THE MEANING AND SCOPE OF THE *ACTE CLAIR* DOCTRINE CONCERNING DIRECT TAXATION: THE PORTUGUESE EXPERIENCE AND THE ESTABLISHMENT OF BOUNDARIES

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1. Introduction

The conference organized in June 2006 by Professor Cécile Brokelind, of Lund University, showed that "there is no homogeneity of Community law in direct taxation, as the ECJ rulings are applied quite differently from Member State to Member State"[1]. A new challenge was thereby posed: to foster analysis of the applicability of the *acte clair* doctrine in the area of income tax case law.

This report provides a general overview of the subject matter, although special and particular attention is given to the Portuguese situation, which is – by far – the one with which the author is most familiar. In any case, it should be stressed that up till 2007 very few papers or statistics have been published addressing the question of how EC law has been applied since the accession of Portugal in 1986[2].

2. Sources and standards of the *acte clair* doctrine in direct tax law

2.1. Cooperation and division of powers between courts and the *acte clair* doctrine

The cooperation between the European Court of Justice (ECJ) and national courts and, in particular, the special relationship established with the courts

1. *Towards a Homogeneous EC Direct Tax Law*, ed. by Cécile Brokelind, IBFD, 2007, p. 403.
2. The paper "EU Law and Portuguese Law", of Miguel Poiares Maduro and Francisco Pereira Coutinho, which deals with the incorporation and application of EU law in Portugal in the last twenty years, and the Portuguese report presented by Ana Paula Dourado during the conference at Lund University, included in the book quoted in footnote 1, pp. 341-356, have played a substantial role in filling this lacuna. "EU Law and Portuguese Law", in *Portuguese Law: an overview*, pp. 51 – 71, Almedina, 2007.

of last instance, which have to refer questions to the ECJ concerning the interpretation of a Community rule or the validity and interpretation of Community acts, dates from the beginning of the EEC. In fact, "...where such question is raised in a case pending before a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law, that court or tribunal shall bring the matter before the Court of Justice"[3].

This means that the ECJ should ensure a uniform interpretation and application of Community law, dealing with cross-border situations and not with specific domestic law or administrative acts of a Member State, namely to determine whether they are compatible with EC law[4].

The obligation that falls upon the courts of last instance has been challenged by several courts, including the Conseil d'Etat and the Bundesfinanzhof, under the *acte clair* doctrine and before the ECJ had opportunity to interpret the scope of that obligation[5]. In the early 1980s, however, the ECJ addressed the *acte clair* doctrine in *CILFIT*, establishing the conditions under which the above-mentioned obligation – i.e. the mandatory obligation to refer the questions to the ECJ – may be avoided. In fact, following the *Da Costa* case, and pointing out the *acte éclairé* doctrine, the ECJ clarified that a court of last instance has the discretion to ascertain whether a decision or a question of Community law is necessary to enable it to give its judgment and is not obliged to refer to the court:

> (...) if considers that operation is not relevant, i.e., cannot affect the outcome of the case[6];
> ...when the question raised is materially identical with a question which has already been the subject of a preliminary ruling in a similar case[7];
> the same effect may be produced where previous decisions of the court have already dealt with the point of law in question (...) even though the questions at issue are not strictly identical"[8].

3. Art. 177 c of the Treaty of Rome, currently Art. 234° of the EC Treaty.
4. See Case 227/82 *Van Bennekom* [1983] ECR 3883 at 3899.
5. See Gerhard Bebr, "The rambling ghost of 'Cohn – Bendit': Acte clair and the Court of Justice", *CMLR* 20: 439-472. In any case, the doctrine of acte clair was invoked for the first time before the ECJ by *Advocate General Lagrange in Da Costa en Schaake N.V. v. Nederlandse Belastingadministratie*, Joined cases 28-30/62, [1963] ECR 31, p. 45 (1963). Although this doctrine is derived from French law it cannot be interpreted as a mere transposition or importation. See Bebr, p. 455.
6. Case 283/81, *Srl CILFIT and Lanifício di Gavardo SpA v. Ministry of Health*, ECR 3415, p. 3429, para. 10.
7. Supra, para. 13.
8. Supra, para. 14.

The doctrine of *acte clair* culminates, under *CILFIT*, with an express exemption from referral whenever the answer to the question is "...so obvious as to leave no scope for any reasonable doubt as to the manner in which the question raised is to be resolved"[9]

However, considering the risk of a misuse of this doctrine, the ECJ held that, bearing in mind the risks of divergence, the national courts should be convinced that the matter is equally obvious to the courts of the other Member States and the ECJ. The Court concluded, thereafter, "only if those conditions are satisfied, may the national court or tribunal refrain from submitting the question to the Court of Justice and take upon itself the responsibility for resolving it"[10]. In addition, the ECJ stressed that "such possibility must be assessed on the basis of the characteristic features of community law and the particular difficulties to which its interpretation gives rise", including: (i) the need to compare the different language versions of Community legislation; (ii) the use of terminology which is peculiar to Community law and does not necessarily have the same meaning in the Member States' domestic law; and (iii) the need to place each provision of Community law in its context and to interpret it in the light of its objective and the actual state of evolution of the Community law.

In taking such an approach, the ECJ refused to follow the Italian Government, which considered that the preliminary references required an "effective filter" of the discretion to be granted to the national courts and also rejected the strict views of the Advocate General Capotorti, albeit evidencing the route the courts of last instance should follow to ensure a uniform interpretation and application of Community law.

2.2. Preliminary overview on the application of the *acte clair* doctrine in direct tax law

As we all know, the initial intervention of the ECJ in direct tax law dates from 1986, and the *avoir fiscal* case, which means that its role in this field emerged at approximately the time that the *CILFIT* decision was handed down.

9. Supra, para. 16. See also case C – 337/95, *Parfums Christian Dior SA* [1997], ECR I-6013.
10. See paras. 17-20

Over the last twenty years the courts of last instance have made several referrals to the ECJ, but have also used their prerogatives to invoke the *acte clair* doctrine, in spite of the fact that *CILFIT* exceptions might have been seen as deterring national courts from making use of such doctrine.

The absence of direct tax measures in the EC Treaty is a clear indication that Member States intended to maintain their sovereignty in this specific area. In this context Member States retained the power to define, unilaterally or by treaty, the criteria for allocating their powers of taxation. This fact justifies the co-existence of several systems that certainly have many similarities, but are totally different as a whole and, of course, in detail.

In my view, this situation, paradoxically, explains a low level of referrals in direct tax matters (some Member States have never referred a single case to the ECJ and Portugal itself has referred just two cases)[11] as well as an incorrect interpretation or/and non-application of EC jurisprudence either by the courts or the tax authorities. In addition, it represents a justification for parliaments and governments to avoid changing their legislation.

In spite of such a lack of direct tax provisions, Art. 220 (currently 293) of the EC Treaty evidenced an immediate interest in abolishing double taxation within the EU. The evolution of the EEC towards an Internal Market, characterized by the abolition of obstacles to the free movements of goods, persons, services and capital including those created by direct tax measures, led the ECJ to call several times for Member States to exercise their tax powers while respecting EC law.

Nevertheless, considering the maintenance of the tax jurisdiction, the absence of EU direct tax provisions (apart from the ones existing in limited areas), the Member States' lack of unanimity in almost all direct tax issues and the way integration has been implemented in this field (with the ECJ deciding cases that relate to different matters, which are not dealt with in the same manner among Member States), the differences of opinion on how tax jurisdiction is limited are not surprising. In my opinion, this also explains why few courts refer cases to the ECJ in the field of direct taxes and why they do apply the ECJ rulings, seldom making use of the *acte clair* doctrine.

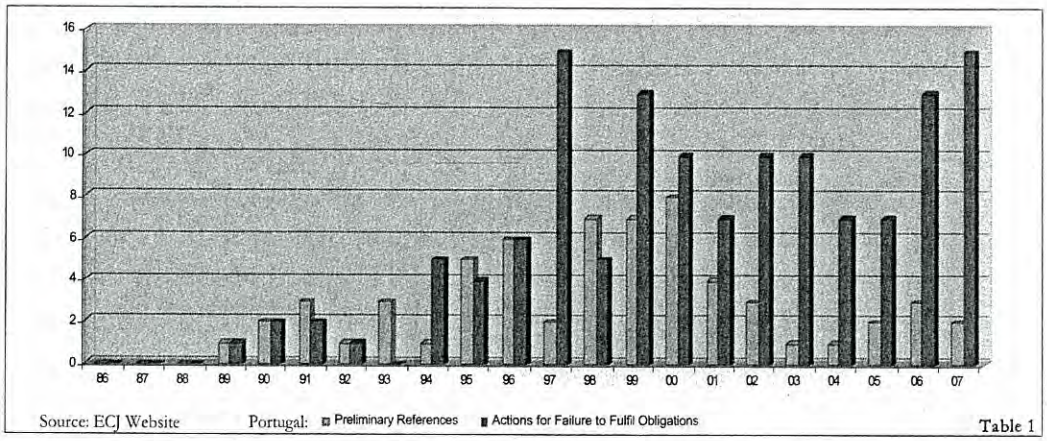
11. Case C-375/98, *Ministério Público, Fazenda Pública v. Epson Europa BV*, 8 June 2000, and Case C-443/06, *Erika Hollmam v. Fazenda Pública*, 11 October 2007.

2.3. Portuguese approach

As Poiares Maduro and Pereira Coutinho recently pointed out:

> "...in terms of written law Portugal can almost be described as a paragon of virtue, symbolized in the recent constitutional revision (2004), which recognizes in broad terms the principle of supremacy of EU law [...]. On the other hand, regarding law in action, however, the reality is quite different. The Portuguese courts [...] represent one of the least EU-enthusiastic judicial systems"[12].

In fact, from 1986 to July 2007, only 35 preliminary referrals were made to the ECJ by the Administrative Supreme Court (the last instance for administrative and tax matters). Of these, only two concerned direct taxes, in spite of the existence of at least 238 claims[13]. See Table 1 below.



The vast majority of preliminary references concerned matters such as customs duties, stamp duties and notarial and registration fees and their com-

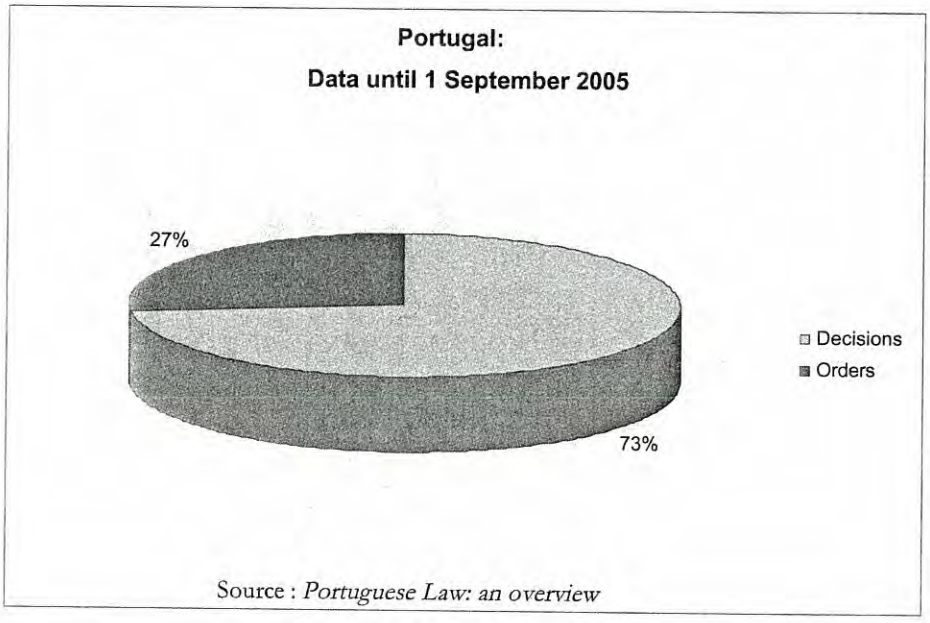
12. Miguel Poiares Maduro and Francisco Pereira Coutinho, *Portuguese Law: an overview*, pp. 51-52.

