. is based on the class of activities that demand the actual application of the broad equal protection clause, and (ii) once established, constrains the actual judgement of the Court on whether there is actual difference of treatment and a restriction in respect to the exercise of a freedom. In practice the core of the equal protection clause is constituted by the establishment by the Court of a set of context-oriented comparables that are applied to specific situations and thus serve as the basis on which the Court decides whether there are restrictions in tax cases.

As the comparables are context-oriented, the ninety-five cases included in the sample of this study have been grouped on the basis of the type of activities that are considered to define comparability. Thus the comparables are classified into three major classes: comparables for economic activities (comparables 1 through 8), comparables for cross-border flows of dividends (comparables 9

40 For details see infra the discussion on comparable n. 8, at ….
41 For details see infra the discussion on comparable n. 14a, at ….
through 12), and comparables for groups of companies (comparables 13a, 13b, and 14a through 14d). The comparables for economic activities are root comparables, while the comparables for cross-border flows of dividends and for groups of companies are derivative comparable that stem from the (inbound and outbound) company comparable (comparables 6 and 7). This is the full list of comparables (for details see infra sections 4-6):

Root comparables for economic activities
1. Inbound comparable for Non-business Activities;
2. Outbound comparable for Non-business Activities;
3. Reinforced comparable for Non-business Activities;
4. Inbound branch comparable;
5. Outbound branch comparable;
6. Inbound company comparable;
7. Outbound company comparable;
8. Bilateral comparable for the transfer of residence of individuals.

Derivative company comparables for cross-border flows of dividends
9. Reinforced dividend comparable for individual shareholders;
10. Residence-country dividend comparable for corporate shareholders;
11. Source-country dividend comparable for subsidiaries of foreign parent companies - ACT cases;
12. Source-country dividend comparable for the recipient foreign shareholders – withholding tax cases.

Derivative company comparables for groups of companies
13a. Inbound comparable for deduction of interest for intra-group financing;
13b. Inbound comparable for deduction of profits transfers within the group;
14a. Bilateral comparable in respect to the attribution to the parent company of the final losses of the subsidiaries;
14b. Outbound comparable in respect to the deduction by the parent company of costs related to foreign subsidiaries;
14c. Outbound comparable in respect to attribution to the parent company of the undistributed profits of the controlled companies;
14d. Outbound comparable for attributes of the parent company differentiated on the basis of the participations in domestic vs foreign subsidiaries.

The third building block of the tax cases (restriction analysis) is conducted by the Court only if the comparability analysis has lead to the conclusion that the two situations are “objectively comparable”. If the comparability check is positive, then the Court first verifies whether there is a difference of treatment, and, second, whether this difference of treatment involves an actual restriction in respect to the exercise of a freedom. This two-stage analysis relies on the comparable, in the sense that once the Court has decided which are the domestic and cross-border situations that must be compared, then it conducts a practical analysis that looks at whether there is actual differential treatment of those situations that may lead to restrictions. In that stage of the reasoning of the Court the comparability and restriction analysis are closely intertwined, sometimes indistinguishable, but two patterns emerge, i.e. explicit vs implicit comparability analysis.

Generally the Court conducts an accurate analysis of the facts presented by the parties and – often rebutting detailed claims of non-comparability advanced by the Member States - establishes an explicit comparable by singling out a domestic situation that is compared to a cross-border
situation\textsuperscript{42}. Once the Court has established an explicit comparable, the restriction analysis is a corollary of comparability, as in those cases the Court derives the holding from the establishment of the comparables and decides that the restrictive treatment provided for by domestic legislation is “precluded” by specific provisions of the Treaty. This can be defined as the “implication constraint” of the ECJ cases in this area and is generally expressed by standard language - such as “It the follows that…” – which connects comparability directly to the holding. In those case the Court develops an explicit comparability analysis.

There are however numerous cases in which the Court does not identify explicit comparable situations, but rather focuses right away on the differentiated treatment of a domestic situation and a cross-border situation. The Court in these cases adopting language patterns such as “Member State X treats domestic situation A differently from cross-border situation B and this constitutes a restriction or discrimination that is precluded by art. .. of the Treaty”\textsuperscript{43}. In these cases the Court conducts a substantive analysis of the domestic legislation that leads the Court to qualify (or not qualify) the treatment as a restriction precluded by Community law. In this pattern the comparable is indeed established implicitly by the Court, but as the assumption on which its finding of a differentiated treatment is based. In those cases the Court develops an implicit comparability analysis\textsuperscript{44}.

The fourth building block of the judicial structure of the tax cases (evaluation of justifications) is conducted by the Court only if the comparability analysis has lead to the conclusion that the two situations are “objectively comparable” and that there is an actual restriction precluded by the Treaty. In practice the Court may hold that certain restrictions are justified under a judicial doctrine based on the so called “rule of reason”. Under that doctrine a domestic direct tax measure which hinders the freedoms laid down by the Treaty can be allowed if it pursues a legitimate objective compatible with the Treaty and is justified by imperative reasons in the public interest. It is further necessary that the application of the measure is appropriate to ensuring the attainment of the pursued objective and does not go beyond what is necessary to attain it (proportionality principle). In about a third of the cases considered here the restrictions have been actually justified by the Court\textsuperscript{45}, but the analysis of causes of justification in the jurisprudence of the Court is massive, as virtually all cases discuss extensively the detailed justifications claimed by the Member States, albeit to reject them.

In conclusion, the comparability analysis is the central block of the judicial structure of the tax cases and it impacts the decision on the merits of the case. According to the impact of comparability analysis on the reasoning of the Court the tax cases included in the sample of this study can be classified in five different classes: (i) the cases that are not based on comparability analysis; (ii) the comparable-and-restrictive situation cases, (iii) the non-comparable situation cases (iv) the

\textsuperscript{42} In certain cases the Court is extremely detailed in the description of the two situations included in the comparable, in so far as this is required by the issues raised by the parties or by the complexity of the case. See e.g. Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue, E.C.R. 2006 I-11673; Case C-436, 437/08 Haribo; Österreichische Salinen, E.C.R. 2010 00000; Case C-446/04 Test Claimants in the Franked Investment Income (FII) Group Litigation v. Commissioners of Inland Revenue, 2006 E.C.R. I-11753; Case C-201/05 The Test Claimants in the CFC and Dividend Group Litigation v. The Commissioners of Inland Revenue, E.C.R. 2008 I-02875; X AB & Y AB case, supra note 32, Case C-307/97 Saint-Gobain, 1999 E.C.R. I-6163.

\textsuperscript{43} When the Court follows a binding precedent, the comparability analysis is not reiterated. See: Rita Szudoczy, How Does the European Court of Justice Treat Precedents in Its Case Law? Cartesio and Damseaux from a Different Perspective: Part I, 37 INTERTAX 346-362 (2009).


\textsuperscript{45} For a list of the cases that accept justifications to restrictive treatment see infra note 51.
comparable-non restrictive situation cases, and (v) the comparable-and-restrictive situation cases based on justifications.

(i) The cases that are not based on the comparability analysis
There are a few cases in which the Court, although expressly requested by the national judge, did not discuss the potentially available comparable (Daily Mail and Cartesio)\(^\text{46}\), or pre-empted the comparability analysis on the ground of third country issues (Fidium)\(^\text{47}\). In all other cases of the sample a comparability analysis has indeed been conducted by the Court.

(ii) The comparable-and-restrictive situation cases
In the vast majority of cases the Court established the comparable either implicitly or explicitly, and then under the implication constraint arising from the comparability analysis decided that there was a restriction, not justified under the rule of reason doctrine, not affecting third country, and therefore precluded by the Treaty\(^\text{48}\).

(iii) The non-comparable situation cases
In a significant pattern of cases the Court conducted the comparability analysis, but then established that there was no actual comparability between a domestic and a cross-border situation. The discussion in those cases is based on certain features that are proposed by the Member States as indicators of non-comparability which are then accepted by the Court\(^\text{49}\). This pattern shares all the basic features of standard comparability analysis, but the analysis here leads the Court to decide that there is no actual comparability between a domestic and a cross-border situation, and this necessarily implicates there can be no restrictions precluded by Community law.

(iv) The comparable-non restrictive situation cases
A pattern is that very seldom found in the tax cases is one in which the Court establishes that although a domestic and a cross-border situation are indeed comparable, there is no actual restriction (“comparable-non restrictive situation cases”). This pattern includes a full (explicit or implicit) comparability analysis, only to deny that comparable situations are treated in a restrictive way. This pattern shares all the basic features of standard comparability analysis, with the significant difference that the analysis leads the Court to decide that there is no restriction between a domestic and a cross-border situation that are comparable\(^\text{50}\).

\(^{46}\) In the Case 81/87 Daily Mail, 1988 E.C.R. I-5505 and Case C-210/06 Cartesio, E.C.R. 2008 I-09641 the Court could have used an outbound comparable for the transfer of residence of companies but it did not. In the Case 371/10 National Grid Indus v. Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, 2011 E.C.R. I-... the Court did develop a bilateral comparable for the transfer of residence of companies (¶¶ 37-41), but then it stated that the difference of treatment was justified (¶¶ 42-49); for further details see infra section 10.

\(^{47}\) In the Case C-452/04 Fidium Finanz AG v. Bundesanstalt für Finanzaufsicht (Bafin), E.C.R. 2006 I-09521, the Court could have used a comparable to identify the restriction as it did in other third country cases to judge whether there was a restriction, but in the that case this analysis is absent.

\(^{48}\) In the sample of cases of this study, a comparability analysis that has lead to the conclusion that there is also a restriction precluded by the Treaty has been conducted in sixty-one cases.

\(^{49}\) The non-comparable situations cases in the sample of this study are eleven and are the following: ACT Group Litigation, supra note 42 (ACT and LOB clauses on domestic and out-going dividends that are not taxed in the source country), Case C-141/99 AMID, 2000 E.C.R. I-11619; Case C-284/08 Burda Verlagsbeteiligungen GmbH v. FA Hamburg, E.C.R. 2008 I-04571; Case C-298/05 Columbus Container Services BVBA v. FA Bielefeld-Innenstadt, 2007 E.C.R. I-10451; Case C-128/08 Damseaux v. Belgian State, E.C.R. 2009 I-06823; Case C-250/95 Futura, supra note 30, and Centro Equestre, supra note 44 (requirement that the tax-deductible costs be directly linked to the profits in the source country); Case C-513/04 Kerckhaert-Morres v. Min of Finance, E.C.R. 2006 I-10967; Case C-194/06 Orange European Smallcup Fund NV v. Staatssecret. van Fin., E.C.R. 2008 I-03747; Case C-290/04 Scorpio Konzertproduktionen GmbH v. FA-Hamburg-Eimsbüttel, E.C.R. 2006 I-09461; Case C-282/07 S.A.Truck Center v. Belgium, E.C.R. 2008 I-10767.

\(^{50}\) The only significant occurrence of “comparable-non restrictive situation cases” so far can be found on a specific issue in the FII Group Litigation, supra note 42, ¶ 113-126.
(v) The comparable-and-restrictive situation cases based on justifications

Another pattern is that in which the Court establishes (either implicitly or explicitly) that there is comparability between a domestic situation and a cross-border situation, but also decides that the restriction is justified and therefore that there is no violation of EC law. These cases share all the basic features of standard comparability analysis between the domestic and cross-border situation but are ultimately based on the acceptance of the causes of justification. There is a variant of this pattern in respect to the third country cases in which the Court conducts a comparability analysis, only to conclude that an actual restrictive treatment of situations that are indeed comparable is yet not precluded by the Treaty because this situations involved third countries.

4. The root comparables for cross-border economic activities and in particular the company comparable

The comparable of economic activities is split in three variants depending on the type of activities: non-business activities, business activities, and transfer of residence of individuals. The first variant looks at activities that are defined here as “Non-business Activities” and thus is a comparable for Non-business Activities. These cross-border activities include both professional and business

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51 In the sample of this study there are fourteen comparable-and-restrictive situation cases based on justifications and they are the following: Case C-204/90 Bachmann, 1992 E.C.R I-249; Case C-196/04 Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inl. Rev., E.C.R. 2006 I-07995 (for CPC only if artificial arrangements); Case C-201/05 The Test Claimants in the CPC and Dividend Group Litigation v. The Commissioners of Inland Revenue, E.C.R. 2008 I-02875, Case C-324/00 Lankhorst-Holhorst v. FA Steinfurt, 2002 E.C.R. I-11779 and Case C-524/04 Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue, 2007 E.C.R. I-02107 (for thin cap rules only if artificial arrangements); Case C-540/07 Komm. v. Italy, E.C.R. 2009 I-10983 (withholding tax on out-going dividends paid to EEA countries may be justified); Case C-157/07 Krankenheim Ruhesitz am Wannee-Seniorenhemstatt, E.C.R. 2008 I-08061 and Case C-414/06 Lidl Belgium GmbH & Co KG v FA Düsseldorf-Mettmann, E.C.R. 2008 I-03601 (for non-final losses of foreign permanent establishments); Marks & Spencer, supra note 30 (for non-final losses of controlled companies); Case C-337/08 X Holding v. Staatsseer. van Fin., E.C.R. 2010 I-01215 (for non-final losses of controlled companies); Case C-231/05 Oy v. FIN, 2007 E.C.R. I-06373 and Case C-311/08 Société de Gestion Industrielle SGI, E.C.R. 2010 I-00487 (deduction of transfer of profits by affiliated company); Case C-384/09 Prunus, E.C.R. 2010 00000 (stand-still clause); Case C-72/09 Establissements Rimbaud, E.C.R. 2010 00000. The comparable-and-restrictive situation cases based on justifications addressing third country issues are five and are the following: Case C-101/05 Skatteverket v. A, 2007 E.C.R. I-11531; Case C-102/05 Skatteverket v. A and B, 2007 E.C.R. I-03871; Case C-157/05 Holböck v. FA Salzburg-Land, 2007 E.C.R. I-04051; Case C-492/04 Lasertec v. FA Emmendingen, 2007 E.C.R. I-03775; Case C-415/06 SEW (Stahlwerk Ergste Westig) GmbH, 2007 E.C.R. I-0015; National Grid Indus, supra note 46. So in total the comparable-and-restrictive situation cases based on justifications are twenty (fifteen cases on justifications and five cases on third country issues) which amount to about one fifth of the full sample of cases).

52 See for example Cadbury Schweppes, supra note 51. Only the acceptance of justifications leads the Court to decide that comparable situations that are treated differently are however not precluded by the Treaty as they are justified. For a survey of these justifications see: Servaas Van Thiel, Justifications in Community Law for Income Tax Restrictions on Free Movement: Acte Clair Rules That Can Be Readily Applied by National Courts – Part 1, 48 EUR. TAX’N 279-290 (2008); Servaas Van Thiel, Justifications in Community Law for Income Tax Restrictions on Free Movement: Acte Clair Rules That Can Be Readily Applied by National Courts – Part 2, 48 EUR. TAX’N 339-350 (2008).

53 Class (i) cases - not based on the comparability analysis - and class (v) cases lead to a holding according to which domestic legislation is not precluded by EC law. Therefore in the sample of this study there are in total twenty-three cases holding that domestic legislation is not precluded by EC law, i.e. the sum of class (i) cases (three) and class (v) cases (twenty).

54 The cases that have used the comparables (n. 1 through 3) for Non-Business Activities are the following: Centro Equestre, supra note 44; Scorpio, supra note 49; Commission v Belgium 2006 (433/04), supra note 44; Case C-294/97 Eurowings 1999 E.C.R. I-7449; Case C-42/02 Lindman, 2003 E.C.R I-13519; Fidium, supra note 47, Case C-265/04 M. Bouanich v. Skatteverket, 2006 E.C.R. I-923, 945; Rimbaud, Prunus and Bachmann, supra note 51, Fournier and Jobra, supra note 44, Case C-219/03 Comm. v. Spain, not published in E.C.R.; Case C-118/96 Jessica Safir, 1998 E.C.R. I-1897; Case C-422/01 Skandia and Ramstedt v. Riksskatteverket, 2003 E.C.R. I-6817; Case C-136/00 Dr. Danner v. Savo-Karjala Tax Office, 2002 E.C.R. I-8147; Case C-76/05 Schwarz and Gootjes-Schwarz v. FA Berg.Gladbach, 2007 E.C.R. I-06849; Case C- 56/09 Zanotti, E.C.R. 2010 I-04517; Case C-334/02 Comm. v France
services that do not amount to the actual establishment of “undertakings”, in particular “companies and firms”, or do not fall under “the setting up of agencies, branches and subsidiaries” pursuant to art. 43.

