

Legal Remedies in European Tax Law

Sample excerpt

2. Some Remarks on the Application of Community Law, Its Legal Effects and the Relationship Between These Concepts

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2.1 Introduction

In this paper I examine some of the aspects of the application and legal effects of Community law and the way in which these concepts relate to each other. With respect to the *application* of Community law, I look first at the direct applicability (section 2.2), primacy (section 2.3) and direct effect of Community law (section 2.4). In section 2.5 I look in detail at what is known as “legality review”, a concept that makes it possible to test the compatibility of national provisions with Community law even though the provision does not have direct effect.

In section 2.6 the legal effects of the application of Community law are highlighted. I discuss the exclusion effect and the substitution effect of Community law as well as the obligation of consistent interpretation. I then go on to deal with a number of specific areas in which the issues discussed previously (among other things, direct effect, substitution effect/legality review) are related.

2.2 Direct applicability of Community law

The central issue is the way in which Community law is applicable in the national legal order. In *Van Gend & Loos*¹, with a reference to the aim of Community law, the European Court of Justice (hereinafter: ECJ or the Court) ruled that Community law is directly applicable. In this decision, the ECJ held that: “the Community constitutes a new legal order of international law for the benefit of which the states have limited their sovereign rights, albeit within limited fields, and the subjects of which comprise not only Member States but also their nationals. Independently of the legislation of Member States, Community law therefore not only imposes obligations on individuals but is also intended to confer upon them rights which become part of their legal heritage”.

This well-known ruling gives expression to the autonomy of Community law, namely that Community law is applicable in the legal order of the Member States autonomously and completely independently of the legislation of the Member States. Its applicability is thus independent of whether a Member State takes as a monistic or dualistic approach to international law. In the Netherlands, for instance, Community law is applicable independently of Article 94 *Grondwet* (Constitution), in which it is provided that treaties take precedence over national laws, since Community law *itself* provides that it is applicable within the legal order of the Member States.

¹ ECJ, decision 5.2.1963, case 26/62, *Van Gend & Loos*, in ECR 1963, p. 1 (Opinion Roemer).

2.3 Primacy of Community law

In *Costa/ENEL*² the ECJ draws an important as well as a logical conclusion from the fact that there is a new legal order in the Community, a legal order that is autonomous in particular with regard to law-making and which, since it has primacy over national law, has hence limited the sovereignty of the Member States in certain areas. This primacy holds for both primary and secondary Community law. In addition, primacy holds for Community law provisions that do not have direct effect (see section 2.4 below for the concept of “direct effect”). Primacy can be seen, namely, with regard to the obligation to consistently apply national law, even with regard to provisions that are not directly applicable.

The primacy of Community law may on occasion mean that national law must be set aside (for more details, see section 2.6.1. below).

2.4 Direct effect of Community law

Direct effect means that individuals³ may directly invoke a subjective right under a Community law provision (for example, the freedom of movement or the right to a tax exemption). A Community law provision has direct effect if the provision is “unconditional” and “sufficiently precise”. If such a provision is “unconditional” and “sufficiently precise”, it grants “minimum rights” to individuals, according to *Denkavit-VITIC-Voormeer*⁴. The terms “unconditional” and “sufficiently precise” are discussed in more detail in the following sections.

2.4.1 Unconditional

“A Community provision is unconditional where it is not subject, in its implementation or effects, to the taking of any measure either by the institutions of the Community or by the Member States”, according to *Regione Lombardia*⁵, as well as other decisions.

In the well-known *Becker* decision⁶ on the Sixth Directive, the criteria for direct effect were clearly set out. The ECJ in this case considered in detail the arguments of the Member States against direct effect. At issue in the case was whether or not Article 13B, sub D-1 of the Sixth VAT Directive had direct effect. This provision reads: “Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of the exemptions and of preventing any possible evasion, avoidance or abuse : (. . .) (d) the following transactions : 1 . The granting and the negotiation of credit”.