13. The 35 preliminary referrals made by the ASC represented more than half of all the referrals made by Portuguese courts (62 in total, during the first twenty-one years). The number and identification of such claims to the Administrative Supreme Court may be directly found on the web (www.dgsi.pt). The vital importance of ECJ jurisprudence in tax matters has been stressed and emphasised by several authors, namely Patricia Noiret Cunha, *A tributação directa na jurisprudência do Tribunal de Justiça das Comunidades Europeias*, ed. Coimbra Editora, 2006, Patrícia Noiret Cunha and Sérgio Vasques, *Jurisprudência Fiscal Comunitária Anotada*, vol. I, Almedina, Coimbra 2002, Bruno Vinga Santiago, *O princípio da não discriminação no cruzamento do direito fiscal internacional com o direito comunitário* (this book is being printed) and in particular, by J.L. Saldanha Sanches, *Os limites do Planeamento Fiscal*, ed. Coimbra Ed., 2006.

patibility with EC secondary law (e.g. Directive on the Concentration of Capital), motor-vehicle tax, VAT and other general issues.

An analysis of the available data shows that: i) it took no long time for the tax courts (in this case the Oporto Tax Court) to start submitting questions to the ECJ; ii) Portuguese violations of primary EC provisions are scarce in comparison with secondary EC law; iii) the ASC referred only one case to the ECJ concerning direct tax matters related to the interpretation of the fundamental freedoms in the EC Treaty and their meaning and scope regarding those issues and tax treaties; iv) the vast majority of referrals were made by the ASC, with very few referrals by the lower courts (e.g. courts of first instance); v) several referrals relate to very similar cases (e.g. motor-vehicle tax, stamp duties, notarial and registration fees).

CHART 1



In addition, statistics also show a high level of orders (27%) resulting from Portuguese preliminary references, i.e. a high level of references made by Portuguese courts that were summarily dismissed by the ECJ. See Chart 1 above.

Despite this scenario, which could convey the impression of great respect for Community law, the statistics concerning actions for failure to fulfil obligations by the Portuguese Republic evidence the opposite[14].

14. Supra, pp. 66-69.

Notwithstanding this, one should grant credit to several judges and courts for their personal involvement in the fruitful cooperation between their courts and the ECJ as well as for the diffusion of the preliminary reference mechanism within the legal world. Three years after the accession of Portugal to the EEC, a judge of the Oporto Tax Court, Almeida Lopes, requested the first preliminary ruling and shortly after the closing of the case published a book containing all the documents related to the case for the analysis of all legal community[15].

Table 2

Portugal	Supremo Tribunal de Justiça	1	
	Supremo Tribunal Administrativo	35	
	Other courts or tribunals	26	62

The following years would see the tax courts (the first instance and the second chamber of the Administrative Supreme Court) taking the lead, with many more requests than all the other Portuguese courts, as shown in Table 2 above. The diffusion of the first cases (concerning customs duties and the motor-vehicle tax), as well as the attention given to a notarial and registration fees case, by the mass-media and the public in general (the case gave rise to several domestic cases where those fees were considered incompatible with the Directive of 17 July 1969 concerning indirect taxes on the raising of capital (69/335/EEC) and led to substantial refunds of fees unduly paid plus the payment of interest), awakened taxpayers, lawyers, companies and authorities to the utmost importance of EC law, although, in practice, the numbers of preliminary references are still quite moderate.

Currently, we may find approximately three approaches followed by the ASC to invoke the *acte clair* doctrine or to reject summarily the request made by taxpayers: the first approach consists in ascertaining whether the question is or is not relevant to decide the case; if irrelevant, the court refuses the request; the second, consists in determining whether there is already any decision concerning the same question handed down by the ECJ; sometimes the court adopts the same approach but uses a different *formula* that may be better accommodated to *CILFIT*; and the final approach may be observed when the court considers that the solution to the question is obvious either for the other courts or the proper ECJ. See Table 3 below.

15. Case - C- 248/89. Almeida Lopes, *O primeiro reenvio prejudicial de um Tribunal Português ao Tribunal de Justiça das Comunidades Europeias,* ed. Almedina, Coimbra 1992. Currently, Almeida Lopes is seated at the ASC (*Juíz-Conselheiro*) and is one of the judges that has sent more preliminary references to the ECJ.

Table 3

	Relevance of the question to solve the case	ECJ precedent doctrine	*Acte clair* doctrine
Expression used by Portuguese Administrative Supreme Court (ASC)	"The question raised is not relevant and it does not have any influence on the decision of the case". Or (positive formulation) "Being a relevant question and necessary to enable this Court to give judgment, one should request the Court of Justice to give a ruling thereon by means of Art. 177 of the Treaty (currently Art. 234)"	"The ASC should not request the Court of Justice to give a ruling because there is already jurisprudence (case law) on the matter" Or "Art. 177 EC Treaty (currently Art. 234) waives national courts to bring matters before the Court of Justice when and if the solution to the case is obvious (there is no reasonable doubt) for all jurisdictions and for the Court of Justice"	"The ASC should not request the Court of Justice to give a ruling if it is already known a stable and uniform jurisprudence (case law) regarding an issue of European law – acte clair theory"
ASC cases Examples	Case 021012 Re: Import Goods Case 07/07 Re: VAT – Offers to Clients[1]	Case 01871/03 Re: Period to tax reimbursement[2] Case 026231 Re: Commercial Registry charges Case 020858 Re: Pharmaceutical charges Case 02277 Re: Vehicle taxation Case 01261 Re: Commercial Registry charges	Case 022401 Re: customs and Community Customs Code Case 022429 Re: Community Customs Code over Portuguese procedural law Case 01909/02 Re: Commercial Registry charges[3] Case 0511/06 Re: VAT deduction/ assignment

1. The Portuguese ASC expressly recognizes the relevance of the case in both national and European terms.

2. The Portuguese ASC makes a precise reference to EJC case law.
3. The Portuguese ASC makes a precise reference to EJC case law.

The main problem arises with regard to the justification made by the ASC; frequently, the Court states that the situation is clear and obvious from an EC perspective but it does not reveal the reasons and grounds why the solution is obvious, at least not in a convincing way referring to Community law or court decisions. In fact, it is common to see this justification invoked without reference to ECJ jurisprudence, to domestic rulings or even to any other elements that could explain why the respective situation should be considered clear and the resolution obvious.

A very recent VAT case, where the right to a VAT deduction was partially denied to the taxpayer, is paradigmatic, given the complexity of the facts, for the way in which the problem is presented and the solution proposed that denied the right of deduction[16]. Notwithstanding the general right to a VAT deduction, the court denied the right of a deduction and rejected the claim to request a preliminary ruling to the ECJ with a simple statement that the solution was clear and obvious. The court ruled that an assignment of a promissory agreement of property purchase would prevent the assignee from deducting the VAT that the assignor had already paid to the seller on the first instalments of the property's price. The VAT relating to the remaining part of the price was paid at a later stage to the vendor by the assignee and its deductibility was accepted by the court. Although this was considered an obvious solution, no legal basis or jurisprudence was invoked.

More recently, the same ASC decided that a Portuguese branch of a Spanish insurance company should be considered a taxable person for VAT purposes in relation to the cost imputed to it in respect of supplies rendered by the head-office, completely ignoring the ECJ ruling on FCE Bank plc of 23 March 2006 that decided precisely the opposite[17].

16. Rec. No. 511/06, Decision handed down by the ASC on 12 July 2007.
17. See the ASC decision of 25 September 2007, Rec. 580/05. On C-210/04, 23 March 2006, Ministero delle'Economia e delle Finanze, Agenzia delle Entrate v. FCE Bank plc, the ECJ ruled that Arts. 2(1) and 9(1) of the Sixth Directive must be interpreted as meaning that a fixed establishment, which is not a legal entity distinct from the company of which it forms a part, established in another Member State and to which the company supplies services, should not be treated as a taxable person by reason of the costs imputed to it in respect of those supplies.

2.4. Absence of referrals where previous decisions have already dealt with the point of law in question

It is absolutely reasonable to alleviate the ECJ's burden and to exempt the national courts from referring cases when the question is materially identical to a question that has already been clarified in a similar case, as the ECJ put it in *Da Costa*[18]. The precedent principle is very important to ensure those results as well as uniformity, certainty and consistency. Under a solomonesque ruling, the formulas adopted by *CILFIT* extended the scope of this exemption, "...irrespective of the nature of the proceedings which led to those decisions" (opening the possibility to consider decisions handed down in proceedings such as actions against Member States), "...even though the questions at issue are not strictly identical"[19]. Although the ECJ's real intention with the *CILFIT* ruling is debatable (i.e. whether it intended to exclude implicitly the application of the *acte clair* doctrine or not) this part of the decision – still in the context of the *acte éclairé* doctrine – seems acceptable provided that one is considering uniform EC case law and that this exception is not used as a pretext to avoid submitting the case to the ECJ.

During the last twenty years the ECJ has interpreted the fundamental freedoms provisions; on several occasions it evidenced the limits the Member Sates should respect in order to avoid discrimination and restrictions. However, while some principles can be observed and the appraisal of certain regimes took place, some others give rise to more difficulties in terms of their acceptability, not only in their perception and accommodation with national sovereignty, but, moreover, with regard to their practical applications in other Member Sates by their own domestic courts.

Under EC jurisprudence it is clear that Member States should respect Community law, both when creating domestic law as well as when signing tax treaties. In this context it is also clear that Member States may not discriminate on the basis of residence, provided the situation of a resident and a non-resident taxpayer is comparable; and, in several cases, unless the discrimination or restriction was justified, the ECJ ruled expressly that non-residents deserve national treatment (outbound income should not be subject to a less favourable regime than the same income received by residents) and foreign-source income should also receive national treatment (inbound income should not be subject to a less favourable regime than the equivalent

18. [1963] ECR 31.
19. Case 283/81, *Cilfit and Others* [1982] ECR 3415.

domestic-source income). Nevertheless, discussions arise, from time to time, as to whether specific ECJ cases do or do not respect those rulings and in which way. Below we will focus on some of these issues.

The analysis of particular cases (e.g. *Marks & Spencer* or *Lasteyrie du Saillant*, just to mention two) also shows the immense difficulties involved in implementing the ECJ's rulings, not to mention implementing them consistently within the 27 Member States.

In Portugal, the ASC has also applied the *acte éclairé* doctrine; in fact, on different occasions the ASC has considered the ECJ case law as stable and uniform regarding a certain aspect of EC law or has indicated that the same question had been submitted to the ECJ[20]. Concerning direct taxes, the database of ASC case law shows two references to the *EPSON* case, which led the court to apply its decision and to avoid a new referral. Moreover, in connection with some other issues, the ASC has referred to other case law from the ECJ, although such cases are not abundant. Moreover, courts of lower instance occasionally also make reference to ECJ decisions and decide their cases accordingly. For instance, the Administrative and Tax Court of Lisbon on July 2006 declared void and null an additional assessment of corporate income tax, considering the Portuguese thin capitalization rules, on which such assessment was based, void and null as a consequence of the *Lankhorst – Hohorst* case[21]. Later on, during 2007, the Administrative Central Court (south) decided two cases referring to the same *Lankhorst – Hohorst* ruling and the *acte éclairé* doctrine (i.e. quoting and explaining *Da Costa* case)[22].

CILFIT still requires that the national courts should be convinced that the matter is equally obvious to the courts of the other Member States and to the ECJ in order a court to be granted dispensation from referring the case to the ECJ. This statement introduces an additional obstacle for the national court when it intends not to refer the case to the ECJ.

20. See Ana Paula Dourado, supra, p. 345, footnote 11 (including several cases related to specific provisions of the EC Directive on concentration of capital and the way as how the notarial and registration fees are being levied in Portugal; others relate to Arts. 9, 12, 90 and 95 of the EC Treaty).
21. See the decision taken by the Administrative and Tax Court of Lisbon July 26, 2006 in the *Huber* case. See Francisco de Sousa da Câmara, "Thin capitalisation rules violated EC Treaty, Lisbon Court says", *Tax Notes International*, 23 Oct. 2006, pp. 272 – 273, and Francisco de Sousa da Câmara and José Almeida Fernandes, "Portugal: Thin Capitalisation Rules", *International Transfer Pricing Journal*, March / April, 2007.
22. Decision concerning BNP Paribas, SA, handed down on 12 April 2007, Rec. 1740/07 and on 17 April 2007, Rec. 1633/07.

Moreover, if the domestic court refers the case it seems that it was itself not convinced that the exception to refer applied, and the ECJ can only dismiss the case where a question referred to the Court for a preliminary ruling is identical to a question on which the Court has already ruled, or where the answer to such a question may be clearly deduced from existing case law[23]. In the latter case it should give its decision by reasoned order in which reference is made to its previous judgment or to the relevant case law[24].

Therefore, if the ECJ decides not to follow this route, in spite of judging a situation very similar to others previously decided (e.g. deciding against discrimination when a non-resident treatment is less favourable than the treatment of a resident in an identical situation), it seems that the *CILFIT* doctrine could not have been applied because the situation was not obvious, even for the ECJ itself.