The Court in the cases involving this kind of Non-business Activities qualifies the exercise of freedom as falling under the relevant provisions of the Treaty, so that in practice Non-business Activities as a general rule fall under art. 49 (services) or under art. 56 (capital). In certain situations, depending on the provisions of the Treaty invoked by the parties, the Court adopts a combination of art. 49 and art. 56. There is also a set of “hybrid cases” in which the Courts adopts various combinations of art. 49 (services), art. 56 (capital), art. 39 (workers), art. 18 (right of movement). In this bundle of comparables the economic activities addressed by the Court do not involve cross-border flows of dividends or group situations (the comparables concerning dividends will be addressed infra at section 5 and 6). These Non-business Activities encompass artistic activities, insurance, financial services and so on, as well as isolated transactions such as specific contracts (participations to pensions funds, insurance policies, leases, sales of goods), and miscellaneous transactions (school fees, participations to lotteries). The cases on Non-business Activities also involve sales of participations that generate capital gains, but do not include the ownership of participations when the issues are in connection with the payment of cross-border dividends, as these situations are addressed by a specific comparable developed by the Court in a distinct line of cases (the so called “dividend cases”, see infra section 5).

The second variant of the comparable of economic activities looks at those cross-border activities encompassed under art. 43, but also includes all sorts of combinations of application of art. 43 with arts. 18, 39, 49 and 56. The common aspect is that those activities amount to the actual establishment of “undertakings”, in particular “companies and firms”, or fall under “the setting up of agencies, branches and subsidiaries” pursuant to art. 43. These activities are defined here as “Business Activities” and thus the second variant is a comparable for Business Activities. This second variant includes an inbound branch comparable (comparable n. 4), an outbound branch comparable (comparable n. 5), an inbound company comparable (comparable n. 6), an outbound company comparable (comparable n. 7). Finally the third variant of the comparable related to economic activities looks at activities that do not have an intrinsic economic nature but that could have an economic impact, such as the transfer of residence of taxpayers and includes a bilateral comparable for the transfer of residence of individuals (comparable n. 8), but not a bilateral comparable for the transfer of residence of companies as the Court actually fell short of establishing such a comparable.


55 Under Community law the freedom of establishment can be, in the first place, exercised by establishing a legal entity in the country of destination (so called “primary establishment”), which is a company governed by the laws of that country and subject to taxation therein,

56 Under Community law the freedom of establishment is also exercised by establishing a branch in the country of destination (so called “secondary establishment”).

57 For example in Commission v Spain (C-219/03), supra note 56.

58 The cases that exclusively fall either under art. 39 (workers) or art.18 (right of movement) of the Treaty are not considered here as they involve just personal situations of individual taxpayers and the only relevance that corporate organizations may have is that they act as employers paying a salary in the workers cases.

59 The cases that have used the comparable n. 8 for transfer of residence of individuals are the following: Case C-9/02 de Lasteyrie du Saillant, 2004 E.C.R. I-2409; Case C-470/04 N v Inspecteur van de Belastingdienst Oost, 2006 E.C.R. I-07409; Case C-104/06 Comm. v. Sweden, 2007 E.C.R. I-00671. Other cases addressed an issue of transfer of residence of companies but did not actually use a comparable are Daily Mail and Cartesio, supra note 46; eventually in
In the comparables related to economic activities in its three variants, when the Court adopts the perspective of the country of destination, the issue is whether there is an inbound restriction in the country of destination (comparables n. 1, 4, 6). Therefore the inbound comparable used in those situations has a common structure because it includes (i) a taxpayer resident in the country of destination that carries out (Non-business or Business) Activities in that country, and (ii) a taxpayer resident in another Member State that carries out (Non-business or Business) Activities in that same country (the country of destination).

Basically what is compared in those cases is a set of domestic (Non-business or Business) Activities carried out in the country of destination by a taxpayer resident in that country of destination, and a set of domestic (Non-business or Business) Activities carried out in the country of destination by a taxpayer resident in another Member State. The judgment addressed by the Court is whether for tax purposes such country of destination treats domestic (Non-business or Business) Activities carried out in that Member State by a taxpayer resident in that Member State differently from (worse than) inbound cross-border (Non-business or Business) Activities carried out in that same Member State by a taxpayer not resident in that Member State. This is a typical example of the comparable internal solution test.

By contrast, when in the cluster of comparables related to economic activities the Court adopts the perspective of the country of origin, the issue is whether there is an outbound restriction in that country of origin (comparables n. 2, 5, 7, 8). Therefore the analysis of the possible outbound restrictions is conducted by the Court from the perspective of the country of origin, i.e. the Member State where both the relevant taxpayers of the comparability analysis are resident. Basically what is compared by the Court is a set of domestic (Non-business or Business) Activities carried out in the country of origin by a taxpayer resident in that country, and a set of domestic (Non-business or Business) Activities carried in out in another Member State by a taxpayer resident in the same country.

Therefore the outbound comparable used in those situations has a common structure because the judgment addressed by the Court is whether for tax purposes such country of origin treats domestic (Non-business or Business) Activities carried out in that Member State by a taxpayer resident in that Member State differently from (worse than) outbound cross-border (Non-business or Business) Activities carried out in another Member State by a taxpayer who is also resident in that same Member State. This is a comparable external solution test. What follows is a description of the distribution and usage of the three variants of the comparables for economic activities: (i) an inbound comparable for Non-business Activities (comparable n. 1), (ii) an outbound comparable for Non-business Activities (comparable n. 2), and (iii) a reinforced comparable for Non-business Activities (comparable n. 3).

**Inbound comparable for Non-business Activities (comparable n. 1)**
The Court has decided the majority of these cases of the sample of this study under the freedom of services (art. 49) by looking at basic economic activities that are protected by the freedom of services, such as equestrian shows and concerts\(^{60}\), or contractors in the construction sector\(^{61}\), leasing

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\(^{61}\) *Commission v Belgium*, supra note 44.
transactions\textsuperscript{62}, or lotteries\textsuperscript{63}. One case involving the purchase of shares has been decided under the freedom of capital\textsuperscript{64}. In the Bachmann, Rimbaud and Prunus cases the Court relied on the comparability with justification approach and therefore held that there was no violation of the Treaty\textsuperscript{65}.

In all the cases that have been decided using an inbound comparable for Non-business Activities there were reasons \textit{not} to establish a bilateral comparable: Centro Equestre, Scorpio and Fidium were not decided using a bilateral comparable because the situations were not comparable at all; Bachmann was decided on the basis of a justification; finally, had Bounanich, Lindman and Eurowings\textsuperscript{66} -that were decided using a unilateral comparable - would have lead to absurd consequences had it been decided using a bilateral comparable.

\textbf{Outbound comparable for Non-business Activities (comparable n. 2)}

The Court has used the outbound comparable for Non-business Activities exclusively to decide two cases viewed in the light of freedom to provide services (art. 49) that concerned the deduction of cost for R&D in the country of origin of such freedom but sustained abroad\textsuperscript{67}, or that concerned the similar issue of investment premiums used in the country of origin on leases of trucks actually used abroad\textsuperscript{68}. These cases should be read in connection with Commission v Spain (2008) that has been decided using the reinforced comparable for Non-business Activities (see infra next Comparable n. 3), with the result that an approach is now clearly predominant.

\textbf{Reinforced comparable for Non-business Activities (comparable n. 3)}

The Court has developed in respect to the majority of cases on cross-border Non-business Activities a reinforced comparable that accounts for both outbound as well as inbound concerns in the country of reference. There are two applications of this reinforced comparable, one for cross-border services, and one for transfers of shares\textsuperscript{69}. Out of twenty-eight cases included in the sample of this study decided by the Court within the cluster of comparables for Non-business Activities, sixteen cases have been decided by using a reinforced comparable, while all the other inbound or outbound cases do not play a significant role\textsuperscript{70}. One can therefore conclude that the reinforced comparable is the standard method used by the Court for Non-business Activities.

\textsuperscript{62} Eurowings, supra note 56.

\textsuperscript{63} Lindman, supra note 56.

\textsuperscript{64} On the Bounanich case see: Cecile Brokelind, The ECJ Bounanich Case: The Capital Gains and Dividend Classification of Share Buy-Backs in Swedish Tax Law, 46 EUR. TAX’N 268-274 (2006). In Fidium art. 56 was invoked but then the case was decided as a third country case. In the case Commission v. Portugal the Commission referred Portugal to the ECJ because of the difference in tax treatment of interest paid to financial institutions, depending on whether or not they were resident in Portuguese territory. The Commission argued that the tax burden on interest paid to non-resident financial institutions was heavier than that on interest paid to resident financial institutions, but failed to demonstrate that the different treatment of interest paid to non-resident financial institutions constituted an infringement of EU law.

\textsuperscript{65} Bachmann, supra note 51; Case C-72/09 Establishments Rimbaud, E.C.R. 2010 00000; Case C-384/09 Prunus, E.C.R. 2010 00000.

\textsuperscript{66} Bounanich, Lindman and Eurowings cases, supra note 56.

\textsuperscript{67} Fournier, supra note 44.

\textsuperscript{68} Jobra, supra note 44.

\textsuperscript{69} There is no bilateral cross-border services comparable for the same reason that there is no bilateral branch/company comparable, i.e. it is impossible to achieve capital export and import neutrality at the same time when tax treatments are different in the residence and source country. For a discussion on these issues see infra section 8. There are also certain comparables tailored to specific situations, for example the comparable used in the school fees case (Goitijes and Zanotti, supra note 56) looks at the recipient of services of local schools vs. “mobile” recipient of services of foreign schools.

\textsuperscript{70} This includes Commission v Spain (248/06) supra note 56, now extending the scope of the Fournier and Jobra cases, supra note 44, that were initially decided on a limited outbound basis, so that one can conclude that also R&D cases come under the reinforced comparable.
In respect to the reinforced comparable for services the Court has adopted consistent language. For example in the *Safir* case involving Sweden as the Member State of residence of the individual recipient of services and the UK as the Member State of residence of the foreign company that provides services, the Court has clarified that in the Member State where individual recipients of services are resident (Sweden) (i) there is an outbound restriction because such a Member State provides a better treatment for domestic-source services than for foreign-source services and thus “deters such taxpayer from taking long-terms contracts in companies resident in other Member State”, and (ii) there is also an inbound restriction because such a Member State provides a better treatment for domestic-source services than for foreign-source services (in that case those provided by UK entities) and thus creates “dissuades foreign insurance companies from providing their services in the Swedish market”\(^7^1\).

This is a reinforced comparable in which, in the country of the service recipient, outbound protection is given to that taxpayer that is supplemented by inbound protection in respect to the foreign service provider. This reinforced comparable is used by the Court to apply a one-country equal protection clause that addresses both outbound and inbound issues in the country of the service recipient. The Court has consistently deployed that reinforced comparable for Non-business Activities to decide cases in the light of freedom of services (art. 49) with regard to pensions and insurance (as well school fees\(^7^2\)). A similar stance has been taken by deciding case that use hybrid combinations of different freedoms hinged on the freedom of services\(^7^3\). In respect to the deduction of cost for R&D abroad, an issue that had been decided in previous cases only from the outbound perspective of the country of the provider of research activities, has been recently decided by the Court also looking at the recipients of such services using a reinforced comparable\(^7^4\).

The same approach has been used in respect to transactions on securities\(^7^5\), and in several cases the Court used consistent language to articulate the structure of a reinforced comparable specifically for sales of shares\(^7^6\). For example in the *De Baeck* case involving Belgium as the Member State of residence of the seller of shares and the France as the Member State of residence of the purchaser of shares. The Court clarified that in the Member State where the seller of shares is resident (Belgium) there was (i) an outbound restriction on the freedom of establishment of that seller because the transfer of the shares to a purchaser established in the country of origin was rendered less attractive, but also (ii) an inbound restriction on the freedom of establishment of the non resident purchaser (in that case a purchaser resident in France) of its right of establishment because of such freedom was restricted by the fact that the transfer of the shares to purchasers established in the country of origin was less attractive. This is a reinforced comparable in which, in the country of the seller of shares, outbound protection is given to that taxpayer that is supplemented by inbound protection in respect to the foreign sellers of shares.

**Inbound branch comparable (comparable n. 4)**

In this comparable the activity carried out by the parties involved, is the establishment of “undertakings”, in particular “firms”, or that fall under the “setting up of agencies, branches” (art.\(^7^6\))

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\(^7^1\) *Safir*, supra note 56, ¶ 28-29.

\(^7^2\) In the *Gootijes* and *Zanotti* cases, supra note 56.

\(^7^3\) *Safir*, *Skandia*, *Danner*, *Gootijes* and *Commission v Belgium*, supra note 56, were decided on a combination freedom of services and of establishment. *Commission v Denmark* was decided on a combination freedom of services, workers and establishment.

\(^7^4\) *Commission v Spain*, supra note 56.

\(^7^5\) *Commission v France* and *Commission v Spain*, supra note 56, were decided on the basis of freedom of services (art. 49) and capital (art. 56).

\(^7^6\) *X and Y, De Baeck*, *Gronfeldt*, *Glaxo Wellcome*, supra note 56.
43 of the Treaty). This comparability analysis in most cases is a “domestic company vs local branch” comparable, that involves the comparability of the treatment of a company resident in the destination country (a domestic company) vs the treatment of a permanent establishment (a branch) of a foreign company operating in the same destination country. This is a comparable internal situation test and what matters is the fact that the domestic company carries out a trade or business in the destination country (in practice it operates in such a country with a “local permanent establishment”). In these cases the comparability focuses on the actual business activities conducted by that company in the country of destination, and therefore it does not matter whether the domestic company has shareholders that are resident in the same country or in another country.

The cases of the sample of this study decided by the Court using the “domestic company vs local branch” comparable focused on the entitlement to domestic or treaty benefits to branches, such as increased rates for branches vs domestic companies, or entitlement to avoid fiscal and/or treaty benefits to domestic companies but not to branches, the refund of interest on overpaid tax available to domestic companies but not to branches, the carry forward of losses allowed to domestic companies but not to branches, wealth tax exemption available to domestic companies only in relation to transactions involving “local permanent establishments”, or denial of registration for branches. These cases have developed the standard inbound protection clause for activities protected by the freedom of establishment, because they have all been decided by applying art. 43 of the Treaty.

Outbound branch comparable (comparable n. 5)
In this comparable the activity carried out by the parties are the same as those of comparable n. 4, with the difference that this comparability analysis involves an outbound comparable, and more precisely a “domestic company vs foreign branch” comparable, that clearly adopts a comparable external situation test. In the six cases of the sample of this study the Court has used the outbound branch comparable with exclusive reference to the issues of the losses of foreign permanent establishments. Lidl Belgium and Krankenheim focused on the treatment of losses of foreign

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77 The cases in the sample of this study that have used the comparable n. 4 are the following: Case 270/83 Avoir Fiscal, 1986 E.C.R. 00273; Saint-Gobain, supra note 42; Commerzbank, supra note 28; Futura, supra note 30; Case C-406/07 Comm. v. Greece, E.C.R. I-00064; Case C-212/97 Centros, 1999 E.C.R. I-1459; Case C-1/93 Halliburton 1994 E.C.R. I-1137; X AB & Y AB, supra note 32.

78 Please note that there is no perfect overlapping between the treaty law concept of a “permanent establishment” and the Community law concept of “undertaking” in the form of a “branch or an agency”. That issue was first addressed in the Saint Gobain case, supra note 42. For a general review see: Aarnio Katri, Treatment of permanent establishments and subsidiaries under EC law: towards a uniform concept of secondary establishment in European tax law?, 15 EC TAX REV. 18–26 (2006).

79 Royal Bank of Scotland, supra note 27.


81 Commerzbank, supra note 28.


83 Halliburton, supra note 77.

84 Centros, supra note 77. For a comment on that case see: Erik Werlauff, The Consequences of the Centros Decision: Ends and Means in the Protection of Public Interests, 40 EUR. TAX’N 42 (2000).

85 These cases in which the comparable n. 5 has been used for outbound issues of foreign permanent establishments are the following: Lidl Belgium, Stahlwerk Ergste, A and B, Krankenheim, supra note 51 (losses of foreign permanent establishments); Case C-293/06 Deutsche Shell GmbH v. FA für Großunternehmen Hamburg, E.C.R. 2008 I-01129
permanent establishments in the country of residence of the parent company that adopted the exemption for foreign permanent establishments. *A and B*, and *Stahlwerk Ergste* dealt with the losses of permanent establishment located in third countries. *Deutsche Shell* addressed the possible recognition at the level of the parent company of the losses of foreign permanent establishments by way of a write-down, in a situation in which the country of residence of the parent company adopted the worldwide taxation for foreign permanent establishments.

The AMID case addressed the treatment of profits of foreign permanent establishments in the country of residence of the parent company that adopted the exemption for foreign permanent establishments in the view of their compensation with losses of the parent company and therefore AMID will be discussed *infra* at … in the context of cases concerning the use of cross-border profits and losses.