First, the ECJ held that the provision is sufficiently precise to be relied on by an individual.

² ECJ, decision 3.6.1964, case 6/64, *Costa/ENEL*, in ECR 1964, p. 1203 (Opinion Lagrange).

³ “Individuals” means all subjects (in other words, both natural persons and legal persons and regardless whether these are entrepreneurs or not), but which cannot be characterized as public authorities. The ECJ’s case law defines “public authorities” as: “organizations or bodies which are subject to the authority or control of the State or have special powers beyond those which result from the normal rules applicable to relations between individuals, such as local or regional authorities or other bodies which, irrespective of their legal form, have been given responsibility, by the public authorities and under their supervision, for providing a public service” (see ECJ, decision 4.12.1997, joined cases C-253/96 - C-258/96, *Kampelmann*, in ECR I-6907, para. 46 (Opinion Tesaurro)).

⁴ ECJ, decision 17.10.1996, joined cases C-283/94, C-291/94, C-292/94, *Denkavit-VITIC-Voormeer*, (Opinion Jacobs).

⁵ ECJ, decision 23.2.1994, case C-236/92, *Regione Lombardia*, in ECR 1994, p. 483 (Opinion Darmon).

⁶ ECJ, decision 19.1.1982, case 8/81, *Becker*, in ECR 1982, p. 53 (Opinion Gordon Slynn).

Then, the ECJ considered the argument of certain Member States that the “exemption” was not “unconditional” because it was granted “under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of the exemptions and of preventing any possible evasion, avoidance or abuse”.

The ECJ held (paras. 32 - 35) with regard to this point:

“It should first be observed in that regard that the ‘conditions’ referred to do not in any way affect the definition of the subject-matter or the exemption conferred.

The ‘conditions’ referred to are intended to ensure the correct and straightforward application of the exemptions. A Member State may not rely, as against a taxpayer who is able to show that his tax position actually falls within one of the categories of exemption laid down in the directive, upon its failure to adopt the very provisions which are intended to facilitate the application of that exemption.

Moreover, the “conditions” refer to measures intended to prevent any possible evasion, avoidance or abuse. A Member State which has failed to take the precautions necessary for that purpose may not plead its own omission in order to refuse to grant to a taxpayer an exemption which he may legitimately claim under the directive, particularly since in the absence of specific provisions on the matter there is nothing to prevent the state from having recourse to any relevant provisions of its general tax legislation which are designed to combat evasion.

The argument based on the introductory sentence of Article 13 b must therefore be rejected.”

It can be seen from the *Becker* case that a mandatory exemption, which may be made subject to certain conditions (such as correct and straightforward application or the combating of abuse), must also be characterized as “unconditional” and that such an exemption has direct effect.

Minimum rights may still be granted in this kind of situation. A court is, in such a situation, still able to establish whether there can be said to be provisions aimed at a correct and straightforward application and which are appropriate and proportionate to this purpose.

Minimum rights are not granted only in situations where the legislator must make certain choices when setting conditions. If a court *were* to grant minimum rights in such a situation it would be overstepping its bounds and impinging on the legislator’s role.

As an example, one can think of a directive in which it is provided that a Member State has various ways to calculate a given tax. It is hence exclusively up to the Member States to choose among the various possibilities. This is also at stake in the *Brinkmann* case⁷, which will be discussed in more detail in 2.6.3.1.

Another issue in this respect is whether a deviation from the main rule in a directive may be such that it removes the direct effect of the main rule.

This was at stake in *Denkavit-VITIC-Voormeer*⁸ on whether Article 5 of the Parent-Subsidiary Directive (no withholding tax on dividends) has direct effect. Article 5 provides, among other things, that under certain conditions a Member State must grant an exemption from withholding tax when a subsidiary pays a dividend to a parent company that is established in another Member State. Article 3(2) of the Parent-Subsidiary Directive allows the Member States to deviate from this provision if the parent company does not maintain its holding in the subsidiary for a minimum

⁷ ECJ, decision 15.6.2000, case C-365/98, *Brinkmann*, in ECR 2000, p. 4619 (Opinion Mischo).