2.5. The role played by national courts in the interpretation of the *CILFIT* doctrine: are the CILFIT guidelines alive?

For more than ten years now several criticisms have been made of the *CILFIT* guidelines, ranging from the more pragmatic and prosaic approach of Advocate General Jacobs that the *CILFIT* should apply "where a reference is truly appropriate", to the more blunt approach of Advocate General Colomer, who characterized the *CILFIT* test methodology as impractical at the time the decision was made and as unreasonable (translated into Portuguese and Spanish as *disparatada* and in French as *surréaliste*)[25]. Along these lines, it was recommended that the ECJ should relax its guidelines to allow national courts to decide whether or not to refer cases using their own discretion.

It seems that up till now the ECJ has refused – at least explicitly – to dispense with the obligation for national courts of last instance to observe the *CILFIT* guidelines. In other words, they should make a reference unless the question (i) is irrelevant, (ii) was already interpreted by the ECJ (whether the position is strictly identical or not); or (iii) the correct application of the EC law is so obvious as to leave no scope for any reasonable doubt. In the latter case such a possibility must be assessed in light of the specific charac-

23. Rules of procedure of the Court of Justice – Art. 104(3), first part.
24. Supra, final part.
25. Advocate General Jacobs, C – 338/95, paras. 64 and 65 and Advocate General Colomer, C – 461/03 paras. 44 – 59.

teristics of Community law, the particular difficulties to which its interpretation gives rise and the risk of divergence in juridical decisions within the Community. Moreover, a comparison of different language versions should be made, considering that terminology and legal concepts may have different meanings, which requires that every EC provision should be placed in its context and be interpreted in the light of the EC as a whole, considering its objectives and the state of evolution at the date on which it is applied[26].

As David Anderson and Marie Demetriou put it, "examples abound of cases in which supreme courts of the Member States have declined to make preliminary references on grounds which do not appear to meet the strict requirements of the European Court", although they conclude that "...a high degree of respect among national supreme courts for the obligation to refer" exists[27]. Moreover, considering these hindrances "...there are signs that in some jurisdictions at least, supreme courts which are conscious of their obligations under Article 234 (3) may have deliberately chosen to decide cases on domestic law grounds so as to avoid their obligation to refer and its attendant delays"[28].

In this context, it seems the ECJ is reluctant to relax the current guidelines that ensure uniformity of interpretation and application of Community law, preferring to adopt a more cautious and prudent approach that consists in accepting nuances of interpretations regarding each of the *CILFIT* exceptions, namely in the appreciation of the last requirement and the comparison of several languages[29]. On the other hand, pressure continues to be exerted in favour of easing the *CILFIT* requirements, or at least following the lines of the requirements mentioned in Art. 104 (3) of the Court's Rules of Procedure, which are the sole ones referred to in the Information note or reference from national courts for a preliminary ruling[30]. Considering all the arguments and, in particular, the cases on direct income tax (see below), I believe that the Court should continue to be conservative and prudent in relation with the flexibility of these requirements.

26. See the ECJ 15 September 2005, case C-495/03, *Intermodel Transports BV* para. 33 and the opinion of the Advocate General Stix – Hackl delivered on 12 April 2005, paras. 76 – 128. See also Gaston Schul case C – 461/03, 6 December 2005.
27. David W.K. Anderson Q.C. and Marie Demetriu, *Reference to the European Court*, London, Sweet & Maxwell, 2002, p. 177 and 182.
28. Supra, pp. 179 – 180.
29. See the Advocate General Opinion on Case C – 289/05 and the decision of the ECJ on C – 466/03 (para. 62).
30. See para. 12, 2005/C 143/01, JOCE C 11.6.2005.

3. What is the object of the *acte clair* doctrine in direct tax issues?

3.1. Portuguese experience: the status quo

Although Portuguese courts, and in particular the tax chambers of the Central Tax Court and the Administrative Supreme Court, recognize and apply Art. 234 of the EC Treaty and the *acte clair* doctrine from time to time, on several occasions making express references to the *CILFIT* guidelines, they have been reluctant to use it in direct tax matters or, perhaps, they were not expressly asked to apply Community law. As we have observed, statistics show that the mechanism for presenting preliminary references to the ECJ is acknowledged but used with extreme moderation, especially in direct tax matters.

The ECJ does not refrain from reminding everyone that "it must be borne in mind that, according to settled case-law, although direct taxation falls within their competence, Member States must none the less exercise that competence consistently with Community law"[31]. In this context, the general perception is that Member States are still sovereign in their own countries, namely with regard to the right to levy direct taxes. The almost complete lack of reference to any direct tax provision within the EC Treaty, the reduced level of positive harmonization, the creation of taxes and their amendment by the state every year, as well as the signing of tax treaties by the state, together with an almost total absence of Portuguese direct tax cases ruled upon by the ECJ, all contribute towards the appearance of the absolute legitimacy of Portuguese direct tax law and of compliance with Community law.

Of course, lawmakers (parliaments or governments), as well as the tax authorities and lawyers that deal with cross-border issues, are quite familiar with EC law and jurisprudence, but they do not share a common opinion as to the precise limits imposed upon the Portuguese State. Lawmakers have been trying to avoid introducing blunt discrimination or restrictions, either on the inbound or outbound movements of goods, persons, services or capital, but they have been much more reluctant in eliminating provisions and dismantling tax regimes that prove to be contrary to EC law. It seems that they just eliminate provisions or dismantle regimes, provided the ECJ decides the measure is contrary to EC law, an infringement process is initiated

31. For example ECJ, 13 December 2005, Case C-446/03, Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes, ECR 22005 p. I – 10837, 10866 (para. 29).

by the EC Commission and it seems well grounded, or a great number of domestic reactions are observed either administratively or judicially. Later some examples will be given[32]. On the other hand, taxpayers, confronted with so many obstacles, seem to be inhibited in trying their chance based on EC law: (i) tax courts do not seem to be aware of the ECJ rulings in direct tax matters or at least they do not refer to them[33]; (ii) in judicial dossiers the tax authorities very rarely, not to say never, recognize the prevalence of an ECJ ruling over a tax assessment based on the law; (iii) in other tax matters, unless the same precise case has already been decided by the ECJ (as statistics show, based on a Portuguese preliminary reference), the courts seem to be very reluctant to decide cases by making references to other ECJ rulings that interpreted Community law at the request of other Member States' courts; (iv) in spite of ECJ rulings only deciding on the interpretation and application of EC law, they consider facts and laws of other Member States, often leading the domestic court, the tax authorities or the Portuguese State to consider that the situation is not the same and preventing the ruling's application or, otherwise, leading the last entities to justify their reasons for sustaining the validity of such a rule.

Two other relevant factors may contribute towards the current status quo: firstly, because taxpayers fear that a preliminary ruling may lead to an additional delay in the decision being taken (this fear may be unfounded in the majority of cases if the preliminary reference is made by courts of first

32. A substantial list of situations that seem incompatible with Community law or/and ECJ decisions were pointed out by Ana Paula Dourado. See, "Portugal", *Towards a Homogeneous EC Direct Tax Law*, pp 346-356. See also Ricardo Borges and Pedro Sousa, "Portugal, Legislation", *EC Tax Review* 2 (2006) p. 125 et seq.

33. In this particular case, the ASC dismissed an appeal considering compatible with EC Law a 90 – day period to challenge a fiscal or para-fiscal assessment (in this case, notary fees). The reasoning of the ASC was that taxpayers may challenge those assessments via a judicial route (*impugnação judicial*) during the period of 90 days following such assessment, or request a refund of notarial fees unduly paid by lodging an administrative claim during a period of four years counted from that assessment. If the authorities deny the latter request, taxpayers could then present a judicial request. What they could not do, according to the ASC, was to attack the assessment after the period of 90 days using a judicial route directly. If they did so, they would lose the possibility of getting a refund due to their own mistake (*sibi imputat*). In a very controversial manner, accepting absolutely different terms to follow an administrative (four years) or a judicial (90 days) path to attack an assessment and request a refund of unduly paid notarial fees (considered contrary to Directive on the raising of capital), the ASC held that Portuguese law respected both the principles of equivalence and efectiveness – See proc. 1871, 16 March 2005, Rapporteur Almeida Lopes. See a specific critic to earlier decisions on this issue on Francisco de Sousa da Câmara, Claims for the recovery of unduly paid taxes: empirical domestic cases show that progress is required, *The EC Tax Journal*, vol. 6, issue 2, 2002, pp. 145-164.

instance); secondly, because they want to minimize potential litigation costs, and assess probabilities under a narrow cost/benefit principle, especially in individual tax cases.

Despite this, we find three direct tax cases addressed to the ECJ, two under Art. 234 EC Treaty and one under Art. 226 EC Treaty. The first case that reached the ECJ concerned an interpretation of Art. 5(4) of the Parent-Subsidiary Directive (the Court ruled that the withholding limits of 15% or 10% on profits distributed by Portuguese subsidiaries to their parent companies in other Member States must comprise not only corporation tax but also any other taxation, of whatever nature or howsoever described)[34].

In the second case, decided by the Court under an action against the Portuguese Republic for failure to fulfil obligations, in relation to Portuguese direct tax matters, the ECJ considered that by maintaining provisions such as Art. 10(5) of the Personal Income Tax Code (whereby capital gains arising from the transfer of real estate are not subject to tax, provided the proceeds are reinvested in the purchase of real estate situated in the territory of Portugal) the former has failed to fulfil its obligations under Arts. 18 EC, 39 EC and 49 EC and under Arts. 28 and 31 EEA Agreement[35].

The third and the last case was decided on 11 October 2007. The ECJ held that Art. 56 of the EC Treaty must be interpreted as precluding legislation such as the Portuguese law that does not subject to tax 50% of the capital gains realized with the sale of real estate provided the seller is resident in Portugal (i.e. not extending such exemption to other EU residents)[36]. Moreover, I am not aware of a single decision taken by the ASC in which the latter invoked the *acte clair* doctrine in direct tax issues, and I only found a few

34. ECJ, 8 June 2000, Case C- 375/98, *Ministério Público, Fazenda Pública v. Epson Europe BV*, ECR 2000, I–4245, 4263. For an analysis of the case, see Francisco de Sousa da Câmara, "Parent-Subsidiary Directive: The Epson Case", *European Taxation*, 9 (2001) pp. 307- 313.

35. ECJ, 26 October, 2006, Case C – 345/05, *Commission of the European Communities v. Portuguese Republic*. It should be stressed that the reference to the Portuguese legislation appears as a full exemption (it is translated into English as "gains [...] shall be exempt from tax..." – see paras. 5 and 14) although Portuguese law regulates the situation as gains not subject to tax (i.e. the Portuguese relevant rule states that: "São excluídos de tributação os ganhos provenientes ...").

36. Case C-443/06, *Hollmann v. Fazenda Pública*. The Portuguese rule corresponds to Art. 43(2) of the Personal Income Tax Code. See OJ C 326, 30 December 2006, p. 35. Following the ECJ decision of 11 October 2007, the Administrative Supreme Court held that Art. 43(2) of the Personal Income Tax Code is contrary to EC law and declared the tax assessment void and null. This decision was handed down on 16 January 2008, Rec. 439/06.

decisions in which courts made an express reference to an ECJ ruling (the *Lankhorst-Hohorst* decision) to conclude that the Portuguese thin capitalization rules violated EC law.

Furthermore, if we scrutinize the Portuguese income tax codes closely we find a significant deficit of analysis in interpreting the fundamental EC freedoms and their meaning and scope in relation to several direct tax measures contained therein.

3.2. Domestic tax law principles and EC law: their interaction

3.2.1. General overview

Portuguese domestic tax law principles are enshrined either in the Constitution or in the General Tax Law (*Lei Geral Tributária*) in a broad, liberal and sometimes pragmatic manner, which makes it difficult to consider them contrary to EC law per se[37]. Yet, whether in the way they are applied together with other substantive provisions, or in the way they are used by the tax authorities, these legal provisions and decisions are susceptible to being considered contrary to EC law. In fact, some direct tax legal provisions supported – to a certain extent – by those principles or by specific justifications might be considered contrary to EC law since they allow direct or indirect discrimination and restrictions to the freedom of movement without, in my view, any accepted rule of reason justifications.