In four cases out of four concerning losses of foreign permanent establishments the Court has established a coherent judicial doctrine of the consolidation of profits and losses of parent company and branch*66*. According to that doctrine national legislation that denies a resident company the deduction of losses incurred by a permanent establishment situated in another Member State does not violate the freedom of establishment to the extent that the income of that permanent establishment is (i) exempt in the Member State where the parent company is resident, and (ii) taxable only in the country where the permanent establishment is located, unless the company can demonstrate that all the possibilities to take the losses into account in the country of the permanent establishment are exhausted*87*.

In these four cases the Court has adopted the Marks & Spencer rule*88*, which prevents the use of foreign losses (unless it is proved that they cannot be used in the country were they were produced (for details see *infra* at…))*.89* The foreign permanent establishment cases have been decided on the basis of a justification as the Court found that a differentiated treatment (use of losses in the

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*87* These cases rely on *Marks & Spencer* as they adopt the rationale of the “non-usable” losses; see *infra* at 35-37.

*88* In respect to the Marks & Spencer rule see *supra* at …. All the six cases on cross-border use of losses (the permanent establishment cases plus *Marks & Spencer*, *supra* note 30, and X *Holding*, *supra* note 51), adopt the Marks & Spencer rule on final losses.

domestic situation vs non-use of losses in a cross-border situation) was either justified\textsuperscript{90} or not encompassed under art. 43 because the permanent establishment was in a third country\textsuperscript{91}.

**Inbound company comparable (comparable n. 6)**

In this comparable the activities carried out by the parties specifically involve the establishment of a “undertaking” in the form of a “company” in those cases in which there is a national of a Member State (the country of origin) who has a participation in the capital of a company established in another Member State (the country of destination) which gives to such a national (an individual or a company) a “definite influence” over the company's decisions\textsuperscript{92}. These activities generally amount to the creation of subsidiaries in another Member State and thus there is comparability of the treatment of a company resident in the destination country that is assumed to have domestic shareholders (a domestic company) vs the treatment of another domestic company with foreign shareholders operating in the same destination country (a “domestic company with-domestic shareholders vs domestic company-with-foreign shareholders” comparable)\textsuperscript{93}. This is another comparable internal situation test.

The company resident in the country of destination of the direct investment owned by foreign parent company is not usually subject as such to tax rules or tax rates different from those imposed on other companies resident in that same country and owned by domestic shareholders. Rather what happens is that in certain cases the company is treated differently from domestic companies in respect to transactions with the foreign parent company (payment of dividends or deductions of cost paid to the parent) or in respect to other matters, such as entitlement of treaty benefits, just because its shareholders are not resident in the country of destination. The inbound company comparable thus branches off into different sub-comparables that are actually applied by the Court in different situations in which there is a comparison a “domestic company with-domestic shareholders and a domestic company-with-foreign shareholders” (comparables n. 11, 12, 13a and 13b, which will be discusses in detail infra at sections 5 and 6).

The difference of the inbound company comparable from the inbound branch comparable is that in the former comparable the Court looks at the foreign ownership of subsidiary to ensure that in the country of destination a non resident parent company is treated equally irrespective from the fact that is operating through a subsidiary or through a branch, while in the latter comparable the Court focuses on the actual business activities conducted by that company in the country of destination without looking at the domestic vs foreign ownership issue. The Court has in fact also developed an ancillary inbound branch vs subsidiary standard to check whether a foreign parent company that carries out business activities in the country of destination through a subsidiary is treated differently


\textsuperscript{91} A and B and Stahlwerk Ergste, supra note 51.

\textsuperscript{92} This concept of “definite influence” and “control” is used by the Court in virtually all the cases involving the freedom of establishment exercised inbound or outbound through subsidiaries addressed by comparable n. 11 (source-country dividend comparable for subsidiaries of foreign parent companies - ACT cases), comparable n. 12 (source-country dividend comparable for the recipient shareholders - withholding tax cases), comparable n. 13 (inbound comparables in respect to deductions by affiliated companies), and comparable n. 14a through 14d (outbound comparable in respect to tax attributes of the parent company vis-à-vis foreign subsidiaries). For an inbound example see the *Lankhorst-Hohorst* case, supra note 51; for an outbound example see Case C-251/98 Baars, 2000 E.C.R. I-2787.

\textsuperscript{93} In addition to capital export and import neutralities, ownership neutrality focuses on economic decisions that may be distorted by taxation, see, e.g., Mihir A. Desai & James R. Hines, Jr., *Evaluating International Tax Reform*, 56 NAT’L TAX J. 487 (2003) 56
from (worse than) a foreign parent company that carries out business activities in that country of 
destination through a branch. This standard was used in the CLT-UFA and Avoir Fiscal cases\(^{94}\) but 
it does not amount to an actual comparable because it looks at the same foreign taxpayer and 
compares an actual situation (activities carried in the destination country out through a branch) to a 
counterfactual (hypothetical activities carried out in the destination country through a subsidiary).

**Outbound company comparable (comparable n. 7)**

In this comparable the activity carried out by the parties are the same as those of comparable n. 6, 
with the difference that this comparability analysis involves an outbound comparable, and more 
precisely a “domestic parent with-domestic company vs domestic parent-with-foreign company” 
comparable. Such a comparable involves the comparability of the treatment of a company resident 
in the country of origin that owns a domestic company vs the treatment of another domestic 
company that owns a foreign company operating in another country, i.e. the destination country. 
This is a comparable external situation test.

A foreign participated company is not usually subjected by its country of origin to tax rules or tax 
rates different from other domestic companies operating in that same country, but in certain cases 
the foreign company is treated differently in the country of origin from domestic companies in the 
context of intra-group transactions\(^{95}\). As a response to this need the Court has broken down the 
outbound company comparable into different sub-comparables that are deployed in context-specific 
situations (comparables n. 11, 12, 14a and 14b, which will be discusses in detail *infra* at sections 5 
and 6).

Both the outbound company comparable and the outbound branch comparable ensure that in the 
country of origin a resident parent companies operating abroad through either a permanent 
establishment or a subsidiary are treated equally. The Court has in fact also developed an ancillary 
outbound branch vs subsidiary standard to check whether a parent company that carries out 
business activities in the country of destination through a subsidiary is treated in its country of 
origin differently from (worse than) a parent company that carries out business activities in another 
country of destination through a branch\(^{96}\). An application of this comparable can be found in the 
KBC and in the X Holding case where the Court concluded that taxpayers are free to choose the 
vehicle (branch or subsidiary) most appropriate to their needs\(^{97}\). This standard does not amount to 
an actual comparable because it looks at the same taxpayer and compares an actual situation 
(activities carried out abroad through a branch) to a counterfactual (hypothetical activities carried 
out abroad through a subsidiary).

**Bilateral comparable for the transfer of residence of individuals (comparable n. 8)**

In certain situations the establishment of the comparable developed by the Court has focused on 
other activities that do not have an intrinsic economic nature but that can have an economic impact, 
such as the transfer of residence of individuals. The Court has established a comparable in which it 
addressed the issue of outbound restrictions in respect of individuals who transfer their residence 
from one Member State to another Member State (the “transferring individual”) that were imposed 
by the country of residence of the transferring individual (so called “exit tax cases”\(^{98}\)). In this cases

\(^{95}\) This is another aspect of ownership neutrality that has been mentioned *supra* at note 93 in respect to the *inbound* 
company comparable.
\(^{96}\) This standard is the outbound symmetrical complement of that developed in the CLT-UFA case form an inbound 
perspective.
\(^{97}\) KBC case, *supra* note 22, and in the X Holding case, *supra* note 51.
the Court held outright that exit taxes area an outbound restriction that violates Community law. The Court has not developed a similar comparable for the transfer of residence of companies.\textsuperscript{99}

In the exit tax cases for individuals the Court has established a bilateral comparable that addressed three situations that were simultaneously equated. In fact such a comparable encompasses not only (i) a transferring individual in the country of origin, together with (ii) a non-transferring individual in the same country of origin, but also (iii) a non-transferring individual in the country of destination. In practice the outbound analysis from the perspective of the country of origin is extended also to domestic situations in the country of destination and meets the equality concerns of both countries. This is a bilateral comparable because a situation that meets the outbound concerns of the country of origin in which the transferring and the non-transferring individual are equally not taxed on their unrealized gain because of the prohibition of restrictive exit taxes, dovetails with the inbound concerns of the country of destination where the transferred individual (who comes from its country of origin) and the local non-transferring individual equally retain the basis on their assets for the taxation of gains that may be realized in the future. In practice the prohibition of exit taxes introduces a roll-over relief of unrealized capital gains of individuals who transfer their residence.

Three cases have been decided so far by the Court in respect to the issue to the transfer of residence of companies: the \textit{Daily Mail} case (1988), the \textit{Cartesio} case (2008) and the \textit{National Grid Indus} (2011). In the first two cases the Court, even if requested, did not use a comparable in respect to companies. In the third case the Court did establish a bilateral comparable that in theory could have prohibited restrictive exit taxes and attained the equal treatment of three situations, i.e. (i) a transferring company in the country of origin, together with (ii) a non-transferring company in the same country of origin, but also (iii) a non-transferring company in the country of destination. The fact is that the Court in the \textit{National Grid Indus} case held that that the difference of treatment was justified. This implies that exit taxes are currently not precluded when a company transfers its tax residence but maintains its status in the country of origin a roll-over relief of unrealized capital gains of companies who transfer their residence is not in place.\textsuperscript{100}

5. \textit{The derivatives of the company comparable: the comparables for cross-border flows of dividends}

In addition to the situations encompassed under the comparables n.1-8 in respect to economic activities discussed supra at section 4, the Court has also addressed situations in which a national of a Member State has a participation in the capital of a company established in another Member State (which may or may not give a “definite influence” over the company's decisions) that leads to the payment of cross-border dividends. In respect to these so called “dividend cases” the ECJ has


developed a comparable that breaks down in a series of sub-comparables, and which is meant to address outbound and inbound restrictions issues.

These comparables are specialized variations of the inbound or outbound company comparable (respectively comparable n. 6 and 7), but the comparability analysis of the dividend cases is different from that developed in the cases that used in a broad fashion the inbound company comparable n. 6\(^{101}\) or outbound company comparable n. 7\(^{102}\) discussed supra at section 4. While the dividend cases just focus on the cross-border flows of dividends, those comparables n. 6 and 7 involving participations in companies hinge on the entity that reports the profits, rather than on the actual distributions of such profits as dividends. The dividend cases also differ from the comparables used for group of companies that will be discussed infra at section 6: the former focuses on the actual flows of dividends, while the latter involves activities carried out through a subsidiary in both an inbound\(^{103}\) and outbound\(^{104}\) dimension. The comparability analysis developed by the ECJ in the dividends cases is also different from that developed in respect of such transactions on securities that involve Non-business Activities discussed supra at section 4 because those cases address issues that do not involve actual payments of dividends\(^{105}\), or issues that are related to the gains arising from sales of shares\(^{106}\).

From the perspective of the country where the recipient shareholders are resident (residence-country of dividends) there are two types of dividends: (i) residence-country domestic dividends paid by a distributing company resident in that country and received by a shareholder resident in that same country, and (ii) residence-country in-coming dividends paid by a distributing company resident in another country (source-country of dividends) and received by a shareholder resident in the residence-country. In turn, from the perspective the country where the distributing company is resident (source-country of dividends) there are two types of dividends: (i) source-country domestic dividends paid by the distributing company resident in that country and received by a shareholder resident in that same country, and (ii) source-country out-going dividends paid by a distributing company resident in that country and received by a shareholder resident in another country (the residence-country of dividends).

In a two-country setting (residence-country and source-country of dividends), the in-coming dividends received by the shareholders viewed from the perspective of the residence-country of dividends are the out-going dividends paid by the distributing company viewed from the perspective of the source-country of dividends. As a result, in the country where the recipient shareholders are resident (i.e. the residence-country of dividends) there is a national treatment of domestic dividends vis-à-vis a national treatment of foreign in-coming dividends, and these two classes of dividends can be compared from the perspective of the country of residence of the recipient shareholders. By contrast, in the country of residence of the distributing company (i.e. the source-country of dividends) there is a national treatment of domestic dividends paid by a distributing company to another resident company (generally no withholding tax is levied) vis-à-vis

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\(^{101}\) See supra comparable n. 6 (“domestic company-with-domestic shareholder vs domestic company-with-foreign shareholder”).

\(^{102}\) See supra comparable n. 7 (“domestic parent-with-domestic company vs domestic parent-with-foreign company” comparable).

\(^{103}\) See supra comparable n.13a and 13b (“domestic company with-domestic parent vs domestic company-with-foreign parent”), in relation to the inbound issues in respect to deductions by parent companies included in a group.

\(^{104}\) See comparables n. 14a through 14d (“domestic company-with-domestic company vs domestic parent-with-foreign company”) in relation to the outbound issues in respect to tax attributes of the parent company related to group situations (consolidation cases, Bosal legacy cases, CFC cases, attributes of parent company).

\(^{105}\) Commission v France and Commission v Spain, supra note 59, have been decided on the basis of freedom of services (art. 49) and capital (art. 56).

\(^{106}\) X and Y, De Baec, Gronfeldt, Glaxo Wellcome, supra note 56.
a national treatment of out-going dividends (generally a withholding tax is levied), and these two classes of dividends can be compared from the perspective of the country of residence of the distributing company (source-country of dividends).

This multitude of perspectives that can be adopted in establishing a comparable in this inter-locked scenario makes the comparability analysis of the Court in respect to cross-border dividends particularly complex. To understand the Court’s approach one has to go back to the classical debate on company/shareholder integration which was initiated in the U.S. in the seventies\textsuperscript{107} and then went on with further studies on the interdependence of national systems\textsuperscript{108}. This U.S debate on corporate integration somehow spread to Europe with the advent of the ECJ dividend cases at the beginning of the last decade\textsuperscript{109}. In light of those decisions of the ECJ some commentators have emphasized the need of an overall cohesion of the national systems in respect to situations that involve domestic dividends in different countries as well as out-going dividends exiting each country and in-coming dividends entering each country\textsuperscript{110}. By contrast, other commentators have emphasized the need to maintain the legitimacy of separate solutions\textsuperscript{111}, or the advantages of an international consistency of the EU regime\textsuperscript{112}.

The fact that the situations concerning cross-border dividends are complex does not mean that they are not comparable, and as a matter of fact, the Court has developed four separate comparables in this area (comparables n. 9 through n. 12) that address different facets of the same situation from different angles, and this is a striking feature of its jurisprudence, often criticized. Thus one cannot prescind from the complexity of the comparability analysis in his area and this section will show that ultimately there is a rationality in the choices made by the Court in the dividend cases once it is accepted that in this area one must account for the need to single out different situations to carry out a meaningful comparability.


Residence-country reinforced dividend comparable for individual shareholders (comparable n. 9)

A first comparable established by the Court (n. 9) focuses on situations that involve in-coming dividends in respect of the country of residence of the individual shareholder recipient of dividends (residence-country of dividends). These are situations in which individual shareholders basically make an investment of capital into foreign companies, which, in turn, through those contributions are able to raise capital form such foreign shareholders. Therefore the Court adjudicates the case from the perspective of the residence-country and the legal basis is art. 56 (freedom of capital).

This comparable has been consistently used in a lineage of cases concerning individual shareholders, and was also used in the Holböck case, that was however decided on a third country issue that excluded the application of Community law. That comparable was also mentioned in other cases where the Court however decided that the situations were not actually comparable. There are also two cases (Kerckhaert-Morres, and A cases) addressed by the Court that potentially demanded for the use of an outbound comparable for the recipient individual shareholder, but in both cases the Court reached the conclusion that there was no violation of Community law.

The Court has adopted standard language to express this residence-country reinforced dividend comparable. For example in the Lenz case involving Austria as the Member State of residence of the shareholders and Germany as the Member State of residence of the distributing company, the Court has clarified that in the Member State where shareholders receiving dividends are resident (Austria) (i) there was outbound restriction because such a Member State provided a better treatment for domestic-source dividends than for foreign-source dividends and thus “deters such shareholders from investing their capital in companies resident in other Member State”, and (ii) there was also inbound restriction because such a Member State provided a better treatment for domestic-source dividends than for foreign-source dividends and thus created “obstacles for non resident companies to raise capital in that Member State” (in that case companies resident in Germany). So in the country of residence of the shareholders receiving dividends there is outbound protection of those resident shareholders that is reinforced by inbound protection of non resident companies. This is a comparable in which, in the country of the portfolio shareholder, outbound protection is afforded to that taxpayer that is supplemented by inbound protection in respect to the foreign company in which the shareholder has made an investment.

Residence-country dividend comparable for corporate shareholders (comparable n. 10)

The ECJ in a different set of cases has focused exclusively on outbound restrictions in the residence-country in respect to corporate shareholders (rather then individual shareholders as in comparable n. 9) that own participations in foreign companies and has established a residence-

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114 Holböck, supra note 51, ¶ 30.


