

Towards a Homogeneous EC Direct Tax Law

An Assessment of the Member States'
Responses to the ECJ's Case Law

Edited by
Cécile Brokelind



IBFD

Visitors' address:
H.J.E. Wenckebachweg 210
1096 AS Amsterdam
The Netherlands

Postal address:
P.O. Box 20237
1000 HE Amsterdam
The Netherlands

Telephone: 31-20-554 0100
Fax: 31-20-622 8658
www.ibfd.org

© 2007 by the authors

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the written prior permission of the publisher. Applications for permission to reproduce all or part of this publication should be directed to: permissions@ibfd.org.

Disclaimer

This publication has been carefully compiled by the IBFD and/or its author, but no representation is made or warranty given (either express or implied) as to the completeness or accuracy of the information it contains. The IBFD and/or the author are not liable for the information in this publication or any decision or consequence based on the use of it. The IBFD and/or the author will not be liable for any direct or consequential damages arising from the use of the information contained in this publication. However, the IBFD will be liable for damages that are the result of an intentional act (*opzet*) or gross negligence (*grove schuld*) on the IBFD's part. In no event shall the IBFD's total liability exceed the price of the ordered product. The information contained in this publication is not intended to be an advice on any particular matter. No subscriber or other reader should act on the basis of any matter contained in this publication without considering appropriate professional advice.

Where photocopying of parts of this publication is permitted under article 16B of the 1912 Copyright Act jo. the Decree of 20 June 1974, Stb. 351, as amended by the Decree of 23 August 1985, Stb. 471, and article 17 of the 1912 Copyright Act, legally due fees must be paid to Stichting Reprorecht (P.O. Box 882, 1180 AW Amstelveen). Where the use of parts of this publication for the purpose of anthologies, readers and other compilations (article 16 of the 1912 Copyright Act) is concerned, one should address the publisher.

ISBN 978-90-8722-003-7
NUR 826

FOREWORD

The trigger for this project was a conversation between Axel Cordewener, Pasquale Pistone and myself which took place a couple of years ago. We discovered that we had had similar experiences when defending a client in a case involving a fundamental freedom or an EC tax directive, or had often been frustrated by the tax authorities or domestic judges who did not take EC law on direct taxation seriously.

So we joked about how we could investigate the “disgraceful” or “honourable” applications of EC law in our Member States and try to compare them on the basis of common issues.

One of the questions we asked ourselves was how *active* or *reactive* our Member States' institutions had been from the start. The focus was on reviewing past behaviour, not hypothesizing as to how things might evolve in the future, which we felt had been adequately dealt with elsewhere. So the main question we were interested in was: what has been achieved so far?

It didn't take long for us to realize that the issue was not unique to Sweden, Germany and Italy. We had all heard colleagues and friends in other Member States or in EEA states complain about similar issues or reflect on the actual impact of the ECJ's case law on their own tax landscape.

Thus, the idea of a large comparative study was born. I took the initiative of designing a questionnaire for a conference where we would present our experiences/findings. Axel and Pasquale helped me a great deal by introducing me to their international network of contacts and we finally succeeded in collecting a large range of opinions. These were presented on 21 and 22 June 2006 in Lund, Sweden.

This book contains the findings presented at the Lund conference, along with shorter reports and answers to questions involving Member States that were not presented in Lund.

I am very grateful to Axel and Pasquale for their enthusiasm for this project. Without them the book would never have been written. The other participants also demonstrated an impressive level of commitment by presenting a deep analysis of their Member States' direct tax landscape. Special

thanks go to Leif Mutén, whose wonderful speech opened the conference, and to Ana Paula Dourado (Portugal), Georg Kofler (Austria), Georgios Matsos (Greece), Søren Friis Hansen (Denmark), Dennis Weber and Otto Marres (the Netherlands), Kristiina Aima (Finland) and Andreas Bullen (Norway), who attended the conference and provided us all with a rich and personal view of their country's reactions to the ECJ's case law.

Kerstin Malmer and Maria Elena Scoppio, who are both with the EU Commission, contributed the official view on our Member States' attitude towards the ECJ rulings, for which I am also very thankful.

Adam Zalasinski (Poland) and Eric Ginter (France) were kind enough to provide additional material enabling a broader comparison and thereby enriching the study.

This project would never have been carried out without the financial support of the Department of Business Law, School of Economics and Management, Lund University, the Wenner Gren Foundations, and the Skattemytt Foundation. The Nordisk skattevitenskapelig forskningsråd also provided a generous grant for the publication of this book. Thanks also go to the Law Faculty of Lund University for hosting our conference.