In any case, the lack of a harmonized tax field created by primary or secondary legislation, the natural existence of several differences or disparities within the EU, and the fact that the ECJ rulings are not always consistent, taken together, make it extremely difficult for national courts to ascertain whether domestic rules are or are not in conformity with EC law and whether or not they may invoke the *acte clair* doctrine with regard to previous decisions, but slightly different facts. Indeed, although many principles have been reinforced countless times (e.g. recognition of national treatment for non-residents by the source state and national treatment of foreign-source income by the residence state) and the boundaries of the tax

37. Principles such as non-discrimination, legality, ability-to-pay, non-retroactivity of taxes, legal certainty, justice, good faith, proportionality, access to justice and to an effective judicial system have a precise proviso or reference in the Portuguese Constitution. In addition, the General Tax Law reaffirms those principles or regulates them at the same time that it addresses other ones, such as the burden of proof and the use of presumptions, thus providing for a specific framework in tax matters.

sovereignty of Member States is permanently under the ECJ's scrutiny, it is still difficult to obtain and predict clear-cut answers (will it be possible without harmonization?); it is not easy to reconcile specific decisions with those principles or among themselves, considering that so often they are justified by particularities [(e.g. *Schumacker* and *Gilly* – should personal allowances be granted by the source or the residence state?), or different perspectives (*Bosal* – must the parent company state accept the deductibility of interest used by the parent company to finance a non-resident subsidiary insofar as the latter is not subject to tax?), or other more recent decisions in which the Court seemed to be interfering with Member States' sovereignty (e.g. *Marks & Spencer*, *Manninen*), not to say approaches towards the way in which restrictions should be considered and the way in which taxpayer treatment should be analysed (i.e. under a single/per country approach or under the rules of more than one Member State). Although some recent decisions (*ACT Class IV*[38], and *Denkavit Internationaal*[39]) followed in very close terms Advocate General Geelhoed's views[40] that tax treaties and taxation in other Member States (i.e. the tax treaty domestic provisions) has to be taken into account in deciding whether a restriction occurs or not, others seem to be less liberal (*Bouanich*)[41], just referring to treaty obligations; it still seems to be too early not only to predict if this will be the definitive approach but also to determine if it is the better approach to follow in the current stage of Community law. At the end of the day won't this approach definitively prevent the efficacy of the *acte clair* doctrine? Are national courts prepared to adopt such a methodology and decide cases without a preliminary reference to the ECJ? Considering that the facts arising in each court case are different by nature and that the need to analyse tax treaties and foreign domestic legislation seems to be quite a complex task for a common national court won't these requirements reduce the possibilities for the *acte clair* doctrine

38. ECJ, 12 December 2006, C – 374/04, *Test Claimants in Class IV of the ACT Group Taxation*, para. 71.
39. ECJ, 14 December 2006, C – 170/05, *Denkavit Internationaal BV, Denkavit France SARL v. Ministre de l' Économie, des Finances et de l' Industrie*, paras. 45-47.
40. See Advocate General Geelhoed's Opinions on 23 February 2006, Opinion on C – 374/04, *Test Claimants in Class IV of the ACT Group Taxation*, paras. 71-72, on 6 April 2006, Opinion on C – 513/04, *Mark Kerckhaert, Bernadette Morres v. Belgische Staat*, paras. 25-26, and on 27 April 2006, Opinion on C – 170/05, *Denkavit Internationaal BV, Denkavit France SARL v. Ministre de l' Économie, des Finances et de l' Industrie*, paras 35-38. See also the recent Opinion of the Advocate General Paolo Mengozzi on 7 June 2007, C- 379/05, *Amurta SGPS v. Inspecteur van de Belastingdienst*, paras 77 et seq., which is clearly in favour of considering tax treaties but not the domestic legislation of the other state, which still seems acceptable under a single approach.
41. ECJ, 19 January 2006, C – 265/04, *Margaret Bouanich v. Skatteverket*, para. 51. See also the Opinion of Advocate General Juliane Kokott on 14 July 2005, C- 265/04, paras. 42 et seq.

to be applied respecting the *CILFIT* ruling? As we will observe later on, considering the justifications invoked by Member States (see section 5.3), it is fair to consider tax treaties in order to determine the final result (as it could be relevant to consider the domestic provisions of the home country from an economic perspective) on whether a non-resident is or is not discriminated against, but one cannot ignore the problems created for application of the ACD.

3.2.2. Specific Portuguese law principles and their compatibility with Community law

Not surprisingly, many of the domestic tax principles and the features of specific regimes towards non-residents are common to other Member States' regimes. In this context we also note that several ECJ decisions are particularly useful as guidance in order to make an assessment of those principles and regimes. Below, we limit our short analysis to three situations: (i) taxation of non-residents as a whole; (ii) the use of presumptions to combat anti-avoidance and fight abuses; and, (iii) and the burden-of-proof rules and the principle of proportionality in relation to the practical application of double tax treaties.

While residents are subject to tax on a net profit basis, non-residents are subject to tax on their gross income obtained in Portugal. As a rule, for reasons of simplification, the latter are subject to final flat tax rates, which do not take into account any particular personal situation, or the costs incurred in order to provide the services, to lend capital or to license intellectual or industrial property, just to mention a few situations. Portuguese legislation in this respect does not respect the reasoning in the *Asscher, Gerritse*, *Scorpio, Conijn* or *Centro Equestre da Lezíria Grande* decisions. This means that non-residents may be subject to an effective tax higher than that to which residents are subject, since, in the situations at issue, they never have the possibility to adjust the tax assessment at the end of the year by way of an annual tax assessment as do residents. Of course, this may dissuade not only non-residents from providing services or capital in Portugal but also Portuguese residents from buying those services or borrowing from non-residents. Recently the European Commission requested that Portugal should bring an end to this type of discrimination towards non-Portuguese service-providers. Indeed, the European Commission has already referred Portugal to the ECJ because the former did not amend its tax legislation concerning outbound interest payments made to credit institutions which require a withholding tax of 20% to apply to the gross income while residents are

exempt from such withholding (although they are subject to a tax rate of 25% on their net income at the end of year). Clearly, in the majority of cases the application of these rates on the gross income of non-residents (15% on services and royalties or 20% on interest) represents a heavier tax burden than the tax applicable on the net income of residents and, moreover, disrespects the ability-to-pay principle. In order to comply with the above-mentioned ECJ case law and to recognize national treatment for non residents, we agree with Peter Wattel that "the simplest manner [...] is to grant the non-resident the possibility of correction by assessment on request"[42]. Not doing so in time, considering in detail the ways it is possible to control the deduction of costs, may increase litigation and lead to considerable costs for Portugal, as a result of the recent rulings on the limitation of effects (*Banca Popolare di Cremona* and *Meilicke*)[43].

Considering this possibility, the Budget Bill for 2008 adopted two specific measures: one was directly introduced in the Personal Income Tax Code with the goal of allowing individuals residents in the EU or in the EEA to opt to be subject to the tax rate applicable to residents in Portugal[44]; the second is a legislative power granted to the Government to adopt measures on the strict lines of the *Schumacker* decision. Under this authorization individuals that are resident in other EU Member State may opt to be taxed as residents in Portugal when at least 90% of their income has been obtained in Portugal, and also when in such circumstances the foreign income of the non-resident taxpayer is taken into account for the purposes of determining the tax rate applicable to income obtained in Portugal. No reference is made to foreign losses, expenses and costs (to calculate the net taxable income) or to personal allowances and credits, although they may became pivotal in guàranteeing identical treatment between residents and non-residents. On the other hand, the ceiling is fixed at 90% of Portuguese income without any other flexible measures. How this authorization will be used is, therefore, crucial in order to make a final assessment of this policy, although the

42. Ben J.M. Terra and Peter J. Wattel, *European Tax Law*, p. 69, Kluwer, 2005.
43. Of course, such a right of deduction should be effectively granted and the ways for taxpayers to provide proof should be acceptable and proportional, especially considering the possibility that the tax authorities have to obtain further information under the Mutual Assistance Directive.
44. See numbers 7 and 8, which have been added to Art. 72 of the Personal Income Tax Code. The Law makes this conditional on whether the exchange of information may be enforced and requires that all foreign income is also included in the tax base in order to determine the tax rate. No references are made to expenses, costs or losses.

rather strict and literal references to facts in previous ECJ cases seems quite dated[45].

A second particularly relevant area concerns the use of presumptions or legal fictions in order to prevent abuses and tax avoidance in cross-border transactions. During the 1990s and in this new century, legislators have been prodigious in creating rules that prevented the deductibility of expenses, costs or interest (e.g. either as remuneration for services or loans) when payments were made to certain entities or locations abroad (usually in offshore centres) or, on the other hand, by adopting strict CFC rules, requiring that when income is obtained abroad by subsidiaries (or companies in which residents own more than 25%, or 10% in case 50% of the company's capital is also owned by residents), such income should be included in the taxpayer's taxable income. Scant attention was paid to rulings such as *ICI*, *Leur-Bloem* or *Cadbury Schweppes*, although we may also recognize that some of these rules were already deleted or amended, as indicated above, in relation to the thin capitalization rules that no longer apply under the EU[46]; others already admit of proof to the contrary, but they still only target payments to non-residents and contain a certain number of requirements that do not apply when payments are made between residents, even if the payee is exempt from taxes[47]; certain others maintain their automatic features, not allowing any proof to the contrary, and they clearly restrict the freedom of establishment and the movement of capital and also restrict cross-border activity[48].

45. This legislative power also envisages the possibility of extending this option to members of the non-resident's household when at least 90% of their total income derives from Portuguese sources. See Art. 47 of Law No. 67-A/2007, 31 December 2007.
46. See notes 24 and 25 above.
47. See, for instance Art. 59 CIRC. Here, in order to be able to deduct a certain amount paid to a non-resident subject to a more favourable tax regime, the taxpayer (payor) has to proof that such payment was related to genuine transactions with the payee and that the amount was not of an abnormal character nor excessive, being these requirements at the discretion of the tax authorities to judge.
48. CFC rules (Art. 60 CIRC) and a rule that reduces from a total to a partial exemption (50%) the dividends that correspond to profits that were not effectively subject to tax, unless the recipient is a SGPS (i.e. a specific type of Portuguese holding company). This rule is very recent (Budget Bill for 2007) and does not explain at what level works (i.e. how many tiers may be considered) – Art. 46(11) CIRC. Not to say another rule that allows a partial elimination of double economic taxation for inbound dividends, but does not grant any relief for outbound dividends when the criteria that implemented the parent subsidiary directive do not apply (e.g. Arts. 46 (8) vis-a-vis (14), respectively, of the Corporate Income Tax Code).

Finally, an area that has been extremely relevant in all payments made abroad concerns the formalities that one must observe to obtain the benefits provided by the EC Directives or the tax treaties. In tax audits of companies doing cross-border business the tax authorities take formal requirements to apply DTT or the EC Directives very seriously[49]. Additional tax assessments are made when the payer of the income has failed to comply with the current domestic rules that could reduce or abolish withholding tax. Such requirements, for example entail obtaining the correct certificates of residence of the payee, duly certificated by its own tax authorities.] According to Portuguese law, the payer to non-residents is always in the first instance responsible for any tax that was not withheld in due time (tax, interest and penalties), although the payee remains liable at a second stage (in case tax is due, the law recognizes that it was the payee who received the income and who should be taxed). On the one hand, this system creates a stronger pressure to withhold, but, on the other hand, it should oblige the tax authorities to accept other means of proof and at different times (namely when the audit is underway) considering the possibility to attack the payer's as well as the payee's assets[50]. The *Scorpio* decision, handed down on 3 October 2006, may represent a first step towards changing one of the most draconian European regimes in this respect, considering the new EC Directives on mutual assistance and the recovery of tax claims together with principles such as proportionality, simplification and the burden of proof, and notwithstanding the fact that Scorpio lost in that same case. In fact, the circumstances invoked to maintain such restrictions towards Arts. 49 and 50 no longer justify very narrow regimes such as the Portuguese one[51].

The Budget Bill for 2008 changed the rules concerning the practical application of tax treaties; namely, the time limit for filing the forms for triggering tax treaties (RFI forms) was extended until the end for the period set for passing on the tax (i.e. on or before the 20th day of the month following that in which the obligation to pay the tax arose[52]. The most important rule, however, is the one that allows the payer of income to evidence the payee's right to benefit from tax treaties, at a later stage, eliminating in that case his

49. This rule was amended by Budget Bill for 2008 (Law No. 67-A/2007 of 31 December 2007).

50. An analysis of these issues is made on Francisco de Sousa da Câmara, "Treaty overrides administrative rule, tax court says", *Tax Notes International*, 30 April 2007, pages 458 *et ses.*

51. ECJ, 3 October, 2006, FKP Scorpio Konzertproduktionen GmbH v. Finanzamt Hamburg-Eimsbuttel, paras. 53 et seq., in particular paras 56-60.