116 In the Kerckhaert-Morres case, supra note 42, the conclusion that there was no violation of Community law was reached because there was no differentiated treatment of comparable situations, while in the A case, supra note 51, that conclusion was reached because the restrictive treatment was justified.

country dividend comparable for corporate shareholders. There are two variants of this comparable: (i) a residence-country dividend comparable for parent companies making direct investment abroad through subsidiaries, and (ii) a residence-country dividend comparable for corporate portfolio shareholders making financial investment abroad through target companies.

The residence-country dividend comparable for parent companies making direct investment abroad through subsidiaries

The ECJ in a set of cases has focused exclusively on outbound restrictions in the country of origin in respect to corporate shareholders that own controlling participations in foreign companies and has established a residence-country dividend comparable for parent companies making direct investment abroad through subsidiaries ("parents" and "subsidiaries"). In those cases the Court has mainly focused on the restrictions to foreign direct investment covered by art. 43 (freedom of establishment) attributable to the country of origin of direct investment which treats dividends paid by the foreign subsidiary to the parent resident in that country of origin (residence-country incoming dividends) differently from (worse than) dividends paid by the subsidiary to the parent resident in the same country (residence-country domestic dividends). So this comparable involves an external situation test and is a specific application of the baseline outbound company comparable.

The analysis of these types of outbound restrictions on cross-border dividends has been conducted by the Court on the basis of that comparability approach and from the perspective of the country of origin, i.e. the Member State where the recipient shareholder is resident essentially in two major cases (FII Group Litigation and CFC and Dividend Group Litigation cases). Those cases focus in detail on the types of relief on domestic dividends, vs incoming dividends. In short, the Court in those cases stated that the country of residence of the recipient is free to grant relief trough either exemption or imputation (tax credit), provided however that (i) ultimately the rate of tax applied to incoming dividends is no higher than the rate of tax applied to domestic dividends, and (ii) the tax credit is at least equal to the amount paid in the country of the distributing company, up to the limit of the amount of the tax charged in the country of the recipient shareholder. The same holding is found the Cobelfret and KBC cases dealing with the Parent Subsidiary Directive.

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118 These dividends are usually defined inbound dividends. However in comparable n. 10 (residence-country dividend comparable for corporate shareholders) such inbound dividends create outbound restriction issues. Therefore for the sake of clarity they will be denominated “residence-country in-coming dividends” as opposed to “residence-country domestic dividends”.

119 The baseline comparable has been denominated “domestic parent-with-domestic company vs domestic parent-with-foreign company” comparable (see supra comparable n. 7).

120 The FII Group Litigation case, supra note 50, was decided on December 12, 2006. The CFC and Dividend Group Litigation case, supra note 42, was decided on April 23, 2008 and the Court confirmed the holding of the FII Group Litigation case. On this latter case see: Eric Tomsett, ECJ Confirms Rulings Relating to U.K. Taxation of Foreign Dividends and CFCs, 36 INTERTAX 416-417 (2008); Simon Whitehead, Practical implications arising from the European Court's recent decisions concerning CFC legislation and dividend taxation, 16 EC TAX REV. 176-183 (2007).

121 It is important to note that the legislative situation concerning these cases is basically the same as Case C-397/98 C-410/98 Joined cases - Metallgesellschaft Ltd. v. The Commissioners of Inland Revenue and - Hoechst v. Inland Revenue Commissioners 2001 E.C.R. 1-1727, and ACT Group Litigation cases, supra note 42, with the difference that here the UK ACT system is mainly reviewed by the Court from the perspective of the UK as the residence-country of dividends (the country of residence of the parent company), rather than from the perspective of the UK as the source-country of dividends (the country of residence of subsidiaries) as it occurred in the Metallgesellschaft and ACT Group Litigation cases (these latter cases used comparable n. 11).

122 The Cobelfret and KBC cases addressed Belgian law implementing the Parent Subsidiary Directive, under which the 95% deduction on received dividends was limited to the amount of taxable profits for the tax year concerned and could not be claimed in a year in which no profits were realized. The Court in those cases held that the mechanism provided for by Belgian legislation was incompatible with Art. 4 (1) of the Parent Subsidiary Directive as it imposed an additional requirement not envisaged by that directive. On the Cobelfret case see: Marie Lamensch.& Servaas Van
The residence-country dividend comparable for corporate portfolio shareholder making financial investment abroad through target companies

In this second variant of the residence-country dividend comparable for corporate shareholders the ECJ has focused exclusively on outbound restrictions in the country of origin in respect to resident companies that make portfolio investment in the country of destination by acquiring non-controlling participations, i.e. participations of a financial nature (hereinafter “corporate portfolio shareholder” and “target companies”). In those cases the Court has focused on the restrictions to foreign direct investment covered by art. 56 (freedom of capital) created by the domestic tax systems of the country of origin that treat dividends paid by the company to the corporate portfolio shareholders resident in that country of origin (residence-country in-coming dividends) differently from (worse than) dividends paid by the resident company to resident corporate portfolio shareholders (residence-country domestic dividends).

Basically in this second variant of the residence-country dividend comparable for corporate shareholders the Court held that the foreign in-coming dividends must be treated equally to domestic dividends and that the residence-country of dividends can decide how to provide relief. This comparable was introduced by the FII Group Litigation and CFC and Dividend Group Litigation cases in those parts that addressed portfolio corporate shareholders and has been used systematically in the Haribo and Salinen case. The Orange European Smallcap Fund case also addressed issues that specifically concerned foreign in-coming dividends from participations that involved financial investment, but the recipient was a collective investment vehicle. In that case the Court established that the situations encompassed under the dividend outbound comparable were not actually comparable. As a result, the Court held that domestic laws of the country of residence of the recipient of dividends were consistent with Community law.

Source-country dividend comparable for subsidiaries of foreign parent companies - ACT cases (comparable n. 11)
The ECJ in a different set of cases has focused exclusively on inbound restrictions in the source-country of dividends in respect to non resident companies (“foreign parents”) that make direct investment in that country through controlled companies of which they own a controlling interest (“subsidiaries”). Those cases mainly address the restrictions to foreign direct investment created by the domestic tax systems that treat dividends paid by the subsidiary to the non resident parent (source-country out-going dividends) differently from (worse than) dividends paid by the subsidiary to the resident parent (source-country domestic dividends). This is a comparable internal


123 FII Group Litigation and CFC and Dividend Group Litigation, supra note 42, in relation to participations that did not exceed the 10% threshold; Haribo and Salinen case, supra note 42, and Orange European Smallcap Fund case, supra note 49. On these last two cases: Daniël S. Smit, European Union - The Haribo and Österreichische Salinen Cases: To What Extent Is the ECJ Willing To Remove International Double Taxation Caused by Member States?, 51 EUR. TAX’N. 7 (2011), Thomas Spaas & An Weyn, The Lessons of the Orange European Smallcap Fund, 18 EC TAX REV. 53-66 (2009).

124 Haribo and Salinen, supra note 42, ¶¶ 52, 80, 109, 164, 165-169.

125 Orange European Smallcap Fund, supra note 49.

126 These dividends are usually defined “outbound dividends”. In the comparable n. 11 (source-country dividend comparable for subsidiaries of foreign parent companies) such outbound dividends create inbound restriction issues. Therefore for the sake of clarity these dividends will be denominated “source-country out-going dividends” as opposed to “source-country domestic dividends”.

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situation test that looks at covert restrictions. As a result the Court has developed a specific source-
country dividend comparable for subsidiaries of foreign parent companies.  

The cases decided by the Court using this comparable (Metallgesellschaft and ACT Group Litigation) specifically focus on relief mechanisms in respect to distributed dividends (typically the “ACT” mechanism) that are imposed differently on companies depending on the fact that they have or do not have a foreign parent company, so this comparable is a specific application of the baseline inbound company comparable (“domestic company-with-domestic shareholders vs domestic company-with-foreign shareholders”, see supra comparable n. 6). Both cases involved detailed aspects of ACT but in essence they addressed a common issue, i.e. whether it was consistent with EU law for the legislation of a Member State to permit a group income election, allowing distributions to be paid by a subsidiary to its parent without accounting for ACT, only where both the subsidiary and parent were resident in that Member State.

In the Metallgesellschaft case the Court held that such a restriction was precluded by Community law, while in the ACT Group Litigation case the Court introduced the distinction between source-
country domestic dividends and source-country out-going dividends as seen from the perspective of country of the distributing subsidiary (source-country of the dividends) in respect to the mechanisms imposed on that company by domestic law in connection with distribution of profits.

On the basis of that distinction the Court in the ACT Group Litigation case held that the source-
country of dividends (i.e. the country where the subsidiary with a foreign parent company is resident) is not obliged to extend to the non resident parent companies the partial imputation tax credit it grants upon the distribution of dividends to resident parent companies for the underlying corporate tax, if it does not tax the non resident parent companies on such dividends. The Court also clarified that the source-country of dividends is free to differentiate in tax treaties it has concluded with different Member States, granting the imputation credit on outbound dividends to parent companies in some Member State and not in others, depending on whether or not, in the negotiated allocation of taxing powers, that source-country of dividends retained the power to tax out-going dividends. The Burda case, although decided in application of the Parent Subsidiary Directive,

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127 In the bilateral residence-country dividend comparable for recipient individual shareholders (comparable n. 9) the freedom of individual shareholders to invest their capital is symmetrically linked to the freedom of the companies to raise capital from those shareholders. By contrast, in the source-country dividend comparable for subsidiaries of foreign parent companies (comparable n. 11), the freedom of the parent company to make a direct investment through a subsidiary is not symmetrically linked to any freedom exercised by their subsidiaries to raise capital from the parent companies, as the subsidiaries are the mere vehicle for the parent companies to carry out their activities in the country of destination.

128 See Metallgesellschaft, supra note 121, and ACT Group Litigation case, supra note 42. Under the advance corporate tax (“ACT”) the distributing company had to pay an advance corporate tax (the ACT), calculated on an amount equal to the dividends paid to shareholders. The ACT was not a withholding tax on dividends, but instead constituted a prepayment of the mainstream corporation tax (“MCT”) of the distributing company payable in each accounting period and therefore it could be set off against the MCT that became due at a later stage. If the ACT could not be set off against the MCT in the accounting period in question it could be carried forward or carried back. A tax credit system was in place in connection with ACT that differentiated between resident or non resident corporate shareholders. On the Metallgesellschaft case see: Adam Craig, Show Me the Money: What the ECJ’s Decision in Hoechst Could Mean for the United Kingdom’s Tax Haven Legislation, 56 BULL. INT’L FISC. DOC. 19 (2002); Ana Paula Dourado, From the Saint-Gobain to the Metallgesellschaft Case: scope of non-discrimination of permanent establishments in the EC Treaty and the Most-Favoured-Nation Clause in EC Member States Tax Treaties, 11 EC TAX REV. 147–156 (2002).

129 A similar source-country dividend comparable for the corporate shareholders is comparable n. 12, that however focuses on withholding taxes levied in the source-country of dividends which constitutes inbound restrictions on the freedom of establishment or of capital of the foreign shareholders.

130 See the ACT Group Litigation case, supra note 42.
complements the Metallgesellschaft and ACT Group Litigation cases and confirms that the source-country is free to choose the mechanism of relief at the level of the local subsidiary.\(^{131}\)

**Source-country dividend comparable for the recipient foreign shareholders - withholding tax cases (comparable n. 12)**

In a series of cases the Court has focused on out-going dividends from the perspective of the country of residence of the distributing company (source-country of the out-going dividends) acting as the country of destination of the exercise of the freedom of capital or of establishment by non resident shareholders.\(^{132}\) In those cases the Court focused on inbound restrictions\(^ {133}\) in respect to such non resident shareholders when the country of destination subjected source-country domestic dividends to a better treatment than source-country out-going dividends, essentially by exempting them from withholding taxes that were instead levied on out-going dividends (comparable n. 12)\(^ {134}\).

This is a comparable internal situation test. In the cases decided using this comparable the issue is generally that there may be a withholding tax or similar charges on the out-going cross-border dividends that are paid to non resident shareholders, while such a withholding tax may not be levied on the dividends paid to resident shareholders. In all cases the Court held that this disparity violated the Treaty\(^ {135}\), and that such a restriction is precluded by art. 56 if the recipient shareholder is a portfolio (individual or corporate) shareholder, and by art. 43 if the recipient shareholder is a controlling (individual or corporate) shareholder.

In the last few years the Commission has taken three cases involving withholding taxes to the ECJ under infringement procedures, and other Member States were impacted by the decisions of the Court that ensued\(^ {136}\) which relied on the *Denkavit II* case, which is the leading case in this area.\(^ {137}\)


\(^{132}\) The Court also focused on out-going dividends in another comparable (the source-country dividend comparable for subsidiaries of foreign parent companies, n. 11), but that comparable is a source-country dividend comparable in which the Court adopted the perspective of the country of residence of the distributing company acting as the country of destination of the exercise of the freedom of capital or of establishment by non resident shareholders.

\(^{133}\) There can also be inbound restrictions in two other comparables for dividends, i.e. the residence-country reinforced dividend comparable for recipient individual shareholders (comparable n. 9) and the source-country dividend comparable for subsidiaries of foreign parent companies - ACT cases (comparable n. 11).

\(^{134}\) On the notion of withholding taxes see Athinaïki Zythopínia, Epson, Océ Van der Grinten, supra note 22; *Burda*, supra note 49.


On the basis of that case the Court has adopted consistent language to express the comparable n. 12 concerning inbound restrictions from the perspective of the Member State of residence of the company that distributes the dividends. In those cases the Court held that there is inbound restriction in the Member State where the company distributing the dividends is resident because such a Member State provides a better treatment for domestic dividends than for out-going dividends and thus it makes it less attractive for companies established in other Member States to exercise freedom of establishment so that they may, in consequence, refrain from acquiring, creating or maintaining a subsidiary in the State which adopts that measure.

Another set of cases decided by the Court is about the actual application of the Parent Subsidiary Directive in respect to the withholding taxes: these cases are not based on the establishment of a comparable by the Court and therefore are not considered here. The same definitional issue was addressed by the *Burda* case, in which the Court held that the tax levied on the untaxed profits of the distributing company upon distribution of dividends did not constitute a withholding tax prohibited by art. 5 (1) of the Parent Subsidiary Directive.

6. Other derivatives of the company comparable: the comparables for groups of companies

In addition to the situations encompassed under the comparables n. 1-8 in respect to economic activities discussed supra at section 4, and to the situations encompassed under the comparables n. 9-12 in respect to cross-border dividends discussed supra at section 5, the Court has also addressed situations in which interactions between affiliated companies have an impact on the tax positions of such companies and has therefore developed context-oriented comparables concerning the activities of groups of companies. These comparables are specialized variations of the baseline inbound or outbound company comparable (respectively comparable n. 6 and 7) and come into two variants: an inbound comparable in respect to deductions by affiliated companies (comparables 13a and 13b), and an outbound comparable in respect to tax attributes of the parent company vis-à-vis foreign subsidiaries (comparables 14a through 14d).

**Comparables in respect to deductible profit transfers by affiliated companies**

In the *first variant* (comparables 13a and 13b) the Court has adapted the baseline company inbound comparable n. 6, into a more specific comparable tailored to groups of companies (“domestic company-with-domestic parent vs domestic company-with-foreign parent” comparable) that involves the comparability of the treatment of a company resident in the destination country that has a domestic parent company vs the treatment of another domestic company that is operating in the same destination country but which has a foreign parent company or that is affiliated with foreign companies belonging to the same group. This inbound comparable breaks down in two different context-specific sub-comparables: (i) an inbound comparable for business activities carried out through a subsidiary in connection to payments of interest by the subsidiary to a foreign parent or to other affiliated companies (comparable n. 13a), and (ii) an inbound comparable for business

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138 See e.g. *Denkavit II*, supra note 134, ¶ 30.

139 *Athinaïki Zythopia*, *Epson, Océ Van der Grinten*, supra note 22, specifically focused on the notion of withholding taxes and did not use comparability analysis.

140 *Burda*, supra note 49.


142 A company may be affiliated with foreign companies belonging to the same group, for example when both companies are (directly or indirectly) under the control of a same company, or when the foreign company exercises *de facto* control in another company.
activities carried out through a subsidiary or an affiliated company in connection to profits transfers by such a company to a foreign parent or affiliated company (comparable n. 13b). These are both comparable internal situations that look at covert restrictions.

The comparability analysis conducted by the ECJ in respect to the subsidiaries of foreign companies is to be distinguished from that conducted using the source-country dividend comparable for subsidiaries of foreign parent companies - ACT cases (comparable n. 11), or using the source-country dividend comparable for the recipient corporate shareholders withholding tax cases (comparable n. 12). The difference is the following: in the dividend cases that use an inbound comparable (comparables n. 11 and 12) the comparable specifically focuses on flow of dividends\(^{143}\), while in the group cases that use an inbound comparable (comparables 13a and 13b) the comparable looks at the *deductions* by the subsidiary or affiliated companies. Thus the inbound dividend cases are focused on the covert restrictions in the country of destination against foreign parent companies doing business in that country through a subsidiary, while the inbound group cases in addition to addressing covert restrictions in the country of destination, also focus on the potential *extraction of income* from that country (where the subsidiary is located) toward the country of origin (where the parent or affiliated company is located) because they bear on payments that (differently from dividends) are deductible in the country of destination.