⁸ ECJ, decision 17.10.1996, joined cases C-283/94, C-291/94, C-292/94, *Denkavit-VITIC-Voormeer*, (Opinion Jacobs).

period; it leaves to the Member States a certain margin of discretion with respect to the length of this period (it may, however, never be longer than two years) and with respect to the applicable administrative procedures.

The ECJ held that this possibility of deviating (with a margin of discretion) does not preclude the fact that under the principles contained in Article 5 of the Parent-Subsidiary Directive minimum rights have been granted. In this case the possibility of deviating did not preclude the direct effect of the main rule.

Finally, whether a provision allowing a discretionary deviation from a main rule has direct effect *itself* is still an open question.

The same question arises with respect to EC provisions that contain a number of options by which to achieve the desired goal. In both cases the legislator still has to take a decision on the matter and thus it is uncertain whether in such circumstances there can be said to be an “unconditional” right with direct effect. Even if there is no direct effect, such provisions can nevertheless be tested for Community law compatibility on the basis of a “legality review”. For more details, see section 2.5 below.

2.4.2 *Sufficiently precise*

A “(...), ‘provision is sufficiently precise to be relied on by an individual and applied by the court where the obligation which it imposes is set out in unequivocal terms’, according to, among other decisions, *Regione Lombardia*⁹.

The point is that it has to be *possible* for a Community provision to be sufficiently clearly interpreted. That legal concepts can be interpreted in various ways is irrelevant. Moreover, discussion in the literature on how a provision should be interpreted does not preclude it from being “sufficiently precise” and having direct effect. Thus, a provision combating tax avoidance may in fact have direct effect, despite the lack of unanimity among legal scholars on the meaning and scope of the concept “tax avoidance” (see also the remarks on “legal review” in section 2.5).

Thus, Advocate General Jacobs observed in point 44 of his Opinion to the *Stockholm Lindöpark* case¹⁰ that “the requirement is not that the meaning of the provision must be beyond dispute. (...) What is meant is rather that the content of the provision must be capable of clear and precise interpretation and of direct application by the national courts”.

2.4.3 *Horizontal and vertical direct effect*

Persons may rely on provisions of Community law having direct effect. Generally persons invoke provisions with direct effect in their relations with the government. This is called the vertical direct effect of Community law. That vertical direct effect exists is undeniable.

However, there is no unanimity about whether Community law may be applied *between (or among)* persons. This is known as the horizontal application of Community law.

⁹ ECJ, decision 23.2.1994, case C-236/92, *Regione Lombardia*, in ECR 1994, p. 483 (Opinion Darmon).

¹⁰ ECJ, decision 18.1.2001, case C-150/99, *Stockholm Lindöpark*, in ECR 2001, p. I-493 (Opinion Jacobs).

One could think, for example, of an entrepreneur who invokes Community law because, in his view, it is being infringed by a fellow entrepreneur. In cases such as *Walrave & Koch*¹¹ and *Angonese*¹², horizontal effect has been permitted with respect to the free movement of persons and services. For example, in the *Walrave & Koch* decision *Walrave and Koch* (both sportsmen) claimed that a regulation of an international sport federation (an individual as well) was discriminatory on grounds of nationality. However, the ECJ has always rejected the horizontal effect of directives on the grounds that directives themselves cannot bind individuals because they have to be implemented first. See for example: *Faccini Dori*¹³.

Nevertheless, there are decisions in which the ECJ has implicitly applied a directive in a dispute between individuals. A well-known example is *CIA Security*¹⁴ (a non-tax case also known by the name *Securitel* decision)¹⁵, in which a number of security companies claimed that the others were engaged in unfair competition.

Legal scholars have been struggling with how to deal with this case law when the horizontal effect of directives is, on the one hand, disallowed but, on the other hand, it is occasionally applied to individuals by the ECJ¹⁶.