52. The certificate will be valid for a period of one year from the date of certification by the tax authorities in the beneficiary's country of residence, regardless of whether or not there is a continuing contractual relationship with the latter.

liability for the tax not withheld in due time. The fact that this proof still has to be provided on specific forms approved by the Portuguese tax authorities and does not preclude liability for administrative penalties still show an incapacity to adhere to more flexible and proportional regimes and contains a certain scepticism about how EC Mutual Assistance Directives may work in comparison to domestic immediate enforceable provisions[53].

3.3. Tax rules that might be object of Art. 234 EC Treaty and object of *acte clair*

3.3.1. Rules defining and concerning the scope of the taxable item and taxpayer

Given the current state of harmonization of direct taxes, Member States remain free to draw up the rules concerning the definition and the scope of the tax object and taxpayer as well as to choose the connecting factors, providing they do not violate EC law and its principles and do not create obstacles contrary to EC law. In my opinion, EC law precludes any discrimination or restrictions created by "abusive" definitions and, therefore, such rules should also be interpreted under Art. 234 EC Treaty. Of course, the ECJ only interprets EC law and does not even have jurisdiction to give a ruling on the compatibility of a domestic or a treaty provision with EC law[54].

Considering the purpose of Art. 234 and the object of *acte clair* as indicated above, this means that Member States remain not only free to define who is subject to tax but also to determine which income should be subject to tax (i.e. to create the subjective and objective framework of direct taxes), although this freedom should still be exercised in compliance with EC law. In fact, in my opinion, Member States are not free to create discriminatory or restrictive rules in this domain and, as a rule, they do not. However, if the definition of a specific type of income has a different and less favourable

53. See Arts. 90(A)(6) of CIRC and 18(6) of Decree Law No. 42/91 of 22 January 1991 approved by Law No. 67-A/2007 of 31 December 2007. This provision has retroactive effect, regardless of whether a tax assessment has been already made, except when the tax has been paid and no administrative or judicial appeal proceedings are pending.
54. Moreover, as a rule, a simple definition of income (e.g. the scope of employment income as defined by domestic law) is not limited by EC law. The ASC and the ACC, for instance expressly refused to make a preliminary referral to the ECJ, holding that "tips" attributed to casino employees are considered within the scope of the Personal Income Tax Code and the EC law does not limit such a definition, by invoking the principle of equality.

scope when paid or received from a non-resident vis-à-vis resident taxpayers, or if categories of rules (not-subject-to-tax clauses) just apply to resident taxpayers and do not comprise non-residents that carry out the same activity, EC law may be invoked. Both of the recent decisions in *Test Claimants in the Thin Cap Group Litigation* (concerning the re-characterization of interest as profits) and *Commission v. Portugal* (concerning the non-subject-to-tax clause only applicable to residents) seem to support this view[55]. Besides, the fact that the rules on the allocation of rights remain with Member States does not prevent them, in my opinion, from acting in compliance with EC law when they exercise their rights. Even the distinction between residents and non-residents is not always a sufficient basis for treating taxpayers differently, as the ECJ has repeatedly stated. Moreover, the proper definition of resident or non-resident, which at first sight remains under the control of Member States, as stressed by the *van Hilten* ruling, may, in my opinion, be challenged if it is discriminatory or restrictive in itself. For instance, Art. 16(5) of the Portuguese Personal Income Tax Code establishes that if Portuguese nationals change their residence to a low-tax jurisdiction (including EU Member States such as Cyprus)[56], as defined by an Order issued by the Minister of Finance, they are deemed to be residents of Portugal for an additional period of four years, unless the taxpayer can demonstrate legitimate motives for such a decision, namely taking up a dependent employment in that state or jurisdiction. The burden of proof remains with the taxpayer who automatically assumes dual residence. Whether the taxpayer is able to invert this situation is a matter that remains to be seen. The anti-avoidance measure is clearly perceived, as well as the safeguard measure that, at least theoretically, allows the taxpayer to avoid such result. However one may also clearly detect a measure that has the direct effect of preventing Portuguese nationals (but not other nationals who may have been residents in Portugal for all their lives) from leaving the country and taking up residence in those jurisdictions (e.g. Cyprus), especially if their motives are not to assume a dependent employment. If they do so, they automatically become taxpayers with double residence and are theoretically subject to double (or triple) taxation in case they obtain income in

55. ECJ, 13 March 2007, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, paras. 51 et seq. and ECJ, 26 October, 2006, Case C – 345/05, *Commission of the European Communities v. Portuguese Republic* (please see note 38 supra concerning the point that the case applies to a tax exclusion and not to a tax exemption).

56. The test of compatibility with the free movement of capital could also be done again in case the change of residence is to a third state, since the *van Hilten* facts as well as the law applicable and its results are different.

a third state, especially considering that Portugal has not concluded any treaties to avoid double taxation with Cyprus[57]. We clearly face a measure that constitutes a typical restriction "on leaving a country"; the strict rule that provides taxpayers with a dispensation from this regime may prove to be insufficient to legitimize what clearly seems to be an infringement to the freedom of establishment[58]. Moreover, in the current state of affairs in the EU, permitting a certain level of competition as well as permitting the possibility to foresee different measures to combat abuse and tax avoidance should be exercised in compliance with the proportionality principle and they may not be more restrictive than necessary to reach that goal, since it is also settled case law that the abuse must be real and the facts analysed in a specific and casuistic manner.

This type of reasoning may also be applied in relation to domestic definitions, such as permanent establishments, in case a Member State intends to use such concept to cover all types of situations; Such a broad definition would clearly go beyond international practice but might also restrict the fundamental freedoms. Let us assume that one Member State uses such a broad domestic PE definition that it has the effect of preventing a national from another Member State from exercising its right to provide services in the former state without being subject to tax as a PE. This would clearly deter non-residents from providing services there whilst also creating an obstacle for residents to contract services in other Member States. On the other hand, this measure could theoretically also cause double taxation, considering that the origin Member State may continue to tax all income, refusing to allow for a credit (assuming it does not apply the exemption method) on the amount taxed at source[59]. This measure may hinder cross-border situations, blocking access to the market and effectively preventing someone

57. If the unilateral measure to eliminate double taxation provided for in Art. 81 CIRS would also be insufficient to neutralize this result from a Portuguese perspective.
58. In my opinion, this rule goes further than typical exit rules allow, as defined by Lasteyrie du Saillant and N. cases (the formulation used is obviously different but the tax purpose is, in the majority of cases, even broader insofar the intention is to continue to tax the individual's income as a resident for a long period), as well as beyond what seems allowable under the freedom of a Member State to use fictions to define a resident and subject such a resident to tax (van Hilten) (clearly the comparison with nationals who stay in Portugal or who move somewhere else in the EU or other EU nationals who move from Portugal to Cyprus show that treatment granted to the nationals who move their residence to Cyprus is worse and that the elimination of double taxation is not ensured).
59. This may also occur if the PE concept is broadened by the adoption of the force-of-attraction principle (in Portugal, see Art. 3(3) CIRC), although the application of such a rule in relation to entities located in the EU almost never occurs in practice due to the existence of tax treaties. See also Pasquale Pistone, "Italy", *Towards a Homogeneous EC Direct Tax Law*, p. 338, edited by Cécile Brokelind, IBFD, 2007.

from rendering services in another Member State. Moreover, the existence of such a diversity of concepts among Member States is not acceptable, not only where they lead to double taxation, but also if they result in effective restrictions to the single market, which would prevent them from being seen as mere disparities in legislation[60].

Notwithstanding this, I consider that when we look to areas already covered by harmonization (e.g. directives) or we consider the domestic rules concerning the scope of the tax object and the determination of taxable income we find many more occasions in which discrimination or restriction prohibited by EC law may exist.

60. Although double taxation has been tolerated in several occasions by the ECJ (Kerret (para. 137), Gilly (para. 23), D. (para. 50, 51), Nygard (para 38), as well as by authorized opinions (e.g. Geelhoed in C – 513/04, Mark Kerckhaert, Bernadette Morres v. Belgische Staat, (paras. 28 and 29) and C- 194/06, Staatssecretaris van Financien v. Orange European Smallcap Fund NV (para. 48) and Dennis Weber, "In search of a (new) equilibrium between tax sovereignty and the freedom of movement within the EC", *Intertax*, 2006, No. 12, p. 594), the domestic tax measures that allow them have to pass another test (i.e. they cannot restrict or have the effect of restricting access to the market, clearly also putting non-residents vis-à-vis residents – i.e. non-nationals vis-à-vis nationals – in an unfavorable position that effectively consists of an additional burden that the EC Treaty itself aims at eliminating) in order to be acceptable. The same type of reasoning could be applied to different types of domestic rules, such as transfer pricing rules (not only those on procedural matters, requiring the provision of documentation) that allow adjustments in a myriad of situations based on a domestic definition of "special relationship" that is broader than "associated enterprise" provided for in Art. 9(1) of the tax treaty and Art. 4(1) of the Arbitration Convention (90/436/EEC). In a certain way this corresponds to the Portuguese situation, where the definition ("special relationships") that allows profit adjustments by making use of transfer pricing rules is extremely broad. The simple fact that double taxation could, eventually, be eliminated at the end of a long process as provided for in that Convention, should not allow Member States to adjust profits in a manner that it is not consistent with international practice and in line with the framework established in Art. 9(1) of the OECD Model Convention (namely, assuming the existence of "special relationships" between companies that effectively are not "associated enterprises" and, therefore, allowing adjustments in a much wider context). In these cases, it often happens that the tax adjustments do not give rise to correlative adjustments. Thus, this gives rise not only to double taxation, but is also responsible for effective obstacles for the non-resident company to have access to the market. For instance an adjustment to the profit of a franchisee of an international (EU) group to whom he does not belong (based on the domestic rule that considers the domestic entity as dependent on the non-resident from an economic point of view), could, for instance lead to double taxation in that particular case, but it also might prevent or make it extremely difficult for the franchisor to have access to that particular market (i.e. Portugal) and to sign the same type of contracts with new franchisees. In my opinion, it is possible, as it seems the case in the Portuguese situation, that the three exceptions to the Dassonville ruling, namely the Cassis de Dijon, and the Keck decisions and the rule of remoteness do not suffice to justify such a restriction.

3.3.2. Rules concerning the methods to eliminate or reduce double taxation

Member States have been free to eliminate double taxation by using the credit or the exemption method, either in their unilateral or bilateral rules, and it seems that the status quo will continue, provided the use of such methods does not qualify as discrimination[61]. As we have already seen, Member States are not even obliged to eliminate double taxation and therefore it seems possible to argue for the time being that double taxation per se does not constitute a prohibited restriction to the freedom of movement.

Ultimately, the option chosen by the residence state represents the exercise of its own sovereignty rights[62].

3.3.3. May EC direct tax law principles, simple legal arguments or facts be object of acte clair?

The expression "acts of the Community Institutions" used in Art. 234 to define the matters in which the ECJ has jurisdiction to give preliminary rulings has been interpreted very broadly. This is understandable in order to allow the preliminary ruling mechanism to fulfil its own purpose. Therefore, such acts have included not only secondary law but also other measures, treaty provisions as well as unclear principles inherent to Community law[63].

In interpreting the written legal provisions of Community law (either primary or secondary legislation) and EC legal principles, the ECJ has been ensuring a uniform interpretation of Community law and, at the same time, preventing Member States from maintaining discriminatory and/or restrictive (including direct tax) measures that would violate the EC Treaty freedoms. Thus, it seems that national courts may not be obliged to make new preliminary references in these cases.

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61. The same can be said for the same methods in their specific variations (e.g. full or normal credit, full or partial exemption or exemption with progression).
62. I agree with the comments and observations made by Dennis Weber, "In search of a (new) equilibrium between tax sovereignty and the freedom of movement within the EC", *Intertax*, 2006, No. 12, pp. 613, 614.
63. Case 11/70, *Internationale Handelsgesellschaft mbH v. Einfuhr –und VVorratsstelle fur Getreide und Futtermittel* [1970] ECR 1125 (respect for human rights) and Case 84/78 *Angelo Tmandini Snc v. Amministrazione delle Finanze dello Stato* [1979] ECR 1801 (protection of legitimate expectations).

In this context the ECJ has also developed the rule of reason, which may justify restrictions[64] as well as indicate several grounds that are definitively banned as justifications. Moreover, despite having already identified and accepted some grounds that may justify non-discriminatory restrictions (i.e. principles invoked by Member States to justify restrictions to the four fundamental freedoms under the Treaty), the Court still required the restrictive measure to be appropriate[65] and proportional[66], which, in practice, led to cases of restrictions accepted by the ECJ being so scarce that it is still difficult to recognize a pattern or an indisputable precedent. In fact, in the field of direct taxes, the ECJ's scrutiny of a large number of unrelated tax measures has contributed to market integration. Not surprisingly, given the obstacles thrown up by the Member States with regard to EC legislative action, this has led to considerable conflict, whereby the Member States attempt to maintain their domestic measures, either by defending an obviously untenable position that there is no overt discrimination or restriction or more often, by putting forward justifications.