**Inbound comparable for deduction of interest for intra-group financing (thin cap cases) (comparable n. 13a)**

What generally happens in these comparables is that in the *domestic situation* the subsidiary or affiliated company can deduct interest that are paid to the parent or affiliated company resident in the same Member State, while in the *cross-border situation* the subsidiary or affiliated company cannot deduct the interest that are paid to the parent or affiliated company resident in another Member State. The ECJ conducts a comparability analysis addressed at two distinct kinds of recipients of the payments arising from the deductible profit transfers, i.e. a parent or affiliated company (i) resident in the same Member State of residence of the subsidiary making the payment, or (ii) resident in another Member State. The perspective that is taken in those cases is that of the country of destination, and more specifically the issue is whether there are inbound restrictions in the Member State of residence of the subsidiary or affiliated company that acts as the payor of deductible profit transfers\(^{144}\).

In the classic “thin cap cases” (*Lankhorst-Hohorst* and *Thin Cap Group Litigation*) the Court held that thin capitalization rules which treat interest paid to non resident parent companies less favourably than that paid to resident parent companies unjustifiably restrict the freedom of establishment\(^{145}\) if they are not specifically targeted to “wholly artificial arrangements” designed to circumvent national tax rules. So these cases ultimately addressed the issue of transfer of profits

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\(^{143}\) For example in the *Metallgesellschaft case*, supra note 121, discussed supra at section 5 in the context of the source country dividend comparable for subsidiaries of foreign parent companies (comparable n. 11), the Court established the comparable between (i) resident subsidiaries of resident parent companies, and (ii) resident subsidiaries of non resident parent companies, in relation to certain aspects of the ACT related to source-country out-going dividends.

\(^{144}\) The cases of the sample of this study that use this comparable are the following: *Lankhorst-Hohorst, Thin Cap Group Litigation* and *Lasertec*, supra note 51; Case C-105/07 NV Lammers & Van Cleeoff v. Belgium, E.C.R. 2008 I-0017; *Truck Center*, supra note 49.

across jurisdictions and therefore spurred a significant debate both in terms of their systemic effects\(^\text{146}\) and in terms of their impact on individual Member States\(^\text{147}\).

The \textit{Lasertec} case, differently from the classic “thin cap cases”, involved a third country where the affiliated lender was resident: in that case however, the Court established that there was actual comparability between a domestic situation and a cross-border situation involving third countries, only to conclude that the differentiated treatment that constituted a restriction was in practice not relevant because the relevant provisions of the Treaty do not apply to third country situations\(^\text{148}\). Similar issues of re-characterization of interest and a similar approach to the comparable are found in the \textit{Lammers & Van Cleeff} case in a slightly different factual setting that concerned resident vs foreign directors of a company. In that case the Court held that rules requiring to re-classify as dividends only interest payments to a foreign director company made on a loan exceeding a certain level of paid-up capital plus taxed reserves, but not requiring to reclassify interest paid to a resident director company, were incompatible with EC law.

The \textit{Truck Center} case involved out-going interest but is to be distinguished from the other thin cap cases, because in that case the Court decided that there was no actual comparability between a domestic and a cross-border situation, and this necessarily implicated there was no restriction that was precluded by Community law\(^\text{149}\). The Court in fact stated that (i) interest subject to corporate tax in the hands of resident recipients and exempt from withholding tax and (ii) interest paid to a non-resident recipient but subject to withholding tax were two non-comparable situations. Consequently the actual disparity of treatment did not amount to a restriction and was compatible with the freedom of establishment and of capital simply because there cannot be restrictions if two situations are not comparable\(^\text{150}\).

In two important cases (\textit{Oy aa}\(^\text{151}\) and \textit{SGI}\(^\text{152}\)) the Court used again the inbound comparable in respect to companies included in a group. This comparable involves a “payor affiliated company” resident in a country of destination that carries out a profits transfer, and a “recipient affiliated


\(^{148}\) In the \textit{Lasertec} case, \textit{supra} note 51, the Court held that legislation which re-qualifies interest payments to substantial shareholders resident in third countries as hidden profit distributions primarily affects the freedom of establishment, and clarified that the application of thin capitalization rules in those circumstances is not precluded by the Treaty because the freedom of establishment cannot be relied on in a situation involving a borrower in a third State.


\(^{150}\) So the \textit{Truck Center}, \textit{supra} note 49, is a case that belongs to the “non-comparable situation cases” cluster.


company” resident in a country of origin that receives the profits. The recipient affiliated company is exercising its freedom of establishment in the destination country through an affiliated company. What occurred in these group situations was that an affiliated company received a contribution of taxable profits from another affiliated company that were claimed as deductible for the same payor affiliated company in its country of residence. What generally happens in these cases is that, under the so called group contribution systems, in the domestic situation the affiliated company that transfers the profits can deduct those profit contributions that are paid to the other affiliated company, while in the cross-border situation the affiliated company that transfers the profits cannot deduct those profit contributions that are paid to the other affiliated company.

The ECJ conducted in those cases a comparability analysis addressed to two distinct kinds of recipients of the payments arising from the deductible profit contributions: respectively a recipient affiliated company resident in the same Member State of residence of the affiliated company making the profit transfer, or resident in another Member State. The perspective that is taken in those cases is that of the country of destination, and more specifically the issue is whether there is inbound restriction in the Member State of residence of the affiliated company making the profit transfer.

In those cases the Court stated that a different treatment of resident affiliated companies transferring profits depending on the residence (domestic or foreign) of the affiliated company receiving such profits constitutes an obstacle to the freedom of establishment, but such a restriction is justified by the need to safeguard the balanced allocation of taxing rights between Member State and the prevention of tax avoidance that is proportionate to those objectives.

Comparables in respect to tax attributes of the parent company related to group situations

In the second variant of the comparable related to activities of groups of companies (comparable 14a through 14d) the Court has applied the baseline outbound company comparable n. 7 (“domestic company vs domestic parent company-with-foreign subsidiary” comparable), into a more complex comparable tailored to groups of companies (“domestic parent-with-domestic company vs domestic parent-with-foreign company” comparable) in situations that involve the interactions between companies belonging to the same group. This comparable breaks down into four sub-comparables that embody a comparable external situation test:

a) a bilateral comparable in respect to the attribution to the parent company of the losses of the foreign subsidiaries (consolidation cases) (comparable n. 14a);
b) an outbound comparable in respect to the deduction by the parent company of costs related to foreign subsidiaries - Bosal legacy (comparable n. 14b);
c) an outbound comparable in respect to attribution to the parent company of the undistributed profits of the controlled companies - CFC cases (comparable n. 14c);

153 Both in the group contribution system (see the OY aa case, supra note 51) or when the profit transfer is carried out through intra-group transactions (see the SGI case, supra note 51), the profits can be transferred from the parent to the subsidiary, from the subsidiary to the parent, and between affiliated companies. Therefore the companies involved in these intra-group transactions can be generally defined as “affiliated companies” (a “payor affiliated company” and a “recipient affiliated company”).
155 OY aa, supra note 51, ¶ 39, citing Lankhorst-Hohorst, supra note 51, ¶ 32, and Thin Cap Group Litigation, supra note 51, ¶ 61. In the Oy aa case the Court, in theory extended the unilateral inbound comparable to a bilateral comparable, but then held that the differentiated treatment under such a comparable was justified; for details see infra at...
156 OY aa, supra note 51, ¶ 44 – 67.
d) an outbound comparable in respect to attributes of the parent company differentiated on the basis of the participations in domestic vs foreign companies (comparable n. 14d).

The comparability analysis conducted by the ECJ in the comparables 14a through 14d with regard to the parent companies resident in the country of origin and owning foreign subsidiaries is to be distinguished from that conducted using the residence-country dividend comparable for parent companies making direct investment abroad through subsidiaries (comparable n.10). The difference is the following: in the dividend cases the comparable specifically focuses on the flows of dividends, while in these group cases the comparable looks at the attribution to parent companies of certain relevant tax situations originating at the level of subsidiaries (losses of foreign controlled companies, deduction of the costs related to foreign subsidiaries, attribution of profits of the subsidiaries). Moreover while the outbound dividend cases address the outbound restrictions in the country of origin, the outbound group cases not only focus on the outbound restrictions, but also on the potential transfer of profits/losses from the country of destination (where the subsidiaries are located) toward the country of origin (where the parent company is located).

Bilateral comparable in respect to the attribution to the parent company of the losses of the subsidiaries (consolidation cases) (comparable n. 14a)

The perspective that is taken by the Court in this comparable is that of the country of origin, i.e. the country of residence of the parent company, and there is comparison between two entities resident in the same Member State, i.e. two parent companies, one owning domestic subsidiaries and the other owning foreign subsidiaries. The issue is whether the consolidation of losses allowed in domestic situations should be extended to cross-border situations. This evaluation of the outbound restrictions has been conducted by the Court essentially in the Marks & Spencer and X Holding cases (but specification can be found in the ICI and Papillon cases), in which the Court has extended the outbound perspective reaching into a bilateral comparable.

The holding of the Marks & Spencer case has become the “Marks & Spencer rule” that breaks down into an explicit and an implicit rule. According to the “Marks & Spencer explicit rule”, the UK group relief provisions were held to pursue legitimate objectives compatible with the Treaty, which were justified by overriding reasons in the public interest, and thus arts. 43 and 48 of the Treaty do not preclude provisions in a regime of group taxation of a Member State which generally prohibit a resident parent company from deducting from its taxable profits losses incurred by a subsidiary established in another Member State, even when these allow the deduction of such losses incurred by a resident subsidiary. By contrast, according to the “Marks & Spencer implicit rule”, the UK group relief provisions were held to go beyond what is necessary for cases in which the non resident subsidiary had exhausted all possibilities to deduct the losses incurred in its Member State of residence and the losses could not be carried forward by the subsidiary or a third party to which the subsidiary was sold (so called “final losses”).

The Court has created in the Marks & Spencer case a bilateral comparable, but not for current losses of foreign subsidiary, only for final losses, i.e. those losses that cannot be eventually “used” by the subsidiary in its country of residence. The Court in the Marks & Spencer case held that only the losses of the foreign subsidiary that cannot be “used” in its country of residence can be “used” by the foreign parent company to be offset them with profits. That ruling of the Court is based on the concept that in order to respond to equality constraints both in the country of origin (parent) and in the country of destination (subsidiary) the losses can be “used” only once. At domestic level there are mechanisms of vertical loss recovery (such as carry forward/back, domestic tax consolidation,

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157 The Member State of residence of the parent company acts as the country of origin insofar as the parent company resident in that Member State exercises its own freedom through a foreign controlled company that reports losses.
and the like) that can be used locally, so for the purposes of equal protection it makes sense to consider final rather than current losses.

This is a situation in which the outbound equality concern of the country of origin (where the parent company is located) is that final losses of domestic companies and final losses of foreign-owned subsidiaries be treated alike, i.e. used once. This outbound equality of treatment dovetails with the inbound concerns of the country of destination (where the subsidiary is located) that final losses of domestic-owned companies and domestic losses of foreign-owned companies be treated alike, i.e. used once. Thus there are three situations that are included in the comparable and simultaneously equalized: (i) in the country of origin: a parent company with a domestic subsidiary reporting final losses; (ii) in the country of origin: a parent company with a foreign subsidiary reporting final losses; (iii) in the country of destination: a parent company with a domestic subsidiary reporting final losses.

The Marks & Spencer case158 spurred a great deal of interest because reached into a previously unchartered territory, i.e. the extraterritorial scope of the tax jurisdiction of the country of the parent company adopting tax deferral on foreign subsidiaries159. Moreover that case generated a debate on the potential impact of both the explicit and implicit rule included in the holding160, as one of the main issues has been the actual extent of the justification analysis developed in that case161. Finally there is a significant nexus between the Marks & Spencer case and the other cases dealing with the cross-border use of losses, i.e. those related to the losses of the permanent establishments and those the transfer of residence of companies, so that commentators have begun to connect the dots on an wider pan-European approach to the allocation of tax powers of Member States162.

In the X Holding case the Court confirmed the Marks & Spencer case and held that a group taxation regime, under which a parent company resident in a Member State cannot form a tax group with its subsidiaries resident in other Member States, whilst that option is available in respect of subsidiaries resident in the first Member State, is compatible with the freedom of establishment163. In the Papillon case the Court held that national legislation which prohibits tax consolidation of a French parent company and its French lower-tier subsidiaries, if those subsidiaries are held indirectly through an intermediary company resident in another Member State, is incompatible with

158 The Marks & Spencer case has stirred attention even before the actual decision. See for example: Daniel Gutmann, The Marks & Spencer case: proposals for an alternative way of reasoning, 12 EC TAX REV. 154–158; Sheppard Lee, Dowdy Retailer Set To Destroy European Corporate Tax, 104 TAX NOTES 16 (2004); Gerard Meussen, Cross-Border Loss Relief in the European Union Following the Advocate General's Opinion in the Marks & Spencer Case, 45 EUR. TAX’N 282 (2005).


the freedom of establishment. The ICI case was decided in the context of the outbound comparable (comparable n. 14d, see infra...) for Business Activities carried out through subsidiaries abroad, and only marginally affects cross-border consolidation issues.

Outbound comparable in respect to the deduction of costs by the parent company in relation to foreign subsidiaries (Bosal legacy) (comparable n. 14b)

These group situations focus on the deduction by the parent company of the of costs borne in relation to subsidiaries (so called “Bosal legacy”) from the first case decided on these issues) and involve potential issues of outbound restrictions in the country of residence of the parent companies in respect to their foreign subsidiaries. In these group situations the parent company exercises its freedom of establishment through a subsidiary and intends to deduct costs related to subsidiaries or otherwise write down losses borne by those subsidiaries.

The comparable established by the Court in the cases involving requirements for domestic regimes is between two situations (a domestic situation and a cross-border situation). In the domestic situation there is a parent company that controls one or more subsidiaries resident in the same Member State and this constitutes a situation that is relevant for the purposes of taxation of group of companies, such as the possibility for the parent company to deduct costs related to domestic subsidiaries or otherwise write down losses borne by those subsidiaries. In the cross-border situation there is a parent company that control one or more subsidiaries that are resident in another Member State and this constitutes a situation that is equally relevant for the purposes of taxation of group of companies, such as the possibility for the parent company to deduct costs related to foreign subsidiaries or otherwise write down losses borne by those subsidiaries. The Court used this comparable in the Bosal and Keller cases that addressed the issues of deduction of costs by the parent when such costs were not actually matched by taxable income, while the Rewe Zentralfinanz and STEKO cases discussed a similar issue in term of the possibility for the parent company to write-down losses of foreign subsidiaries.

The Bosal case was decided on the basis of the Parent Subsidiary Directive and it applied the outbound comparable in respect to the deduction of costs by the parent company in relation to the foreign subsidiaries. In fact the Court held that such a Directive interpreted in the light of the freedom of establishment precludes national provisions of a Member State which make the deductibility of costs in relation to a subsidiary established in another Member State subject to the condition that the profits from the participation in the subsidiary are taxable in the country of residence of the parent company.

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In the Keller case, in which the Court decided that German legislation which disallowed, for a German resident parent company, the deduction of financing costs of indirect participations in a non resident subsidiary that were related to distributions of dividends which were exempt for such recipient parent company. By contrast, such costs were allowed to be deducted with respect to distributions from a resident indirect subsidiary that were exempt for the recipient parent company. According to the Court this differentiated treatment constituted an unjustified restriction on the freedom of establishment. In the Rewe Zentralfinanz and STEKO cases the Court basically confirmed the Bosal and Keller cases because, by using the same comparable, it held that the non-deductibility of losses incurred by a German resident parent, in respect of write-downs to the book value of its participations in subsidiaries established in other Member State, constituted an unjustified restriction on the freedom of establishment when such losses on participations in domestic subsidiaries were instead deductible.

Outbound comparable in respect to attribution to the parent company of the undistributed profits of foreign controlled companies (CFC cases) (comparable n. 14c)

These group situations focuses on the attribution to the parent company of the current undistributed profits of foreign subsidiaries (so called “CFC cases” after the name of the tax policy measure) and involve potential issues of outbound restrictions in the country of residence of the parent companies in respect to their foreign subsidiaries.