One could argue that it follows from the *CIA Security* case that horizontal effect may be invoked in a private-law situation when one of the individuals claims that the public law regulation is non-binding on grounds of its incompatibility with Community law¹⁷.

In the area of tax one could, for example, conceive of a situation in which a consumer who purchases a product in a supermarket considers that the VAT on the product is incompatible with Community law. The consumer is not allowed to file an objection to the levy of VAT (only an entrepreneur, the person charging the VAT, is entitled to make an objection). Hence, the consumer cannot claim that the national VAT legislation is non-binding on the supermarket on grounds of the legislation's incompatibility with Community law (and by doing so rely on the horizontal effect of Community law). However, if the consumer cannot rely on either vertical or horizontal effect, he may invoke the principle of state liability against the government.

On grounds of state liability, a consumer may claim damages (for the VAT that has been unduly paid) because of the incorrect implementation of the VAT Directive.

2.4.4 Inverse direct effect

¹¹ ECJ, decision 12.12.1974, case 36/74 *Walrave & Koch*, in ECR 1974, p. 1405 (Opinion Warner).

¹² ECJ, decision 6.6.2000, case C-281/98 *Angonese*, in ECR 2000, p. I-4139 (Opinion Fennelly).

¹³ ECJ, decision 14.7.1994, case C-91/92, *Faccini Dori*, in ECR 1994, p. I-3325 (Opinion Lenz).

¹⁴ ECJ, decision 30.4.1996, case C-194/94, *CIA Security*, in ECR 1996, p. I-2201 (Opinion Elmer).

¹⁵ See for more on these issues: Weber, D., "The notification obligation of Directive 83/189/EEC in the field of direct and indirect taxation", *EC Tax Review*, 1998, p. 276 et seq.

¹⁶ See, for example, Prinssen, J.M., *Doorwerking van Europees recht, de verhouding tussen directe werking, conforme interpretatie en overheidsaansprakelijkheid*, Europese Monografieën No. 73, Kluwer, Deventer, 2004, chapter 6 and see Tridimas, T., "Black, white and shades of grey: horizontality of directives revisited", *Yearbook of European law*, No. 21; 2001-2002.

¹⁷ See Jans, J.J., de Lange, R., Prechal S., Widdershoven, R.J.G.M., *Europeanisation of public law*, European Law Publishing, 2007, p. 79.

The idea that directives may be the source of obligations for individuals is at odds with the principle of legal certainty.

A directive has to first be implemented in national law. Consequently, a Member State may not invoke a directive that is disadvantageous to an individual if it has not (yet) been implemented or that has been incorrectly implemented. Inverse direct effect is hence impossible. The idea is that a government is not allowed to profit from its own negligence (also known as the estoppel principle).

The leading case disallowing inverse direct effect is *Kolpinghuis Nijmegen*¹⁸.

Since then, however, the Court has recalled the prohibition of inverse direct effect in tax law decisions such as *Kofoed*¹⁹ on the Merger Directive. At issue in this case was, among other things, whether or not Denmark had included an anti-avoidance provision in its legislation implementing the anti-avoidance provision of Article 11(1) (a) of the Merger Directive. If there was no national anti-avoidance provision in the Danish legislation, the Danish tax authorities could not rely directly on the anti-avoidance provision of the Merger Directive in order to combat abuse since this would amount to inverse direct effect, according to the ECJ. It was then up to the national court to determine whether Denmark had implemented such an anti-avoidance provision in its legislation.

In the area of VAT the prohibition of inverse direct effect means, for example, that if a Member State has neglected to lay down that a certain service is subject to VAT, the government of the Member State may not rely on the VAT Directive in which the levy of the tax is regulated and levy VAT on those grounds²⁰. An example from the Netherlands Supreme Court is a decision of 7 December 1994, No. 29.153, BNB 1995/87 where the Supreme Court ruled that “the government may not rely on a provision of the (VAT) Directive that is to the disadvantage of a taxpayer if the national law contains a provision for the former that is more advantageous”.