Within their respective competences, national courts have to apply Community law and they must respect ECJ rulings, including the different principles developed by the Court. Nevertheless, in my opinion, for the time being it is extremely difficult for the national courts to establish the clear boundaries of an acceptable justification for a specific infringement of EC obligations in accordance with ECJ case law and it would be dangerous for them to attempt to ground their decisions based on the *acte clair* doctrine. More importantly, the *CILFIT* guidelines should not be used to justify ex-

64. Following the Cassis de Dijon reasoning, the Court accepted four (or five) restrictive tax measures: (i) preservation of fiscal coherence within the same jurisdiction (*Bachmann* case: balancing pension contributions deductions with later payment of taxes within the same jurisdiction); (ii) effective fiscal supervision (Futura Participations case: tax law may justify double checks and "proper accounts" to branches); (iii) prevention of tax abuse which can be reinforced by shifting the emphasis from the domestic prohibition to the EU rules (Halifax and Cadbury Schweppes may play an important role, although other cases such as Marks & Spencer, Test Claimants in the Thin Cap. and OY AA will certainly continue being an important source for analysis in this domain); (iv) allocation of tax jurisdiction; (v) preservation of the fiscal principle of territoriality (Futura Participations: a state has the right to tax income that is substantially connected with its territory). See section 5 for further developments.

65. Is such a restrictive provision appropriate for the protection of the public interest involved? See Case C-345/04, 15 February, 2007 (Centro Equestre), para. 35 and C-433/04, 9 November 2006 (Commission v. Belgium), paras. 33 et seq.

66. Is such restrictive measure proportionate vis-à-vis the goal aimed at? See the following cases, C-524/04, 18 July 2007 (*OY AA*), para. 63, C-524/04, 13 March 2007 (*Thin Cap.*) paras. 80 et seq., C-9/02, 11 March 2004 (*Lasteyrie du Saillant*), para. 69.

ceptions to the application of EC rules but to avoid unnecessary preliminary references.

On the one hand, it seems that these justifications and their context (namely, the principle of proportionality) require further consolidation by the ECJ in order to ensure that courts will clearly hold that the obvious and only solution (still the *CILFIT* doctrine) is to accept such justification; on the other hand, I believe that should national courts start to accept the current justifications under the *acte clair* doctrine (in something less than a very strict way, where the facts and the legal framework are different), this will open a Pandora's box, permitting different applications, giving rise to a widening and uncontrolled definition of the current justifications and, more importantly, to the development of different markets through the back (national) judicial door.

Finally, in my opinion, legal arguments and facts cannot be the object per se of the *acte clair* doctrine, although they certainly are very important elements that should be considered by national courts when they interpret and apply Community law (often those arguments are already part of settled case law) and they may even, together with the consideration of all the facts of a specific case and the fulfilling of *CILFIT* criteria, justify dispensing with a preliminary ruling. Although *CILFIT* culminated with a total exemption from referring even without precedent, it still required that the answer should be obvious and could not leave scope for any reasonable doubt.

4. When does *acte clair* in direct tax issues occur?

4.1. From the *acte éclairé* forward

In the *CILFIT* decision the Court took its previous decision in *Da Costa* forward, admitting that the issues being examined do not need to be strictly identical in order to allow a national court to invoke a precedent. However, this broadening was compensated for by the fact that it required the ECJ to have already dealt with the point of law in question, in order to invoke a uniform application of Community law.

Although *CILFIT* culminated with a total exemption from referring even without a precedent, it still required that the answer should be obvious and could not leave scope for any reasonable doubt.

Considering that different direct (domestic or/and treaty) tax rules in force in each of the 27 Member States may lead to completely different results in each cross-border situation, despite the same type of substantive matters being under discussion (e.g. dividends, CFC, etc.) a thorough analysis must always be made to minimize inconsistencies and mistakes that may jeopardize the internal market.

In fact, even the rules applicable to inbound or outbound income within a specific Member State may change significantly by virtue of the different set of treaty rules applicable to a specific situation (e.g. employment income, income from self-employment, dividends, capital gains, etc.), since there is no European tax treaty. This means that certain domestic rules that are tolerated under an approach that looks to domestic-source legislation and a specific tax treaty (applicable to a specific concrete case) may nevertheless not pass the test if we consider a different tax treaty, and vice-versa.

Moreover, from time to time the ECJ introduces some nuances or adopts approaches that seem contradictory or inconsistent with previous decisions, thus increasing the difficulties involved in defining clear borderlines.

Not surprisingly, not only for the parties involved (or at least for the party that intends to rely on a previous ruling) but also for the national courts, matters are facilitated when a precedent exists on the same legal provisions and similar facts.

In such circumstances, national courts usually apply the previous ECJ ruling. The most obvious case occurs when national courts are obliged to consider the legality of a specific provision and its compatibility with EC law and the ECJ has already scrutinized – or is in the course of scrutinizing – the issue of whether Community law precludes such national legislation.

As we know, this situation usually occurs in a single jurisdiction, in particular when the court recognizes that there is a violation of Community law. An initial case triggers others and is followed by several new cases in which taxpayers seize the opportunity to see their rights recognized by the courts.

Of course, when cases are identical, national courts follow the previous ruling. If the initial case is still pending with the ECJ they tend to suspend the national procedure, waiting for the final decision in order to apply the ECJ ruling when the latter is released. This situation has occurred several times in Portugal in matters related to notarial and registration fees and the vehicle tax. However, if one looks at the EC as a whole, these situations are far

more frequent, giving rise to test claims lodged by several companies, which relate to the same matter, as has often taken place in the UK.

Nevertheless, if the question does not directly involve the same national legislation and may even involve slightly different factual circumstances, albeit centred around the same issues – e.g. exit taxes or the payment of dividends – national courts will possibly not follow the previous ruling, either because they consider that the *CILFIT* conditions are not met or simply because they ignore such a decision deliberately or negligently.

On the other hand, if a preliminary reference reaches the ECJ, it may review the request and judge otherwise, deciding by reasoned order. In fact, in such cases the ECJ may decide to make a reference to the previous judgment or to the relevant case law from which the answer may be inferred. This scenario has already occurred in Portugal several times, namely in VAT matters, as well as in other countries, in direct tax matters as well. The Belgian *De Baeck* (concerning exit taxes) and *Philippe Mertens* cases (concerning the deduction of business losses) were, for instance, decided by Reasoned Orders, to the effect that they were similar to previous cases[67].

In other cases, however, national courts have invoked the *acte clair* doctrine but no reference has been made at all to the *CILFIT* conditions (see section 2.1 above), or even to precedents, which often leaves litigants somewhat puzzled as to the result and the interpretation made by the national court under an "authority argument" (a precedent or a clear Community law solution) that it is undisclosed.

One should not forget that at other times, in applying EC law, national courts simply ignore the fact that a previous decision was handed down by the ECJ or not, and decide the case based on the Opinion of the Advocate General[68]. Alternatively, even if they are courts that decide in the last instance, they adopt a discretionary judgment and ignore the need to take the *CILFIT* conditions into account[69].

67. ECJ 8 June 2004, case C – 268/03, Jean-Claude De Baeck v. Belgische Staat, [2004] ECR I – 0000 was considered to be similar to ECJ 21 November, 2002, case C – 436/00, X and Y v. Riksskatle verket [2002] ECR I – 10829; ECJ 12 September 2002, case C – 431/01, Philippe Mertens v. Belgian State, was considered to be similar to ECJ 14 December 2000, case C – 141/99, AMID v. Belgian State [2000] ECR I – 11619.
68. See Pasquele Pistone, op. cit., p. 329/footnote 4 referring to the odd case concerning the Banca Populare di Cremona.
69. See Cecile Brokelind and Mark Kanter, "Sweden", "*Torwards a Homogenous EC Direct Tax Law*", pp. 236 and 237, IBFD 2007.

Thus, in my opinion, any decision based on the *acte clair* doctrine should expressly invoke the ECJ precedent or the arguments put forward by the national court to justify the fact that the correct application of Community law does not leave room for discussion, thereby demonstrating that the *CILFIT* conditions are met in a precise and rigorous manner[70].

4.2. Particular difficulties in applying the *acte clair* doctrine in direct tax issues

First of all, I must acknowledge the enormous success of the ECJ case law in direct tax matters; without legislative measures being taken and in the face of forceful resistance from Members Sates, the Court was able to create the foundations of a non-discriminatory and non-restrictive direct tax environment, the quintessence of an effective internal market.

Today, within this framework, we recognize the recurrence of several principles in settled case law that may be invoked in accordance with the *acte clair* doctrine to prevent national direct tax measures that discriminate (directly or covertly) against permanent establishments vis-à-vis subsidiaries, reverse the burden of proof in cross-border situations, prevent deductions of necessary expenses by non-resident providers of services, impose thin capitalization rules vis-à-vis other EU Member State, prevent deductions of pension contributions by non-residents, and impose withholding tax rates on payments to other EU Member States.

These rulings are still grounded upon basic international (and EC) principles:

- "although direct taxation falls within this competence, Member States must nonetheless exercise that competence consistently within Community law"; and
- residents and non-residents are not, by definition, in comparable circumstances vis-à-vis the state of source of the income but some measures distinguish (directly or covertly) merely on the basis of nationality.

70. The fact that the Court avoided that term "interpretation" and instead referred to the expression "correct application of application of community law (para. 16 *CILFIT*) could be justified by the idea that a clear provision does nor require interpretation ("in claris non fit interpretatio") but would not preclude the testing of whether the *CILFIT* conditions were or were not met. See the Opinion of Advocate General Capetorti in *CILFIT* (point 4) and the Opinion of Advocate General Stix-Hackl in *Intermodal* (point 85) – case C-495/03.

Moreover, either the facts or the legal provisions presented to the courts of the 27 Member States are necessarily different and, in majority of the cases, have *nuances* that justify different questions and solutions. This fact per se shows that few have recourse to the *acte clair* doctrine.

For instance, what would be the result in the *Schumacker* case if Belgium had applied the credit method (instead of the exemption method) and his family had also obtained part of this income from a Belgian or other source? Recently, in relation to *Denkavit Internationale*, what would be the result if the Netherlands had also adopted the credit method? Along the same lines, we may also consider *Amurta* and consider whether the Advocate General's Opinion (or the pending ECJ ruling) would have been different if the Portuguese State had adopted the full credit method instead of the exemption method to relieve economic double taxation?

Difficulties are, however, exacerbated not only by the hardships in interpreting the rulings but also by certain ECJ inconsistencies and, in particular, by a lack of clear and settled case law guidance in some areas.

Let us consider two or three aspects in analysing discriminations and restrictions in crucial direct tax matters.

First, in principle, residents and non-residents should be taxed differently, except if they are in objective and comparable situations, in which case non-residents should receive national treatment. Along these lines, the Court also accepts deductions of necessary expenses (e.g. *Gerritse, Conijn Scorpio*), as well as progressive rates for non-residents, provided they are not subject to a higher tax scale than residents (e.g. *Biehl I, Biehl II* and *Asscher*).

However, despite the extraordinary enlargement of prohibited discriminations based on nationality or restrictions that jeopardize the internal market, whether the "relevant" or "objective" reasons that may justify a different treatment between residents and non-residents exist or not[71], but also whether the public interest or the justifications based on the rule of reason may allow a different treatment is an open issue.

71. See, for instance the *Schumacker* and *De Groot* cases, where the Court still did not hold that the host state is obliged to guarantee, without reservations and limits, national treatment for non-residents, thus putting further pressure on the home state. On the other hand, an incorrect comparison may change disparities into discrimination and thus oblige the host state to grant an advantage without a clear justification.

As long as these two set of carve-outs are embedded in the system, non-residents will not receive a full national treatment.

In this context, current national systems that distinguish between the treatment of residents and non-residents will continue to be thoroughly scrutinized by the ECJ.

Whether this classic international tax approach will still be accepted within the internal market in a number of years or whether Member States will agree to, or the Court will impose, a different approach (e.g. a strict territoriality principle or a national treatment of non-residents based on their world-wide income) remains to be seen.