The comparable established by the Court is between two situations (a domestic situation and a cross-border situation). In the domestic situation there is a parent company that controls one or more subsidiaries resident in the same Member State and cannot be taxed on the undistributed profits of the controlled company located in that same Member States (this constitutes a situation that is relevant for the purposes of taxation of group of companies, as it allows tax deferral for the parent company on the profits of domestic subsidiaries). In the cross-border situation there is a parent company that control one or more subsidiaries that are resident in another Member State and that is taxed on the undistributed profits of those foreign subsidiaries (this constitutes a situation that is relevant for the purposes of taxation of group of companies, as it denies access to tax deferral for the parent company on the profits of foreign subsidiaries).

The perspective that is taken by the Court in this comparable is that of the country of origin, i.e. the country of residence of the parent company, and there is comparison between two entities resident in the same Member State, i.e. two parent companies, one owning domestic subsidiaries and the other owning foreign subsidiaries. The issue is whether the non-attribution to the parent company of current profits of domestic subsidiaries should be extended to the current profits of foreign subsidiaries that are automatically attributed to the parent company by CFC rules.167

There is a coherent line of cases that adopted this comparable. In the Cadbury Schweppes and CFC and Dividend Group Litigation cases the Court held that CFC legislation was precluded by art. 43 of the Treaty and could be justified only if targeted at wholly artificial arrangements,168 but also that the compliance requirements of CFC regime for companies wishing to be exempted from that

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167 The Member State of residence of the parent company acts as the country of origin insofar as that parent company exercises its own freedom abroad through a controlled company.

regime must not go beyond what is necessary to prevent abusive practices\textsuperscript{169}. The \textit{Columbus Container} case involved a situation in which a foreign subsidiary was re-characterized as a CFC and is to be distinguished from \textit{Cadbury Schweppes} and \textit{CFC and Dividend Group Litigation} cases because in that case the Court established that there was no actual comparability between a domestic and a cross-border situation and this necessarily implicated there were no restriction precluded by Community law\textsuperscript{170}.

\textit{Outbound comparable for attributes of the parent company differentiated on the basis of the participations in domestic vs foreign subsidiaries (comparable n. 14d)}

These group situations focus on the different requirements for application of domestic (favourable) regimes or evaluation methods imposed by domestic rules on the parent company and which were differentiated on the basis of the participations that such parent company had in domestic vs foreign subsidiaries, and thus involved potential issues of outbound restrictions in the country of residence of the parent companies. First, in certain group situations (cases involving certain domestic requirements) a domestic (more favourable) tax treatment is conditioned upon the fact that the parent company owns domestic subsidiaries rather than foreign subsidiaries. In a second cluster of cases (evaluation cases) the parent company is required, for various purposes, to evaluate differently participations in domestic vs foreign subsidiaries.

The comparable established by the Court in the cases involving requirements of domestic regimes is between two situations (a domestic situation and a cross-border situation). In the \textit{domestic situation} there is a parent company that controls one or more subsidiaries resident in the same Member State, and this constitutes a situation that is relevant for the purposes of taxation of group of companies, such as domestic requirements to benefit of a favourable regime (i.e. the possibility to make an election for domestic tax consolidation). In the \textit{cross-border situation} there is a parent company that control one or more subsidiaries that are resident in another Member State and this constitutes a situation that is equally relevant for the purposes of taxation of group of companies, such as domestic requirements to benefit of a favourable regime (i.e. the possibility to make an election for domestic tax consolidation).

The Court used this comparable in the \textit{ICI} case in respect to the domestic requirements that were more favourable for parent companies with domestic subsidiaries than for parent companies with foreign subsidiaries (the case concerned the possibility for a parent company with domestic and foreign subsidiaries to make an election for domestic tax consolidation). In the \textit{ICI} case the Court held that the freedom of establishment precludes legislation that makes a particular form of tax relief subject to the requirement that the a parent company’s business consist wholly or mainly in the holding of shares in subsidiaries that are established in the same Member State concerned\textsuperscript{171}.

The same type of comparable was used by the Court in respect to the adoption of a certain (more favourable) evaluation methods of the participations in domestic vis-à-vis foreign subsidiaries in the \textit{Baars} and \textit{Bauer} cases. In \textit{Baars} the Court held that a Member State’s legislation which provides a full or partial exemption from wealth tax for shareholders having a substantial participation in


\textsuperscript{171} On the \textit{ICI} case, supra note 165, see: David Hughes, \textit{Imperial Chemical Industries Plc (Ici) V. Kenneth Hall Colmer (Her Majesty’s Inspector Of Taxes) BULL. INT’L FISC. DOC. 13 (1999)}; Ton Daniels, \textit{The freedom of establishment: some comments on the ICI decision}, 8 EC TAX REV. 39–42 (1999).
companies established in that Member State but denies such exemption for similar participations in companies of other Member State, infringes the freedom of establishment. Similarly in Bauer the Court held national legislation which provides for different valuation methods for holdings in domestic and foreign partnerships, resulting in a higher value of holdings in foreign partnerships for wealth tax purposes, and, accordingly, a higher wealth tax liability, is incompatible with the freedom of establishment.\(^{172}\)

7. A two-step argument to explain the gaps in the web of the comparables developed by the Court

The previous sections have provided a description the actual comparables (in total eighteen of them) that the Court has developed. The systematization of the comparables that emerges from that empirical analysis of cases can now be brought into play to address the criticisms to the judicial approach taken by the Court that have been summarized at the beginning of this paper. In particular one has to verify whether the comparability analysis developed by the Court can be a way out, albeit partial, of the “labyrinth of impossibility”.

A key-concept in the discussion that will be used in the next sections is that of the dual comparable, which can be either a reinforced comparable or a bilateral comparable. I have evidenced that the Court used a reinforced comparable in three situations: cross-border services and transfers or shares (both transactions are included in comparable n. 3)\(^{173}\), as well as dividends received by the individual shareholders (comparable n. 9)\(^{174}\). The empirical analysis also shows that the Court used a bilateral comparable in two situations. The first situation is the prohibition of exit taxes for individuals (comparable n. 8), where the Court has ensured equal treatment in the country of origin (no deemed realization for the transferring individual) and in the country of destination (roll-over of basis for the transferred individual)\(^{175}\). The second situation is when the Court in the consolidation cases held that final foreign losses can be consolidated in the country of the parent company, thereby ensuring equal treatment of final losses in a two-country setting (comparable 14b)\(^{176}\).

Among the sixty-four cases of the sample of this study in which the ECJ held that domestic legislation was inconsistent with the Treaty, thirty-three used a reinforced or bilateral comparable\(^{177}\). In the other cases of the sample the Court relied only on unilateral (inbound or outbound) comparables that bestowed equal protection only in one direction (inbound comparables n. 1, 4, 6, 11, 12, 13a, 13b; outbound comparable n. 2, 5, 7, 10, 14b through 14d). So it would appear that the Court has failed to achieve the full scope of the equal protection clause mandated by the Treaty in the non trivial number of cases decided on the basis of a unilateral (inbound or outbound) comparables.

If one looks at the cases decided using a unilateral comparable the following scenario emerges. In certain situations there is both an inbound and an outbound version of a comparable, but these two

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172 Baars case, see supra note 92; Case C-360/06 Heinrich Bauer Verlag v. FA für Großunternehmen Hamburg, E.C.R. 2008 I-07333.
173 There are sixteen cases decided on the basis of the reinforced comparable for cross border services and transfer of shares (see supra section 4).
174 There are twelve cases decided on the basis of the reinforced comparable for cross border dividends (see supra section 5).
175 There are three cases decided on the basis of the bilateral comparable for the transfer of residence by individuals (see supra section 4).
176 There are two cases decided on the basis of the bilateral comparable for cross border consolidation (see supra section 6).
177 The sum of the cases on the basis of the dual comparable respectively for cross border services (sixteen), transfer of residence by individuals (three), cross-border dividends (twelve) and cross-border consolidation (two) is thirty-three, a significant one third of the sample of cases of this study.
versions are not inter-linked by the Court into a unified bilateral comparable. There are inbound and an outbound branch/company comparable (comparables n. 4-7) leading to two separate lines of cases considering restrictions in the country of destination or of origin, but there is no bilateral comparable for cross-border business activities carried out through a branch or a company that addresses at the same time both countries\textsuperscript{178}.

Moreover, in respect to cross-border flows of dividends there is a source-country dividend comparable for subsidiaries of foreign parent companies (the ACT cases, comparable n. 11), and a residence-country dividend comparable for corporate shareholders (comparable n. 10), but not a bilateral dividend comparable that addresses at the same time the concerns both of the residence-country of dividends (the country of the corporate shareholder) and of the source-country of dividends (the country of the distributing company, i.e. the subsidiary). Moreover the Court fell short of developing a comparable for the transfer of residence of companies.

These apparent gaps are basically the target of criticism addressed to the Court for not adopting a comprehensive view and thus demand an explanation. The strategy that will be adopted here to provide such an explanation is conducted on the basis of a two-step analysis. First, in each of the situations listed above it will be verified whether there were material or logical reasons that impeded the extension of a one-country comparable to a dual comparable, either reinforced or bilateral\textsuperscript{179}. Second, for each situation it will be discussed what kind of consequences an actual use of a dual comparable would have yielded. The two-step analysis thus becomes a two-step argument that runs as follows: if there were material or logical reasons that impeded the use of a dual comparable, or if such use would have lead to absurd or untenable consequences, then the lack of a dual comparable does not affect the soundness of the equal protection clause based on comparability.

The argument that is advanced here is thus a practical one, i.e. that when the Court has not developed a dual comparable for material or logical reasons or because it would have lead to absurd consequence, this cannot be blamed on the Court, but on the fact that certain disparities in taxation can be eliminated on a cross-border basis only by way of a top-down levelling of effective rates and taxing rules. The next sections will show however that the Court has created an extended grid of comparables consistent with the equal protection clause dictated by the Treaty and has failed to do so only in two notable occurrences. Therefore the Court has developed a comparability analysis that accounts for virtually all possible concerns for restrictions in a setting in which the Member States retains their tax sovereignty.

8. The first aspect of the “labyrinth of impossibility”: the interlocked strategies of capital-import and capital-export neutrality

The first question is why there is an inbound plus an outbound branch/subsidiary comparable (comparables 4 through 7), but not a bilateral comparable for those activities, i.e. a kind of reciprocal two-country equal protection clause about the freedom of establishment. The answer basically lies in the impossible co-existence of capital import neutrality in the source country and

\textsuperscript{178} There are also two unilateral inbound or outbound comparables (comparables n. 1 and 2) that are not intertwined. This is not however relevant in terms of the overall consistency of the system of comparable because the Court uses the reinforced comparable for Non-business Activities (comparable n. 3) as a general method in a pervasive manner, see supra at 17.

\textsuperscript{179} Please note that these material or logical reasons are not derogations or justifications based on policy, but actual impediments in the application of the standard of equality in a multi-country situation, for example the impossibility to attain simultaneously time capital-export and capital-import neutrality – see infra section 8.
capital export neutrality in the residence country when rates are different\textsuperscript{180}. This impossibility, in
the parlance of Community law, morphs into the impossible co-existence of inbound equal
treatment in the country of destination (i.e. the country where the branch or company is located)
with domestic equal treatment in the country of origin (i.e. the country where the parent company is
located).

As a matter of fact the creation of a bilateral comparable that equally protects the country of the
investor (the country of origin) and the country of the investment (the country of destination) would
be an enticing perspective because it would allow the Court to actively develop a comprehensive
view of all the issues in situations involving foreign branches or subsidiaries, but at the same time,
retain its traditional comparability analysis. If both the inbound and outbound concerns were
addressed at the same time, than an integrated solution could be effectively reached through the
judicial role of the Court. Unfortunately there are structural reasons inherent to the basic
foundations of tax treatment of cross-border transactions that have prevented the Court from
adopting such an innovative approach. I will develop here an argument about this impossibility
using a reductionist strategy, i.e. breaking down the general problem into two separate sub-
problems.

Let us look first at the possibility of the extension of a one-country inbound comparable to a two-
country bilateral comparable, i.e. to enlarge the scope of the traditional capital-import locational
argument that has been developed by the Court adopting exclusively the perspective of the country
of destination. This would imply to include in the comparable not only (i) a company resident in the
country of destination doing business in that country (\textquotedblleft situation a\textquotedblright), together with (ii) a company
resident in the country of origin and doing business in the country of destination through a branch
or a company (\textquotedblleft situation b\textquotedblright), but also (iii) a company resident in the country of origin and doing
business in that same country of origin (\textquotedblleft situation c\textquotedblright). In practice the inbound analysis from the
perspective of the country of destination would simultaneously equate three situations by using the
transitive property of equality: situation a is to be treated like situation b (equal inbound treatment
in the country of destination), situation c is to be treated like situation b (equal outbound treatment
in the country of origin), thus situation c is to be treated like situation a (two-country bilateral equal
treatment). This extension is explained here by way of an example that uses simple tax rates, in
spite of the fact that in actual cases the Court looks on a case-by-case at the tax treatments, but this
does not alter the structure of the argument.

In the inbound comparable (equality of situations a and b) the analysis is conducted by the Court
from the perspective of the country of destination, i.e. the Member State where the relevant
activities are carried out, and the comparison is for example between a company resident in the
country of destination (company A, subject to a 15\% tax) and a company resident in the country of
origin (company B) that carries out activities through a branch or a subsidiary in the country of
destination for which it is subject in the country of destination to a 20\% surtax, in practice a kind
of inbound-protectionist tax\textsuperscript{181}. It is assumed that company B earns all its income in the country of
destination. Because of the inbound branch/company comparable, company B must be subject in
the country of destination to the same rate applied in that country of destination to a domestic
company A, i.e. 15\%, and this cures the issue of inbound restrictions (the difference between the
domestic 15\% tax and the 20\% surtax imposed on foreign companies by the country of destination).

Within a bilateral comparable the analysis can then be extended to include also the perspective of
the country of origin, i.e. the Member State where company B (i.e. the company that has a branch or

\textsuperscript{180} This point has been extensively stressed by Michael J. Graetz and Alvin C. Warren in Income Tax Discrimination, at 1207 -1212, and in Labyrinth of Impossibility at 1123 - 1127.

\textsuperscript{181} The Royal Bank of Scotland, supra note 27, is an example of that situation.
a company in the country of destination) is resident. Let us suppose that in the country of destination a 20% tax is levied on a resident company C that carries out in that country its domestic activities (situation c). Given the fact that a 15% tax has been imposed on company B as a result of the application of the inbound comparable applied by the country of destination, should the 20% tax applied by country of origin on the domestic activities of company C in country of origin be reduced to 15%? In other terms, should the inbound equal treatment in country of destination (equality of situations a and b) prevail over the domestic treatment in country of origin (situation c)? The answer is that this equalization can in theory be attained, but this would necessarily imply that the country of origin conceded to the country of destination on the ground of the inbound equal treatment in the former country, an argument clearly irrelevant for the country of destination.

Let us now shift the focus to the country of origin and extend a one-country outbound comparable to a two-country bilateral comparable. This would imply to include in the comparable not only (i) a company resident in the country of origin doing business in that same country of origin (situation c), together with (ii) a company resident in the same country of origin and doing business in the country of destination through a branch or a company (situation b), but also (iii) a company resident in the country of destination and doing business in that same country of destination (situation a). In practice the outbound analysis from the perspective of the country of origin would be extended also to domestic situations in the country of destination, using again the transitive property of equality.

In the outbound comparable the analysis is conducted from the perspective of the country of origin (equality of situations c and b), i.e. the Member State where the exercise of freedom of establishment originated, and the comparison is between a company resident in the country of origin carrying out in that country domestic activities (company A, subject to a 10% tax) and a company resident in the same country of origin (company B) that carries out activities through a branch or a company in the country of destination for which is subject in the country of origin to a 20% surtax, in practice a kind of outbound-restrictive exit tax. It is assumed that company B earns all its income in the country of destination. Because of the outbound comparable for Business Activities carried out through a branch or a company, company B must be subject in the country of origin to the same rate applied in that country of origin to a domestic company A, i.e. 10%, and this cures the issue of outbound restriction (the difference between the domestic 10% tax and the 20% surtax imposed on resident companies doing business abroad).

Within this bilateral comparable the analysis can then be extended to include also the domestic perspective of the country of destination (situation c), i.e. the Member State where the non resident company B is carrying out its activities through a branch or a company located therein. Let us suppose that in the country of destination a 15% tax is levied on a resident company C carrying out in that country its domestic activities. Given the fact that a 10% tax had been constrained by the application of the outbound comparable in the country of origin, should the domestic 15% tax applied by country of destination on the activities of company B in such a country of destination be reduced to 10%? In other terms should the outbound equal treatment in country of origin (equality of situations b and c) prevail over the domestic treatment in country of destination (situation a)? Again the answer is that in theory the equalization can be attained, but this would necessarily imply that the country of destination acquiesced to the concept of equality in the country of origin. Again this argument is irrelevant for the country of destination that is expected to modify unilaterally domestic policies (in this case capital-importing neutrality) on the basis of an irrelevant concern adopted by another country (i.e. capital-exporting neutrality).