2.5 Legality review

2.5.1 Conditions

Some directives do not automatically grant a party minimum rights²¹. This is true of provisions whereby a Member State is allowed a certain amount of discretion and where consequently it is uncertain whether such provisions have direct effect or not. For example, directives come to mind in which the Member States are allowed to introduce a non-mandatory deviation from the main rule or where the Member States are allowed to choose from a number of options in order to achieve the goals set out by the Directive. Is this kind of provision “unconditional”?

¹⁸ ECJ, decision 8.10.1987, case 80/86, *Kolpinghuis Nijmegen*, in ECR 1987, p. 3969 (Opinion Mischo).

¹⁹ ECJ, decision 5.7.2007, case C-321/05, *Kofoed* (Opinion Kokott).

²⁰ In HR 5 January 2007 No. 37 689, BNB 2007/98, (Opinion De Wit, note B.G. Van Zadelhoff) (the final decision in the Charles en Charles-Tijmens case) the Netherlands State Secretary of Finance relied on Article 6(2) of the Sixth VAT Directive (taxation with regard to the private use of a bungalow intended for business purposes), although such a levy did not exist in the Netherlands legislation. Advocate General De Wit rejected the State Secretary's arguments, with, among other things, a reference to the prohibition of inverse direct effect. The Supreme Court also rejected the State Secretary's argument, but did not discuss the issue of inverse direct effect.

²¹ See also Jans, J.J., de Lange, R., Prechal S., Widdershoven, R.J.G.M., *Inleiding tot het Europees bestuursrecht*, Ars Aequi, Deventer, Second edition, 2002, m. no. 124.

The question whether such a provision is “sufficiently precise” to be able to have direct effect arises in these cases as well. In brief, the issue is whether the Community law provision contains a minimum right that is precise enough for it to be determined by the national court without impinging on the legislator’s authority.

A legal deficit would occur if courts were not allowed to examine provisions granting the Member States a certain amount of discretion. It would be impossible to determine whether a Member State has taken all the necessary measures to achieve the goals of the directive (such as the obligation laid down in Article 249 of the EC Treaty). To create a possibility of examining this category of provision, the ECJ has introduced what is known as legality review²². By means of legality review, the courts are able to examine Community provisions in which it is unclear whether there can be said to be direct effect or not²³. The ECJ has held the following in this regard:

“In particular, where the Community authorities have, by directive, imposed on Member States the obligation to pursue a particular course of conduct, the useful effect of such an act would be weakened if individuals were prevented from relying on it before their national courts, and if the latter were prevented from taking it into consideration as an element of Community law in order to rule whether the national legislature, in exercising the choice open to it as to the form and methods for implementation, has kept within the limits of its discretion set out in the directive”²⁴.

On the basis of this test the national court may thus examine whether a Member State has remained within the limits of its discretion. The national court cannot take the legislator’s place and decide for itself; this is exactly the margin of discretion permitted only to the legislator. But once the legislator has made a choice then the national court may, of course, examine whether the course of conduct prescribed by Community law has been sufficiently taken into account and that the limits to the margin of discretion have not been exceeded.

2.5.2 Case law with respect to legality review

Legality review first played a role in the *VNO* case²⁵. In this case the ECJ gave an interpretation of the Second VAT Directive.

This directive grants taxpayers the right to deduct VAT; however, the Member States have the authority to fully or partially exclude such a deduction with respect to capital goods.

The question put by the national court to the ECJ was whether the Netherlands had correctly interpreted the concept “capital goods”. Two problems arose with regard to direct effect: 1) the fact that there was a provision worded with the facultative “may” and 2) the fact that the vagueness of the wording of concept of capital goods gives the Member States a certain margin of discretion²⁶.

At issue was hence whether the VAT Directive was unconditional and sufficiently precise. The ECJ held that there was in fact a problem with direct effect, but it also held that the national court should be the one to decide whether the national measure has exceeded the Member State’s margin of discretion.