For the time being, we have already witnessed the ECJ precluding Member States from maintaining measures that prevent individuals from carrying losses cross-border from the home state to the host/employment state, as was ruled in the *Ritter-Coulais* case, despite several critics who call attention to incorrect comparisons between a resident/non-resident situation or argued the existence of disparities instead of true discrimination[72].

The *Lakebring* case will certainly shed some light on this matter but whether it will settle the current case law in a manner that would allow *acte clair* to be invoked is again an open question[73].

Second, how to remove restrictions that arise from the legislation of one or more Member State?

First of all, one may ask whether restrictions to the freedoms of movement arise from the legislation of a single Member State (including domestic and treaty rules) or from the legislation of more than one Member State and, then, ask who should eliminate such restrictions and how. Despite a considerable number of cases (e.g. *Schumacker, Marks & Spencer, Ritter, Denkavit II, ACT Class IV, Kerckhoert-Morres, Amurta*), and the analysis made

72. See Dr Gerard T. K. Meussen, "The Ritter-Coulais case – a wrong decision in principle by the ECJ", *European Taxation*, July 2006, pp. 335 – 338, Dennis Weber, "In search ...", p. 596 et seq.

73. See case C-182/06; the Opinion of Advocate General M. Paolo Mendonza was issued on 29 March 2007, and is in line with Ritter-Coulais, which gives more importance to the national treatment of non-resident taxpayers than to others factors that could point to a different direction (e.g. namely based on sovereignty reasons).

by several Advocates General and academic authorities, the final and definitive answer does not seem yet *acte clair*[74].

As already observed, in my opinion, the single approach is the only one to be followed and is in accordance with the current legal European tax framework. Notwithstanding the attractiveness of a global approach from an economic and, apparently, "fair" point of view, it seems tax sovereignty is not limited or dependent upon the legislation of other Member States.

We also believe that the difficulties involved in applying Community law for national courts (not to mention for the parties involved) would be so extensive that the scope of the *acte clair* doctrine in direct tax matters would be extremely reduced and the risks of an incorrect Community law answer would increase. The ambition of achieving fairness would, in practice, jeopardize justice and certainty.

It is curious that even the recent *Denkavit* decision raised the discussion of whether the overall approach was accepted or rejected; and, for those accepting the former view, the question remains of knowing if the court decision would be maintained in case the tax treaty or the domestic legislation of the home state (the Netherlands) had provided for a full tax credit, thereby allowing such discrimination to be definitively eliminated. Let us suppose that the credit could not be fully used, namely because the parent company incurred losses and no carry-forward rule would exist to use such credit in the future. Or, in case the tax credit would be fully used, could the taxation at source and the cash-flow disadvantage nevertheless be considered unacceptable?

Moreover, the latest decisions concerning the elimination of economic double taxation also evidence a different approach regarding the treatment of inbound and outbound dividends. While in the former cases the restriction is eliminated by the home state, which has been obliged to give a tax credit (e.g. *Manninen* and *Meilicke*), in the latter case, that obligation has been imposed upon the host state (e.g. *Denkavit* and probably, *Amurta*). But, as observed, would these results be different if the methods to avoid economic double taxation in the home state were different?

74. See, for instance Dennis Weber, supra and the authors he quotes.

5. What role do the "relevant objective elements", capable of justifying a restriction to a fundamental freedom or a discriminatory treatment resulting from a direct tax regime, play?

5.1. Justifications: The last shield of the state?

As already observed, national measures that constitute an obstacle to the freedom of movement are contrary to EC law and must be abolished by Member States. For this purpose, first, national measures have to be evaluated in relation to the EC freedoms in order to determine whether the matters covered by those national rules fall under the scope of the EC freedoms and, if so, whether the national rules constitute an obstacle to those freedoms and, at least in a first approach, an infringement to EC law. Then (assuming no doubts exist about the specific EC violation), it is possible for the national courts to apply the *acte clair* doctrine and not make a preliminary reference or for the ECJ to decide by a Reasoned Order under its rules of procedure (Art. 104(3)).

However, some of those national measures may be considered to pursue legitimate aims justified by measures of public interest that may pass the EC tests (either EC Treaty rules or the ECJ rule of reason) and, therefore, might be recognized as compatible with the EC Treaty.

In this context, to know what those aims and national public interest are is of utmost importance, not only for the lawmakers and each Member State but also for the courts and, in particular, for the ECJ.

Although not absolutely consistent, ECJ rulings indicate that discrimination (i.e. measures of direct or indirect distinction) on the basis of nationality may only be justified by the public interest as laid down in the EC Treaty (Arts. 30, 39 (3) and (4), 45 and 46 (1), 55 and 58 (1) b) EC Treaty), while restrictions may also be justified by the principles accepted by the ECJ under the rule of reason[75]. However, those EC Treaty justifications are almost irrelevant in tax discrimination cases.

75. Following the *Cassis de Dijon* case, non-discriminatory restrictions on free movement may be justified on other grounds of overriding public interest if they are appropriate, necessary and proportional. However, the consistency of the above-mentioned principle was broken on a few occasions. In some cases the ECJ accepted that Member States defended indirect discriminatory tax measures under the rule of reason, and even accepted the justification invoked (e.g. *Bachmann*), but in other cases refused it altogether (e.g. *avoir fiscal* (para. 25) and *Royal Bank of Scotland* (paras. 32 and 33).

In any case, judicial discussions, including those at the ECJ level, do not diverge from domestic disputes where the opposing parties *plead* on the basis of what they consider to be their own interest. Thus often, before the presentation of justifications, Member States start by rejecting the argument that these national measures violate EC law, claiming that no discrimination exists (i.e. they claim that a different treatment is justified by the lack of comparability of situations or/and that some disadvantages are compared with other advantages) and that no restrictions occur[76].

The relevant objective elements that may justify discrimination or restrictions to the fundamental freedoms simply appear as a second or third layer of defence; usually they were also not considered at the time the national measure was enacted. However, Member States are not shy about putting them forward when such measures are challenged by taxpayers or the EC Commission (e.g. under Arts. 234 or 226 EC Treaty) in a particular judicial dispute.

The question then raised is weather is it legitimate that Member States invoke justifications based on "national public interest" without a minimum ground, and merely follow the long repertory of justifications (accepted or rejected by the Court). In doing so, they particularly use the most "fashionable" one, quite often with standard formulas or templates with the sole goal of maintaining their measures (and income) and without the slightest interest in the conditions for achieving the internal market. Will this continue to be acceptable with the growth of preliminary referrals or are certain procedural rules (including monetary consequences) necessary to prevent such behaviour?

5.2. The scrutiny of the relevant objective elements: tension between Community and national interests

Does the internal market really require that direct tax measures also ensure equal economic treatment between EC nationals as well as a single market without the appearance of new markets (i.e. areas covered by permitted res-

76. Cases where Member States immediately recognize that their own measures represent an obstacle to free movement, although justified by specific reasons, are still a minority (e.g. C-104/06, of 18 January 2007, para. 9, *Commission v. Kingdom of Sweden*. The fear that Member States have of losing power, income and sovereignty invariably leads Member States (and tax authorities) to take the explicit position that no EC law violation has occurred. In many cases, the tax authorities do not even mention any type of justification while they are pleading at a national court.

trictions), or is it possible to achieve a fully integrated internal market putting aside direct (or specific aspects of) tax matters?

Certainly we would get a second best result: the minimum possible discrimination/restrictions. But how to determine what these are is the question.

The discussions held at the EALTP conference in Paris, in June 2004, on the "fundamental freedoms and national tax sovereignty in the European Union" were extremely interesting and helpful for understanding that further integration probably requires positive action to be adopted directly by Member States, but that the ECJ should not slow down in the meantime by allowing widening the justifications such as "... a broad economic coherence of national tax systems or a wider and automatic concept of abuse to take more into account 'the legitimate national tax interests of the Member States'..."[77].

Notwithstanding this, Hinnekens still contrasted the concern of Knobbe-Keuk that "*slippery Bachmann* would open the backdoor by which fundamental Treaty freedoms 'risk going to the dogs', with the 'legal uncertainly of the ECJ case law' and its 'disastrous budgetary implications', not to say the premise that 'for national governments there are more things in heaven and earth than European-wide optimization of economic efficiencies'[78]". To conclude, following Richard Lyal, that "we should be open to a broad range of justifications in the public interest"[79].

These comments (by Hinnekens and Lyal) were made taking into consideration the minimum success ratio attributed to justifications (a single case at the time) which "... hardly points to a reasonable, equitable and balanced application of that rule."[80]

77. *EU Freedoms and Taxation*, ed. Frans Vanistendael, p. 219, IBFD, 2006. The three basic reasons are the following: (i) national rules have been responsible for splitting the European market; (ii) Member States may achieve their goals whilst accepting a common baseline of new rules to facilitate the internal market; (iii) new justifications could jeopardize the ECJ role, even leading it to take a discretionary approach that is the privilege of the legislator.
78. Luc Hinnekens, "Basis and scope of public interest justifications of national tax measures infringing fundamental Treaty freedoms", *EU Freedoms and Taxation*, pp. 99-100, ed. Frans Vanistendael, IBFD, 2006.
79. Supra, p. 102.
80. Supra, p. 102.

However, as evidenced by Vanistendael, no specific indication was given on the precise types of public interest matters that should deserve to prevail over Community law and those that should not.

Moreover, if one looks to the considerable amount of cases decided by the ECJ, it is no difficult to find patterns in the justifications presented by Member States.

We may find (i) different approaches between Member States dealing with the same type of situations (e.g. either accepting that an EC violation has occurred or not or pointing out their own justifications)[81]; but also (ii) Member States supporting others in fighting against further (negative) integration by the ECJ, through the presentation of observations that collide with the Community interest itself; or (iii) justifications popping up *"au fur et à measure"* that national tax measures became scrutinized by the ECJ (i.e. the reasons beyond the justifications are not precedent or even contemporary to those measures, which means they are a sort of grounding *a posterii*) with the sole goal of seeking to target the legal arguments and reasoning already accepted by the ECJ for the sake of self-preservation. In my opinion, this explains part of the current accepted/rejected justifications ratio[82].

Some justifications have been put forward often but never allowed (e.g. administrative or economic justifications); some others have been rejected once but have been recently allowed (e.g. allocation of tax jurisdiction) and another one was allowed once (coherence of tax system) but never since then[83]. In my opinion, in the present state of Community law and jurispru-

81. We may compare, for instance the position held by the Portuguese Republic and the Kingdom of Sweden in relation to their domestic individual income (capital gains) tax provisions that grant specific advantages (e.g. an exemption or a deferral of taxation) to residents, whenever the latter reinvest the proceeds of their gains in immovable property situated in Portugal or in Sweden, respectively. See sections 3.1 and 3.3.1. above. See also ECJ 26 October 2006, Case C-345/05, *Commission of the European Communities v. Portuguese Republic*, and ECJ, 18 January 2007, Case C-104/06, *Commission of the European Communities v. Kingdom of Sweden*. Although this comparative exercise may be done for similar cases decided under Art. 177 EC Treaty it is even more impressive when the situations derive from the same type of infringements and are decided under Art. 226 EC Treaty.
82. See note 57 supra.
83. See section 4 of this paper for greater detail.

dence, the nature[84] and the type[85] of justifications accepted by the ECJ is not yet absolutely stabilized, although it is settled case law that all national measures should be appropriate, necessary and proportional. But, even in relation to these requirements, the open question is still, however, to verify, in a case-by-case analysis, whether they are or not met, also considering that, being exceptions, they must be interpreted narrowly.

5.3. Should the *acte clair* doctrine be upheld by courts of last instance when justifications are invoked?

As we observed, courts of last instance should be allowed not to refer a case when the answer is so obvious as to leave no scope for any reasonable doubt as to the manner in which the question raised is to be resolved, provided they are convinced that the matter is equally obvious to the courts of the other 26 Member States and the ECJ. In other words, courts of last instance may use their own judgement and discretion but they must comply with certain conditions in order to achieve uniformity, reducing to the minimum possible inconsistencies, as we also noted above when discussing *CILFIT*[86].

Considering that justifications represent the prevalence of individual over community interests, they can only be accepted if they are; (i) "justified" by overriding reasons in the public interest; (2) appropriate to attain the objective in question; and, (3) necessary to attain the objective and do not go beyond it.

Given the current status quo, I believe that the *acte clair* doctrine should prevent Member States from using justifications rejected over and over by the ECJ. On the contrary, recognizing that apparent EC violations have become acceptable justifications, under the rule of reason, raises particular difficulties for the courts of last instance: first, because of the wording and

84. They should not have a primarily economic or financial nature; since avoir fiscal, (para. 25) through *Lankhorst* (para. 36) and *Bosal* (para. 42), the the ECJ has always refused to accept a negative budgetary consequence as an acceptable justification. In general, Treaty justifications are related to public policy, public security, public health as well as public services activities and the rule of reason justifications are mainly based on the proper allocation of taxation powers and the principle of territoriality or/and the combatting of tax avoidance.