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182 In the country of origin the comparable is between the domestic company C and another domestic company B that carries out business activities in the country of destination. The same reasoning would apply *mutatis mutandis* if the tax rate in the country of destination were lower (i.e. 10%).
There are two conclusions that can be drawn from this exercise. First, a bilateral comparable encompassing both the concerns of the country of destination and of the country of origin (i.e., perfect equality of treatment of the cross-border situation in both countries) can be achieved only when the rates (and tax treatments) are equalized across the board. Second, if rates (and tax treatments) are different, to achieve a bilateral comparable encompassing both the concerns of the country of destination and of the country of origin, a choice must be made between inbound or outbound concerns. If a one-country inbound comparable is extended to a two-country comparable, then inbound concerns must prevail. By contrast, if a one-country outbound comparable is extended to a two-country comparable, then outbound concerns must prevail. The extension of an inbound or outbound solution into a bilateral comparable in a specific case decided by the Court would then be magnified in a multilateral most-favored nation clause, and spread to multiple countries across the board. In practice, in one scenario, inbound equality of the destination country would spread to the origin countries, and in an alternative scenario, outbound equality of the origin country would spread to the destination countries. In both cases the final outcome would be basically an all-or-nothing situation.

This is the classical problem of the impossible co-existence of capital import neutrality in the source country and capital export neutrality in the residence country. This issue has been thoroughly debated over the years and has been recently brought to bear to the analysis of tax cases of the ECJ by Graetz and Warren who conclude by noting that “prohibiting discrimination based on destination is ultimately inconsistent with prohibiting discrimination based on origin”, and that “this indeterminacy confirms the limits of the principle of equality as a tool for resolving basic issues of international taxation”. The reason is obviously that “the core tax policy issue here is the division of the tax base between source and residence countries, the resolution of which has depended more on compromise and practice than on any overarching principle.”

Now one should turn to the second leg of the two-step argument propounded supra at section 7, i.e., whether the establishment of a bilateral comparable by the Court would that have lead to absurd or untenable consequences. There are two hypothetical scenarios here. Had, in the Court decisions, inbound constrains prevailed, then this view would have fully implemented equal inbound treatment by permitting only source-country taxation and eliminating residence-country jurisdiction over this kind of transnational income within the EU (a capital-import neutrality scenario). By contrast, had, in the Court decisions, outbound constrains prevailed, then this view would have fully implemented the equal outbound treatment by basically allowing companies to carry their home-

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184 Graetz, Income Tax Discrimination at 1215 - 1220

185 If one took the Royal Bank of Scotland, supra note 27, case as an example, at the margin there would be taxation of branches across the EU at the domestic rates of the source countries.
country tax status and rates with them wherever they operated in the EU (a capital-export neutrality scenario). It is clear that such a decision between a source-based or a residence-based EU cannot fall within the purview of the Court, not only because the Court is not a policy-maker, not only because this would completely by-pass democratic control by European taxpayers, but also because it would have been impossible for the Court to select either one of the two opposed, radically alternative, options without overlooking an array of consequences that transcend the task of an adjudicatory body. This is a particularly significant concern if one considers that the tax position of the parent companies and its subsidiaries can be “consolidated” in various respects (offsetting of profits and losses, deduction of costs by the parent, attribution to the parent of the profits of the subsidiary): a decision of the Court in either direction could have shifted the European systems toward a residence-based or a source-based taxation approach of transnational income. So in conclusion the case should be settled as there are constraining reasons why the Court has not developed a bilateral comparable for cross-border business activities carried out through a branch or a company. The Court did not overlook the point, instead it simply restrained itself from going ahead with such an option and that is the reason why there is no bilateral comparable in these situations.

9. The second aspect of the “labyrinth of impossibility”: the cross-border dividends conundrum

There are additional questions about the gaps in the web of the comparables and the paths not taken by the Court in connection with cross-border dividends. The first of these questions is: why there is a residence-country dividend comparable that looks at parent companies making direct investment through subsidiaries in the source-country of dividends (comparables n. 10), and a source-country dividend comparable that looks at subsidiaries of foreign parent companies (ACT and withholding tax cases - comparables n. 11 and 12), but not a bilateral dividend comparable for reciprocal corporate investment through companies in a two-country setting?

The comparability issues are significantly different depending on whether they are viewed from the perspective of the source-country of dividends or from the perspective of the residence-country of dividends. The tax treatment of domestic and out-going dividends in the source-country generally involves a relief mechanisms or withholding taxes in respect to distributed dividends that are imposed differently on companies depending on the fact that they have or do not have a foreign shareholder. By contrast, the tax treatment of domestic and in-coming dividends in the residence-

186 The use of an outbound comparable in a two-country setting in practical terms would preclude taxation of foreign profits in the source countries, a kind of judge-made home state taxation.

187 International judiciary bodies such the ECJ in fact have the ability to invalidate the national legislative processes and this creates an issue if there is no adequate political representation, as it is the case at EU level; see for example Ginsburg Tom, Bounded Discretion in International Judicial Lawmaking, 45 VA. J. INT'L L. 631, 632–33 (2005).

188 Here enters the raging discussion over the Case C-376/03 D. v. Rijksbelastingdienst, 2005 E.C.R. I- 5821, that revolved around the question whether a most-favoured clause supported by Community law should extend bilateral treaty benefits to a multi-country situation. The argument developed in the text implies that, at least in respect to taxation of business income, there should be no such a clause, unless adopted through a directive or on a multilateral basis. The debate on a most-favoured clause began in the nineties - Albert J. Rädler, Most-favoured-nation Clause in European Tax Law?, 4 EC TAX REV. 66–67 (1995); Klaus Vogel, Problems of a Most-Favoured-Nation Clause in Intra-EU Treaty Law, 4 EC TAX REV. 264–265 (1995) - but regained momentum in the wake of the D case decided by the ECJ in 2005: Servaas van Thiel, The Future of the Principle of Non-Discrimination in the EU: Towards a Right to Most Favored Nation Treatment and a Prohibition of Double Burdens?, in COMPARATIVE FISCAL FEDERALISM 331 (Reuven Avi-Yonah, James R. Hines, Jr. & Michael Lang eds., Kluwer 2007).

189 The withholding tax on out-going dividends is generally characterized as a charge borne directly by the recipient in the residence-country, rather that an integral part of the corporate tax in the source-country (such as, for example ACT in the ACT Group Litigation, supra note 42, or differential rates of distributed profit in the Burda Case, supra note 59), and thus the withholding taxes levied in the source-countries have been viewed by the Court as inbound restrictions to the freedom of establishment or capital of the foreign shareholders.
country involves an exemption or a credit as relief on double taxation that may be applied differently depending on the fact that the distributing companies do or do not receive dividends from a foreign subsidiary. These dis-alignments involve possible disparities that could be cured by a bilateral comparable that encompassed the concerns of both countries in respect to the cross-border dividends.

To verify whether such a comparable could be established; I will look first at the possibility of the extension of the system of the source-country to the residence-country of dividends. This would require the extension of the source-country dividend comparable for subsidiaries of foreign parent companies (ACT cases and withholding tax cases - comparables n. 11 and 12) to a two-country bilateral comparable. This would imply to include in the comparable from the perspective of the source-country of dividends not only (i) out-going dividends exiting the source-country ("situation a"), together with (ii) domestic dividends paid and received in the same source-country ("situation b"), but also (iii) domestic and in-coming dividends in the residence-country ("situation c"). In practice the inbound analysis from the perspective of source-country of dividends would be extended also to domestic situations in the residence-country of dividends by using the transitive property of equality: situation a is to be treated like situation b (equal treatment in the residence-country of dividends), situation b is to be treated like situation c, thus situation a is to be treated like situation c (two-country equal treatment that simultaneously equates three situations).

As a consequence, whatever mechanism for distributed dividends (i.e. ACT and withholding taxes) that is imposed in the source-country (situations a and b) would then be extended to include also the perspective of the residence-country (situation c), where such mechanism for domestic residence-country distributed dividends might not be adopted. In other terms the question would be: should the inbound equal treatment in the source-country of dividends prevail over the domestic treatment in the residence-country of dividends? The answer is in theory yes, but this would necessarily imply that the residence-country conceded to the source-country on the ground of the inbound equal treatment (ACT and withholding taxes) in the former country.

The same reasoning would apply if one wanted to extend the system of the residence-country to the source-country of dividends. This would imply the extension of the residence-country dividend comparable for corporate shareholders making investment abroad through subsidiaries (comparable n. 10) to include in the comparable from the perspective of the residence-country of dividends not only (i) in-coming dividends in the residence-country, together with (ii) domestic dividends paid and received in the same residence-country, but also (iii) domestic dividends paid and received in the source-country. In practice the outbound analysis from the perspective of the residence-country would be extended also to domestic situations in the source-country, using again the transitive property of equality.

The implication of such an extended comparability analysis would be that whatever solution had been adopted in the residence-country of dividends as relief for domestic and in-coming dividends (for example credit) would then be extended to the source-country. Should the outbound equal treatment of received domestic and in-coming dividends in residence-country prevail over the domestic treatment of received domestic and in-coming dividends in source-country? The answer is again that in theory this equalization can be attained, but also that this would imply that the source-country acquiesce to the residence-country on the ground of the outbound equal treatment in the former country.

190 The Court in the Metallgesellschaft case, supra note 121, and in the ACT Group Litigation case, supra note 42, addressed the ACT mechanism in connection with the imputation system from the perspective of the source-country of dividends. By contrast the FII Group Litigation, supra note 42 addressed the same ACT mechanism in connection with the imputation system from the perspective of the residence-country of dividends.
So one reaches the same conclusions in both cases of the two-horn dilemma for dividends. First, a bilateral comparable encompassing both the concerns of the source-country and of the residence of dividends (i.e. perfect equality of treatment of the cross-border dividends in both countries) can be achieved only if the mechanisms adopted in both countries are the same (for example no ACT or withholding taxes in all cases plus exemption in all cases). Second, if the mechanisms adopted in the two countries differ, to achieve a bilateral comparable encompassing both the concerns of the source-country and of the residence-country of dividends, a choice must be made between inbound or outbound concerns. In practice one would have to choose whether to extend the mechanism of the source-country (for example ACT or withholding taxes) to the residence-country on domestic dividends there, or to extend the relief of the residence-country for in-coming and domestic dividends (for example tax credit) to the source-country for domestic and in-coming dividends there.

Now one should turn to the second leg of the two-step argument propounded supra at section 7, i.e. if the Court used a dual comparable, would that have lead to absurd or untenable consequences? There are two hypothetical scenarios here. Had the source-country approach prevailed in the Court decisions, then this view would have fully implemented equal inbound treatment by basically mandating the adoption in residence-countries of the mechanism adopted in the source-country. By contrast, had the residence-country approach prevailed in a decision involving two countries, than it would have prevailed across the board. It is evident that either solution would have implied an abolition of domestic mechanisms that is far beyond the reach of a judicial analysis that the Court could reasonably pursue, and thus it would trigger a kind of unpredictable domino-effect. In both cases the extension would be magnified in a multilateral most-favored nation clause setting, so that it would spread to multiple countries across the board.

In the face of these practical impossibilities, the indications given by the Court in the cases that either involved outbound issues in the country of the parent company or inbound issues in the country of the subsidiary provide a readily accessible explanation of the dividend conundrum. In those cases the Court in a few strokes clarifies essential down-to-earth policy principles. According to the Court the source-country of dividends retains the power to decide what kind of mechanism (such as ACT or withholding taxes) apply to source-country domestic and out-going dividends, while the residence-country of dividends is free to choose exemption, credit or other relief on double taxation on domestic and in-coming dividends, as long as the two classes of dividends are not treated unfavourably in the residence-country of dividends\(\textsuperscript{191}\). So in the view of the Court the two-countries are not interdependently linked by a bilateral comparable, because that comparable would lock them in an ensuing set of adjustments that would instantly spread at a multi-country level.

In conclusion there are indeed constraining reasons why the Court has not developed a bilateral comparable for cross-border dividends. By contrast, the Court has developed a one-country reinforced comparable for cross-border dividends received by individual shareholders (comparable n. 9) because those situations are akin to activities such as cross-border services or transfer of shares (comparable n. 3) to which the Court has also applied the reinforced comparable. In all these cases the symmetrical expectations of both actors of the transaction constitute the reason of the reinforced comparable\(\textsuperscript{192}\).

\(\textsuperscript{191}\) See e.g. ACT Group Litigation, supra note 42, ¶ 50.
\(\textsuperscript{192}\) In the cross-border dividends cases covered by comparable n. 9 the freedom of individual shareholders to invest their capital is symmetrically linked to the freedom of the companies to raise capital from those shareholders. Similarly in cross-border services cases (comparable n. 3) the freedom of the service recipient to seek services abroad is symmetrically linked to the freedom of the foreign service providers to actually provide those services. Finally the
10. Missed opportunities for an integrated approach: migration of taxable bases and companies

Another set of questions about the gaps in the web of the comparables for group of companies concerns the tax consolidation cases that focus on the “migration” of taxable bases, which are somehow associated with the cases on the “migration” of companies. In respect to the migration of taxable bases the Court adopted in the Marks & Spencer case\textsuperscript{193} a bilateral approach that looked at the attribution to the parent company of the final losses of the subsidiaries (comparable 14a). The same comparability approach has been used in other group cases that looked at the deduction by affiliated companies of profit transfers made to other affiliated companies (comparable 13b), but the Court fell short of implementing a full-fledged bilateral comparables on policy grounds. This occurred in the Oy aa and SGI cases, where the Court was asked whether profit transfers are permitted if made to non-resident affiliated companies\textsuperscript{194}.

In the Oy aa and SGI cases the Court stated that, from the perspective of the country of the affiliated company making the profit transfer, the difference in treatment (deduction of profits in domestic situations, non-deduction of profits in cross-border situations) did constitute an obstacle to the freedom of establishment\textsuperscript{195}. The comparable used by the Court was indeed a bilateral comparable: the profits deducted in the country of the subsidiary would be taxed in the country of the parent company, a situation in which the inbound concerns of the country of destination (where the affiliated company making the profit transfer is located) would dovetail with the outbound concerns of the country of origin (where the affiliated company receiving the profits transfer is located).

Thus three situations are included in that dual comparable that simultaneously equates: (i) in the country of destination, an affiliated company that deducts profit transfers made to other affiliated domestic companies; (ii) in the country of destination, an affiliated company that deducts profit transfers made to other affiliated foreign companies; (iii) in the country of origin, an affiliated company that deducts profit transfers made to other affiliated domestic companies. In the country of destination there would be a deduction of profits both for domestic and cross-border situations, and in the country of origin there would also be offsetting of profits and losses both for domestic and cross-border situations\textsuperscript{196}.

The Court however concluded that the differentiated treatment was justified by the need to safeguard the balanced allocation of taxing rights between Member States and the prevention of tax avoidance. In conclusion in the Oy aa and SGI cases there are no logical or structural reasons (like those derived from the impossible co-existence of capital-import and capital-export neutrality) that prevented the application of a bilateral comparable, but only policy reasons because the Court held that the differences in treatment were justified.

The second part of the two-step argument advanced supra at section 7 to explain the gaps in the comparables then runs here by asking the question of what would have happened if the Court had actually imposed such a bilateral comparable (i.e. allowed profit transfers). The answer is that it is likely that if the Court had done so there would have been massive cross-border migrations of losses and erosion of national corporate bases\textsuperscript{197} and therefore the Court has not barred exit taxes on the

\textsuperscript{193} Marks & Spencer, supra note 30.

\textsuperscript{194} Oy aa and SGI cases, supra note 51.

\textsuperscript{195} The other cases belonging to that cluster are cited supra at note 51.

\textsuperscript{196} Oy aa, supra note 51, ¶ 44 – 46; SGI, supra note 51, 62 – 76.

\textsuperscript{197} Oy aa, supra note 51, ¶ 44 – 46; SGI, supra note 51, 62 – 76.
basis of a policy concern that cross-border migrations negatively the balanced allocation of taxing powers. This concern is found in all the cases dealing with cross-border flows of profits and losses either between affiliated companies or between parents and branches, in which the Court has invariably held that ring-fencing of losses prevails over equal protection¹⁹⁸. Thus the failure by the Court to enforce a bilateral comparable is due to a deliberate policy choice taken by the Court to depart from its traditional approach.

The cases on the “migration” of companies share a common thread with the tax cases on the “migration” of taxable bases, as also in those cases one can identify opportunities that were missed by the Court to fill the gaps in the web of the comparables by using bilateral comparables. Although the Court had created a bilateral comparable for the transfer of individuals that resulted in an outright barring of exit taxes, it did not further develop a similar comparable for the transfer of residence of companies in the cases decided on that topic (Cartesio, Daily Mail and National Grid Indus), so the question posed by the two-step argument advanced supra at section 7 is whether, in the first place, there were logical of structural reasons that prevented the Court from doing so.