²² See for literature Prechal, S., *Directives in EC Law*, Oxford, 2005, p. 234.

²³ Note that there is a discussion in literature whether ‘legal review’ is distinct concept or more a form of direct effect. See Prechal, S., *Directives in EC Law*, Oxford, 2005, p. 235.

²⁴ See ECJ, decision 24.10.1996, case C-72/95, *Kraaijeveld*, in ECR 1996, p. 5403, para. 56 (Opinion Elmer).

²⁵ ECJ, decision 1.2.1977, case 51/76 *VNO*, in ECR 1977, p. 113 (Opinion Mayras).

²⁶ Namely with respect to how the requirements of durability, value and depreciation of the goods are defined.

Another example is found in the *Brinkmann* case²⁷, which revolved around the issue of whether Germany had correctly implemented the Tobacco Excise Directive, which sets minimum excise duties for tobacco.

According to the directive, a Member State has three different possibilities to calculate the excise duty on tobacco. The direct effect of the directive was at issue, since the directive imposes a minimum tax (this is not an entitlement for the taxpayer, but a burden) and the Member State was allowed to choose three different formulas for the calculation of tobacco excises.

Advocate General Mischo rejected direct effect, but the ECJ applied a legality review so that the national court had to investigate the extent to which Germany “had kept within the limits of its discretion as defined by the directive”²⁸.

The legality review thus provides an additional possibility of a judicial examination of Community law compatibility. It is very relevant to tax law, since Community tax law is full of “may” provisions. It should be noted, however, that the ECJ does not even consider this test unless it is explicitly put forward.

In such a case the ECJ does not make an ex officio examination and will examine the compatibility with Community law directly. See, for example *Denkavit-VITIC-Voormeer*²⁹, in which the “may” provision of Article 3(2) of the Parent-Subsidiary Directive was at stake, and the *VOK* case³⁰ in which the “may” provision of Article 13C of the Sixth VAT Directive was examined.

The legal consequence of the legality review is, however, that a national court may not grant EC rights to a party (this is known as the “substitution effect” of Community law), but that it may only disapply a provision or may only interpret national law in a way that does remain within the Member State’s margin of discretion (this is known as the obligation of consistent interpretation; hereinafter: consistent interpretation). For more details, see 2.6.2. below.

2.6 Legal consequences of the applicability of Community law

2.6.1 “Exclusion” effect and “substitution” effect

The fact that EC law is directly applicable and has primacy and direct effect has been discussed in sections 2.2 – 2.4.

However, what does the concrete application of Community law in national law entail and in particular, if a national provision infringes Community law, what are the consequences for the application of Community law?

²⁷ ECJ, decision 15.6.2000, case C-365/98, *Brinkmann*, in ECR 2000, p. 4619 (Opinion Mischo).

²⁸ **Other (non-tax) decisions in which the ECJ applied a legality review are, for example: ECJ, decision 24.10. 1996, case C-72/95, Kraaijeveld, in ECR 1996, p. 5403 (Opinion Elmer) and ECJ, decision 7.9.2004, case C-127/02, LVBH, in ECR 2004, I-7405 (Opinion Kokott).**

²⁹ ECJ, decision 17.10.1996, joined cases C-283/94, C-291/94, C-292/94, *Denkavit-VITIC-Voormeer*, in FED 1996/995 (Opinion Jacobs).

³⁰ ECJ, decision 9.9.2004, case C-269/03, *VOK*, in ECR 2004, p. I-8067 (Opinion Geelhoed).

First, we observe that although the ECJ interprets and applies EC law, it is up to the national court to decide how Community law is concretely applicable to the national legislation. To be more specific: after the ECJ has interpreted Community law, the national court uses this interpretation to decide the dispute before it and to decide whether and, if so to what extent, the national measure is compatible or incompatible with Community law.

The application of Community law is thus not merely a matter of Community law, but also of national law.