85. Mainly they should ensure altogether a proper allocation of the power to tax and also be justified to prevent tax avoidance, tax evasion and tax abuse.

86. That is the reason why the EC Treaty and the ECJ reject granting a greater discretion to courts of last instance in order for them to serve as a filter and be granted more extensive powers – see the Opinion of Advocate General Tizzano, C-99/00 *Lyckeskog*.

teleology of Art. 234 EC Treaty; second, because it does not seem to be the function of courts of last instance to apply the rule of reason, in particular considering the enormous lack of consistency on justifications; third, usually there is a party that challenges the applicability of such approach. Would it then be likely that all courts as well as the ECJ would decide the case in the same way? Would also the other *CILFIT* criteria be met?

Despite these arguments, the history of justifications shows that it would be extremely imprudent to allow national courts to have the last word in upholding justifications applying the *acte clair* doctrine. The current mistakes (of considering to be clear what is obscure or obscure what is clear – in the latter case without major problems) would multiply, which could lead to quite a few illegal domestic legal provisions being allowed to exist.

Thus, in my opinion, without a clear precedent, courts of last instance are not and should not be allowed to accept justifications; because case law is not unambiguous, the justifications do not have direct effect and *CILFIT* conditions would not really be met (at least, not the condition of unanimity among all courts in the EU).

Moreover, even considering precedents, I believe that courts of last instance should be extremely prudent since certain changes of facts, patterns or laws may completely overturn the final result. Let us consider some examples:

Firstly, the *Denkavit* or *Amurta* examples illustrate some of the difficulties that courts of last instance face in applying the *acte clair* doctrine, namely when they have to consider tax treaties, which by nature may all be different.

The French legislation (concretely, a discriminatory withholding tax on the dividends distributed to the Netherlands) was considered in violation of EC Law.

The dividends were exempt in the Netherlands, so the ordinary credit method provided for the tax treaty with France did not allow the Netherlands company to receive the tax credit, but if the full credit method were to be used, this restriction would have been neutralized and the outcome would have been different.

France has other tax treaties; these, or new tax treaties signed by France, may provide for the full credit (regardless the improbable it might be), neu-

tralizing any discriminatory measure in national legislation vis-à-vis the treaty partner.

Amurta SGPS, which involves a Portuguese company that is shareholder of a Dutch company (Retail Box), involves the same type of reasoning (e.g. given the withholding tax on the dividends in the Netherlands, how one should determine what is the tax treatment attributed to those dividends in Portugal?).

Portugal provides for an exemption on dividends received by Amurta, but does not grant a full tax credit either unilaterally or based on the tax treaty signed with the Netherlands. Therefore, the restriction on the free movement of capital is not removed.

In taking cognizance of an ECJ ruling, courts of last instance should be particularly aware of all possible outcomes (theoretical and actual), resulting from domestic legislation, including tax treaties (which requires an appraisal of different tax treaties)[87].

Secondly, the "fashionable" use of two or three justifications (e.g. balanced allocation of taxing rights/prevention of double use of losses/the need to prevent tax avoidance) may create a problem, in particular when the last element is "avoidance/evasion/abuse".
Let me give an example.

In the *OY AA* case, I clearly understand the principle of territoriality (less the balanced allocation of taxing rights considering the mere applicability of domestic law and with no tax treaty intervention), and I understand the potential risks of tax avoidance. But, the Court was much more exigent in other circumstances; a few months earlier, in *Rewe*, the Court rejected both justifications[88].

87. Some authors consider that one should even take into consideration the domestic legislation of other Member States under the overall approach. See also in relation to this case the Opinion of Advocate General Geelhoed. Moreover, in certain specific cases, the ECJ (e.g. Shumacker, Marks & Spencer and Ritter, for instance) looked to the legislation in more that one Member State in order to determine whether a restriction of the freedom of movement had occurred or not.
Gerard Meussen discusses the point in "Denkavit International: The Practical Issues, *European Taxation*, May 2007, 244-247.
88. The question raised intended to determine whether Arts. 43 and 48 (freedom of establishment) preclude a law in a Member State (in this case, Germany) that restricts the right of a resident parent company to deduct for tax purposes a loss incurred in respect of write-downs to the book value of its shareholdings in subsidiaries established in other

Why accept an automatic measure (denial) to prevent tax avoidance as a justification, as in *OY AA*?

Basically, the Court simply acknowledged a potential risk that by means of purely artificial arrangements, income transfers may be organized towards companies established in Member States applying lower tax rates or where income is not taxed[89]. But, the Court refused to do so on other occasions (e.g. *Lankhorst*, para. 37; *ICI*, para. 26; *Leur-Bloem*); i.e. usually the Court refused to consider the potential risk. *Cadbury Schweppes* also showed that only wholly artificial arrangements should be targeted.

Moreover, the Court has stressed on other occasions that abuse may be combated with specific appropriate and proportional national measures (linked with the burden of proof and rebuttable presumptions). Moreover, Member States may also use the prohibition-of-EC-abuse principle (as stressed in *Halifax*[90]) to hamper taxpayers from making an abusive use of EC rights (either guaranteed by the Treaty or by secondary legislation). In the sphere of VAT, an abusive practice requires that (i) the transactions concerned result in the accrual of *a tax advantage the grant of which is contrary to the purposes of EC provisions*; and (ii) it must be *apparent from a number of objective factors* that the essential aim of the transactions concerned is to obtain a tax advantage (i.e. to attack purely artificial transactions).

In this area, it is clear that different concepts and terminology are used, not to say that often the same concept, translated in various European languages, is not understood in the same way in the different European Member States. Moreover, Member States have developed general and specific anti-avoidance legislation and have begun to scrutinize certain actions thoroughly,

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Member States although it allows such deductibility when those losses were incurred by resident subsidiaries. First, the ECJ considered that a difference in treatment of resident parent companies, according to whether they have losses in a subsidiary abroad or at home, is not admissible and denied the balanced-allocation-of- taxing-rights justifications, holding that it may only be considered with other justifications (para. 41 – this is the *Marks & Spencer* jurisprudence). Second, the ECJ denied the justification to combat tax avoidance, holding that the provision did not have a specific object of attacking artificial arrangements (paras. 50-52); and, thirdly, it also rejected the principle-of-territoriality justification, holding that refusing the advantage to the parent company on the grounds that the profits of its non-residents are not taxable is not acceptable, since taking the losses into account losses would not affect competing tax jurisdictions (para. 69).

89. Para. 58 OY AA.

90. In Kofoed the court required the national court to ascertain whether there was or not a provision or general principle prohibiting abuse of rights or other provisions on tax avoidance. See para. 46 of the ECJ decision of 5 July 2007on Case C – 231/05, *Hans Markus Koefoed v. Skatteministeriat.*

even asking for the disclosure of operations and tax planning situations. All this should make it possible for the ECJ to pay more and more attention to the Member States reactions and the use of their justifications (combat of abuse or tax-avoidance) for violations of EC law[91].

Besides, considering the increasing uncertainty on the appraisal of these aspects, why then to relax the proportionality test?

In *OY AA* (Finland as the host Member State imposed a restriction on the freedom of establishment), the proportionality test did not follow previous more restrictive rulings. The three-step test (appropriateness, necessary, not disproportionate) was invoked instead of reasoned, i.e. the two (Community and national/taxpayers and Member States) interests were not weighed) and the proportionality was not demonstrated.

It would have been possible to restrict the rule or to combat abuse in a different way; unless we consider that the objective pursued was not combating abuses but ensuring that such income generated in Finland was taxed in Finland.

The measure could have restrictive effects for parent companies with losses; such a rule could be linked to a claw-back rule in case the parent company starts making profits; it could also be linked to clauses that would oblige those contributions to be taxed at the same level as they were in Finland. The *M&S* case also allowed an exception to use the foreign losses.

In fact, it is extremely dangerous to allow justifications based on the potential risk of tax avoidance; the ECJ started to refuse these in as early as *avoir fiscal*. In *OY AA* the measure was accepted "even if not specifically designed to counter wholly artificial arrangements"[92], and specifically concluded con-

91. Specific attention should be rendered to the recent communication from the EC Commission to the Council, the E.P. and EESC on the application of anti-abuse measures in the area of direct taxation – within the EU and in relation to third parties; Brussels, *10 December, 2007, COM (2007) 785 final*, as well as to the *Opinions of the Confédération Fiscal Européenne* on abuse and avoidance rules, namely the one on the ECJ Halifax judgment (C – 255/02) of August 2007 and on the concept of Abuse in European Law, based on judgments of the European Court of Justice delivered in the field of tax law on November 2007 (see the CFE site: www.cfe-eutax.org) .

92. As Tom O'Shea remarks, "... it provides another hurdle for taxpayers ..." and "... may give the Member States even more leeway when designing their direct tax systems and when justifying those rules rules ..."; *Tax Notes International*, August 13, 2007, para. 638.

sidering the proportionality of the Finnish legislation "as a whole" (para. 63 *in fine)*[93].

In conclusion, the EC] as well as national courts are confronted with the permanent conflict between taxpayers and states but, above all, with the tension between Community and individual interests.

The use and the appraisal of justifications involves, *per se*, a margin of discretion that may be responsible for more uncertainty and inconsistencies. Courts of last instance should be extremely prudent in the use of their prerogatives under the *acte clair* doctrine. Moreover, in my opinion, for the time being, without a clear "precedent", they should not tolerate national measures that violate EC law even if the justifications invoked by the Member States seem attractive.

6. Final considerations

Portuguese courts, namely the Administrative Central Court (second instance in administrative and tax matters) and the Administrative Supreme Court (last instance in administrative and tax matters) have invoked *CILFIT* and applied the *acte clair* doctrine for some time. In the majority of cases, one is genuinely confronted with a previous precedent and with the *acte éclairé* doctrine. However, in certain circumstances the courts consider the solution too obvious without providing any further explanation, apart from a blunt statement to the effect that there is an: "obvious solution in conformity with EC law". Often the decision does not have a solid base in EC law or EC jurisprudence.

Moreover, in those cases, despite quoting the name *CILFIT* or some of its requirements, the courts do not identify each of them, nor do they expressly explain how the obstacles raised were surmounted. There are even cases where previous ECJ decisions were simply ignored. These latter cases are, of course, exceptions.

On the other hand, national courts have not been confronted with specific requests to consider justifications for discriminations or restrictions, perhaps because the Portuguese state rarely accepts that a specific provision or regime is contrary to EC law.

93. Para. 63 (contrary to *Lankhorst* and *Rewe*, where the Court refused two justifications – allocation of the right to tax and double deduction of losses).

Currently two new aspects are changing to some extent the relationship between the state and some types of taxpayers, increasing their own respective responsibilities. On the one hand, the application of anti-avoidance rules and the combating of so-called abuse is as much a preoccupation in Portugal as it is elsewhere. The severe scrutiny of operations has led not only to the challenging of artificial arrangements but also to the challenging of other structures where the authenticity of commercially valid reasons is debatable. In this context, new disclosure obligation rules to prevent tax planning (which were approved and will apply from 15 May 2008 – Decree-Law No. 29/2008, of 25 February 2008) may also prove to be a disincentive to aggressive tax planning or just serve to increase the application of anti-avoidance measures. On the other hand, new rules were also approved, making clear the cases in which the state may be liable for damages caused to individuals and companies (e.g. by action or omission and by administrative, legislative or judiciary behaviour and decisions) and also setting out the system of indemnities (Law No. 67/2007, of 31 December 2007).

Considering the European trends as well as the recent ECJ jurisprudence on matters related to abusive practices and the liability of the state, particular attention should be paid by all players to the topic of this paper: the courts applying the *acte clair* doctrine. This is particularly the case when the courts take an unjustified decision on the assessment of facts or an illegal decision contrary to EC law and/or jurisprudence, including refusing a preliminary referral or deciding against a previous decision of the ECJ when a clear precedent exists.

Obviously, the fact that these decisions might be taken by the same courts that were liable for a previous decision may blunt their potential force. Moreover, the novelty of this regime and the fact that this liability requires that an evident and substantial mistake has occurred may significantly minimize any effective impact. Nevertheless, overall both the tax authorities, using their powers to combat the so-called aggressive tax planning of taxpayers, or courts ruling on the potential liability of the state, considering wrong omissions or decisions taken by the administrative, legislative or judiciary powers, must decide *cum grano salis*...