In the Cartesio and Daily Mail cases there were no reasons akin to those that underlie the impossible co-existence of capital-import and capital-export neutrality that prevented the Court to create a bilateral comparable for transfer of residence of companies. the Court did not even provide policy reasons to support its decisions, as it simply held that a company can wind down and re-incorporate, but cannot transfer the tax residence (place of management and control) and retain its legal status in the country of origin¹⁹⁹. In these two cases the Court simply stuck at the idea that a company does not lose it status unless it is dissolved, and did not address the justifications used in the area of cross-border migration of losses (allocation of taxing powers, anti-avoidance, exchange of information).

In the subsequent National Grid Indus case (supra note 46) the Court has eventually replied to the question raised by the national judge in respect to Treaty protection and held that a company incorporated under the law of a Member State can invoke the freedom of establishment if this Member State imposed an exit tax upon the transfer of the place of effective management of that company to another Member State, and that transfer did not affect its status of being a company of the first Member State. The Court in the National Grid Indus case developed a bilateral comparable for the transfer of residence of companies²⁰⁰, but then it stated that the difference of treatment was justified. The result was that the Court in the National Grid Indus case held that (i) it is possible for the country of origin to definitively fix the amount of the tax due on unrealized capital gains on the company's assets, without taking into account decreases or increases in value, when the company no longer obtains taxable profits as a result of the transfer of residence, but also that (ii) upon election by the taxpayer the collection of such a tax can be carried out at a later stage. This, in practical terms, does not imply the elimination of the exit tax, but only the postponement of its payment. So although in the National Grid Indus case the Court developed a wider policy analysis then that of the Cartesio and Daily Mail cases, it did not actually eliminate the exit taxes on the transfer of residence of companies.

The second leg of the two-step argument propounded supra at section 7 then runs here by asking the question of what would have happened if the Court had actually imposed a comparable based on

¹⁹⁸ The cases concerning losses of foreign permanent establishments in the country of residence of the parent company (Lidl Belgium, Krankenheim, A and B, and Stahlwerk Ergste, supra note 51, were decided in line with the Marks & Spencer rule, which also prevents the use of foreign losses (unless it is proved that they cannot be used in the country were they were produced).
²⁰⁰ National Grid Indus, supra at note 46, ¶ 37–41.
the prohibition of exit taxes on companies, like that created for individuals. There is no trace of a policy rationale in the Cartesio and Daily Mail cases, but the National Grid Indus case focused extensively on the issue of so called “balanced allocation” of taxing powers, so that one can easily infer that the reason for not eliminating exit taxes on the transfer of companies is that there could be more company migrations driven by the tax motive of transferring unrealized gains to jurisdictions with lower taxes\textsuperscript{201}.

The fact that the Court has not developed a comparable for the transfer of residence of companies creates an issue not only from the perspective of the country of origin, but also from the perspective of the country of destination. In fact the exit tax on the transferring company not only violates outbound equal treatment in the country of origin (vis-à-vis a non-transferring company in the same country of origin), but also violates inbound equal treatment in the country of destination if the transferred company is allowed there to retain as basis of its assets their original value. In fact in that situation there would be double taxation of the transferred company on future gains from disposal of assets in the country of destination\textsuperscript{202}. In addition to that, there would be also a differentiated treatment of the transferred company vis-à-vis companies resident in the country of destination (that can usually avail themselves of a stepped-up basis after they pay a tax on realized or accrued capital gains).

\textbf{11. Conclusions on a “gradualistic approach” as a second-best solution to the “labyrinth of impossibility”}

Sections 4-6 supra show that the Court established different types of dual (reinforced or bilateral) comparables that have gained a wide scope of application\textsuperscript{203}. Furthermore the two-step argument proposed supra at section 7 to explain the gaps in the comparables demonstrated that in the cases in which only an unilateral (inbound or outbound) comparable has been used there were material or logical reasons that impeded the use of a dual comparable, or that such an use would have lead to absurd or untenable consequences. Thus the gaps that still remain open in the web of comparables are essentially two and resulted from a deliberate choice taken by the Court to abandon the use of comparables affording complete equal protection. These gaps are the lack of a bilateral comparable for cross-border profits transfers (OY aa, SGI), and the lack of a comparable for the transfer of companies, (Daily Mail and Cartesio). The Court has used in those cases a policy approach – defined as “justification analysis” – with the evident intent of staving off potential “race-to-the-bottom” outcomes, such as cross-border “migrations” of losses or companies. The Court in these cases abandoned its traditional reliance on the comparability analysis and that lapse lead to a containment of pan-EU corporate tax integration, rather than to its facilitation\textsuperscript{204}.

\textsuperscript{201} National Grid Indus, supra at note 46, ¶¶ 42 – 49 (balanced allocation of taxing powers as justification) and ¶¶ 81-82 (election for deferred payment).

\textsuperscript{202} If exit taxes are allowed in the country of origin, the gains are (i) taxed in the hands of the transferring company upon migration, and then are (ii) taxed again in the country of destination in the hands of the same company as a result of disposal of assets that occur after the transfer of residence, in so far as the transferred country roll-overs the original basis of assets. This issue appears now to be solved by the National Grid Indus, supra note 46.

\textsuperscript{203} There are four situations in which a dual comparable has found widespread application either as a reinforced or a bilateral comparable: comparable n. 3 (cross-border services and sales of shares), comparable n. 9 (cross-border dividends received by individual shareholders), are reinforced comparables; comparable n. 8 (transfer of residence of individuals) and comparable n. 14a (consolidation of losses of foreign subsidiaries) are bilateral comparables.

\textsuperscript{204} There are several other cases in which a justification has been developed by the Court. These cases are those on the losses of foreign permanent establishments (Lidl Belgium, Krankenheim, Stahlwerk Ergste, Krankenheim, supra note 51), the profit transfer cases (Oy aa and SGI, supra note 51) and the consolidation cases (Marks & Spencers, supra note 30, and X Holding, supra note 51). In those cases however there is no actual lapse by the Court from the comparability approach because these cases are ultimately based in a bilateral comparable that accounts for final losses in the country of residence and source.
In the end, the two-step argument employed *supra* in sections 8-10 shows that, with only those two remarkable exceptions, there are no major fallacies in the grid of comparables developed by the Court. Furthermore the two-step argument highlights that the so called “overall approach” is just a myth at current EU level because it is basically impossible to attain capital-export and capital-import neutrality if there is no top-down equalization of tax rates. The two-step argument also reveals that it is not true that Court keeps changing the comparables as it elucidates that there is no single catch-all comparables, but rather that the principle of equality of treatment is thus applied through an interlocked system of context-dependent comparables. This system of comparables consists of root comparables in respect to economic activities (comparables n. 1-8), as well as of two sets of comparables that are derived from the baseline company (inbound and outbound) comparable, i.e. the comparables in respect to cross-border flows of dividends (comparables n. 9-12), and the comparables in respect to activities of groups of companies (comparables n. 13 and 14).

Finally the two-step argument reveals that the Court did not miss a golden opportunity to adopt a comprehensive overall perspective that could do justice to policy or efficiency concerns. As a matter of fact the Court in those very cases in which it did not aggregate the two horns of a comparable into a bilateral comparable propounded an explanation of how and why disparities and mis-alignments are acceptable. In those cases where an inbound comparable had not been extended into a dual comparable (for example in the ACT cases), the Court explained that there was no reason to expect that the source-country extended its measures to the residence country of dividends. By contrast, in those cases where an outbound comparable had not been transformed into a dual comparable (for example the cases on the losses of foreign permanent establishments, or the cases on in-coming dividends for corporate shareholders), the Court explained that there was no reason to expect that the residence-country accepted the measures taken in the source-country.

In spite of this broad reach of the comparables developed by the Court, recently there have been several proposals that advocated new approaches the Court should rely on. For example it has been submitted that the Court should abandon the restriction approach in favor of a balancing test under which it would explicitly weigh the Member States’ tax policy interests against the burdens placed on the common market by the challenged tax legislation. Another proposal has been that the ECJ would exercise greater restraint, as it might, for example, give more weight to arguments based on the fiscal coherence of a Member State’s tax system. Another proposal put forth the “internal consistency test” developed by the U.S. Supreme Court to analyze state tax discrimination claims under the Dormant Commerce Clause. Under such a test the ECJ should first apply an “harmony

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205 For example in *ACT Group Litigation*, *supra* note 51, ¶ 56 -59 the Court argued that the Member State in which the profits were derived was not in the same position as the Member State in which the shareholder receiving the distribution was resident, as regards the prevention or mitigation of a series of charges to tax and of economic double taxation. The Court also noted that to attribute to the country of source of dividend the burden to prevent or eliminate double taxation of dividends that are eventually taxable in the country of residence of the recipient shareholder “would mean in point of fact that that State would be obliged to abandon its right to tax a profit generated through an economic activity undertaken on its territory” while it is usually the Member State in which the latter shareholder is resident that is “best placed to determine the shareholder’s ability to pay tax”.

206 For example in *Krankenheim*, *supra* note 51, ¶ 49 the Court accepted the justification raised by the involved country of origin (i.e. country of residence of the parent company) that a Member State cannot be required to take account, for the purposes of applying its tax law, of the possible negative results arising from particularities of legislation of the other Member State where the permanent establishment of such a parent company is situated.

207 *Internal Consistency Test*, *supra* note 7, *passim*.

208 This would involve weighing a Member State’s interest in pursuing its tax policy goals by means of the challenged tax legislation against the burdens imposed on intra-Community commerce by such legislation: *Flunking the Test, supra* note 7, *passim*; *Income Tax Discrimination, supra* note 7, at 1235.

constraint” inspired by the jurisprudence of the Supreme Court in the U.S. under which it would assume that every Member State applied the challenged tax rule. If the relevant cross-border tax disadvantage remains after application of the harmony constraint, the Court could safely conclude that the disadvantage was not caused by lawful disparities, and it would closely scrutinize the law for restriction. The final proposal was to adopt “competitive neutrality” as the guiding principle for judicial decisions regarding tax discrimination.

These proposals however do no appear to constitute a viable alternative to what can be termed as the “gradualistic approach”, according to which the ECJ in tax matters should continue to rely on the path-dependent development of case law based on a systematic web of comparables. The gradualistic approach is rooted in the fact that the solution to double taxation is constrained by evolutionary factors which are the outcome of the strategies of residence and source country, as the former cedes primary jurisdiction over business income to the latter through an exemption or a foreign tax credit. This constitutes an evolutionary stable strategy reflected in the view of the Treaty’s non-discrimination principle, which ultimately relies on the classic distinction between the source country (the country of destination of inbound transactions) and the residence country (the country of origin of outbound transactions).

The upholding of a gradualistic approach in practical terms takes the form of a two-pronged test that makes use of all the available comparables on a case-by-case basis. This test works as follows. **Step one.** First one should check whether in a given situation a dual (bilateral or reinforced) comparable can be employed. The review of the ECJ’s tax cases conducted here has indeed demonstrated that, contrary to conventional wisdom, the Court has surpassed its own tradition of relying on mere inbound protection clauses, and has developed a set of dual comparables that come in two forms: bilateral or reinforced. The bilateral comparables (comparables n. 8 and 14a) afford two-country inbound and outbound equal protection for transfer of residence of individuals and for cross-border consolidation of final losses. Reinforced comparables (comparables n. 3 and 9) afford a slightly weaker form of protection i.e. inbound plus outbound equal protection from the perspective of one country (the country of the service recipient, seller of shares, or recipient individual portfolio shareholder) for cross-border services, sales of shares and dividends received by individual shareholders. If inbound and outbound protection is secured by a bilateral comparable clause, then the gradualistic approach yields an optimal solution based on comparability analysis. If inbound and outbound protection is secured by a reinforced comparable clause, then the gradualistic approach yields slightly weaker protection.

In conclusion when a dual (bilateral or reinforced) comparable is applied, the tax treatment in the country of origin and in the country of destination is simultaneously equalized and the situation defined as “labyrinth of impossibility” does not occur.

**Step two.** If however a dual (bilateral or reinforced) comparable cannot be applied, then one should rely on the traditional inbound comparables developed by the Court based on an internal situation test (comparables n. 1, 4, 6, 11, 12, 13a, and 13b). The Court has developed an inbound comparable virtually for all kinds of situations, so protection in the country of destination should be always attainable. Once inbound protection is secured, one should then check whether such an inbound

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210 Internal Consistency Test, supra note 7, passim.

protection can be matched by an independently established outbound protection afforded by the country of origin by applying outbound comparables, which again have been established by the Court in various forms (comparables n. 2, 5, 7, 10, 14b, 14c, and 14d).

If at the end of this second step of the two-pronged test there is only inbound or outbound protection, then the gradualistic approach yields an *sub-optimal solution* based on comparability analysis. In this case the tax treatment in the country of destination and in the country of origin (for example the tax rates) cannot be simultaneously equalized and therefore the situation defined as “labyrinth of impossibility” does occur. I have demonstrated that in these cases there was no actual reason to create a reinforced or bilateral comparable, and therefore this kind of inbound protection is adequate even if it is not optimal and even if it does not eliminate the labyrinth of impossibility.

By contrast if at the end of this two-step process there is neither inbound nor outbound protection, then the gradualistic approach fails altogether. This has occurred for profit transfers (*Oy AA* and *SGI*, cases) and transfer of residence of companies (*Daily Mail, Cartesio* and *Indus Grid* cases), i.e. the cases in which the Court deliberately fell short of providing any kind of equal protection on policy grounds. The conclusion is that when the comparable approach failed, this was due to a deliberate decision taken by the Court to depart from that framework in a specific circumstance, but not to structural inconsistencies of the comparability approach as a whole.

In conclusion, given the strategic scenario in which double taxation is solved by exemption and credit systems, what is proposed here is that one could envisage a continued well-tempered application of the comparability approach already developed by the Court (the list of the eighteen comparables presented here could be a useful guide). Within this approach generally there would be inbound protection in the source countries, and in many cases it would also be possible to attain protection also in the residence country by relying on a dual (bilateral or reinforced) comparable. In the cases in which bilateral, reinforced, or unilateral protection are not attainable, ultimately the residence country provides some kind of outbound protection independently from Community law through an exemption or a tax credit based on domestic and double taxation treaties. Under this comprehensive solution countries maintain their tax sovereignty but in a wide range of situations are constrained by bilateral, reinforced or unilateral protection clauses dictated by the Treaty, a result that is far beyond those reached by the non-discrimination clause of the double taxation treaties.

To sum up the tests of the gradualistic approach in respect to each specific cross-border situation come in the following order: 1) search for a bilateral comparable; 2) search for a reinforced comparable; 3) search for an unilateral inbound or outbound comparable; 4) search for an unilateral outbound comparable that complements the inbound comparable (or the other way around); 5) relief by residence country (exemption or credit). Is this an acceptable outcome? To reply to such a question it is quite instructive to consider the U.S. experience as a benchmark. It has been recently acknowledged that, even in a federal system like the U.S., it is virtually impossible to reconcile the Supreme Court’s myriad of decisions delineating the scope of state tax power over interstate business. This is how Professor Hellerstein\(^{212}\) describes the incoherence the Supreme Court decisions on tax aspects of interstate business: “[1] Two taxes that have a substantially similar impact on interstate commerce are accorded different constitutional treatment. [2] The Court, conceding that the "line is sometimes difficult to define with distinctness," nevertheless draws one that is discernable, if at all, only to itself. [3] The line drawn is then explained in terms that effectively assure the Court ample discretion to draw lines in the future as it deems appropriate, without providing any clear guidance whether a particular levy will fall on one side or the others.”

\(^{212}\) Cited by Michael J. Graetz & Alvin C. Warren, Jr., Income Tax Discrimination and the Political and Economic Integration of Europe, 115 Yale L.J. 1186 at 1237 (2006).
In stark contrast with this U.S. situation, the reconstruction of the comparables developed by the ECJ shows that, starting from an initial position of full autonomy of the tax jurisdictions involved, it is possible, through the development of multiple context-oriented comparables, to develop a manageable, if not perfect, array of canons of comparability that afford bilateral, reinforced or unilateral (inbound or outbound) protection. This all-inclusive comparability standard has operated as the backdrop of the judicial reasoning of the Court, with the result that the instances where the comparables have been abandoned by deliberate choice of the Court have lead to an outright lack of protection. In conclusion the system of comparables developed by the ECJ appears to be a reasonably adequate, second-best remedial mechanism in a framework (the EU) where capital export and import neutrality cannot be obtained in their fullest extent because of the lack of an harmonized corporate tax, and migration of taxable bases needs to be addressed by coordinated solutions.

213 This departure from the comparables has occurred in the ECJ cases concerning the migration of profits/losses and of companies across jurisdictions, as these migrations has been notably restrained by the Court on the basis of justifications; see supra section 10.