During the project, I had the benefit of many people's assistance – not least from those who simply believed in the idea. Claes Norberg and Lars-Gunnar Svensson helped me identify the central questions raised in this research and were always available for discussions; Marc Kanter travelled all over Sweden in search of court cases and provided me with technical support during the conference itself; Magdalena Mathisen took care of our guests and of all the practicalities with aplomb.

Additionally, we are all thankful to Margaret Nettinga for her work correcting our imperfect English!

Last but not least, I would like to give wholehearted thanks to my family and friends for their unconditional support and for generously accepting my prolonged absences during this project.

Thanks to all of you!

Lund, 1 December 2006

Cécile Brokelind

TABLE OF CONTENTS

| | |
|---|----|
| Foreword | v |
| Introduction | 1 |
| <i>Cécile Brokelind</i> | |
| I. The scope of the book | 2 |
| II. Purpose | 2 |
| III. Method | 3 |
| IV. Limitations | 6 |
| V. Structure | 7 |
| VI. About the reporters | 8 |
| VII. Questions for the reporters | 10 |
| A. General questions | 11 |
| B. Questions more specific to tax law | 12 |
| VIII. General overview | 13 |
| A. Too few or too many references for preliminary rulings to the ECJ? | 13 |
| B. Direct, indirect and improper influence | 15 |
| C. Does geography matter? | 17 |
| Appendix 1: Number of ECJ cases in the field of direct taxation (including inheritance taxation but excluding state aid) on 31 October 2006 | 24 |
| Appendix 2: ECJ cases in the field of direct taxation relating to secondary legislation (directives) on 31 October 2006 | 25 |

| PART ONE | |
|---|----|
| GENERAL REFLECTIONS ON THE ROLE OF ECJ RULINGS AND INFRINGEMENT PROCEDURES IN EC LAW | |
| The effects of ECJ rulings on Member States' direct tax law – Introductory speech | 29 |
| <i>Leif Mutén</i> | |
| I. The historical perspective | 29 |
| II. The role of the ECJ | 30 |
| III. The immediate legal consequences of ECJ rulings | 32 |
| IV. The legislative consequences | 34 |
| V. Exit rules | 35 |
| VI. Exemptions for non-residents | 36 |
| VII. CFC rules | 37 |
| VIII. General anti-avoidance rule (GAAR) | 39 |
| IX. Conclusion | 39 |
| The role of infringements | 41 |
| <i>Maria Elena Scoppio</i> | |
| I. Introduction | 41 |
| II. The enforcement actions against Member States in Art. 226 of the EC Treaty – The procedure | 41 |
| III. The financial penalties for Member States who fail to comply with ECJ judgments – Art. 228 of the EC Treaty | 46 |
| A. The procedure | 46 |
| B. Current examples of failures to comply with ECJ judgments by Member States in the field of taxation | 49 |

| IV. Some statistics | 49 |
|--|----|
| A. Total number of detected infringement cases (situation at 31 December 2005) | 50 |
| B. Taxation sector (situation at 31 December 2005) | 50 |
| C. Situation in the field of taxation on 15 November 2006 | 51 |
| V. Communicating infringements | 51 |
| VI. Standard form for complaints to be submitted to the European Commission for failure by a Member State to comply with Community law | 52 |
| PART TWO | |
| A DYNAMIC APPROACH TO THE ECJ'S RULINGS | |
| Austria | 59 |
| <i>Georg W. Kofler</i> | |
| I. Tax sovereignty, EC law and the Austrian constitutional framework | 59 |
| II. Procedural issues of implementing ECJ judgments | 65 |
| III. Substantive influence of the ECJ's case law on Austrian direct tax law | 68 |
| A. Inbound situations | 68 |
| 1. Introduction | 68 |
| 2. Taxation of non-resident individuals | 70 |
| a. Subjective benefits for non-residents: <i>Schumacker</i> and Sec. 1(4) of the EStG | 70 |
| b. Objective benefits for non-residents: <i>Gerritse</i> , <i>Conijn</i> , <i>Scoppio</i> , and the Tax Reform Act 2004 | 74 |
| 3. Taxation of non-resident companies: <i>Avoir Fiscal</i> and <i>Saint-Gobain</i> | 78 |
| B. Outbound situations | 81 |
| 1. Introduction | 81 |
| 2. Taxation of capital income and capital gains: <i>Schmid</i> , <i>Lenz</i> , and the Budget Supplementary Act 2003 | 84 |
| 3. Exit taxation: <i>X and Y</i> , <i>Hughes de Lasteyrie du</i> <i>Saillant</i> , <i>N</i> , and the Tax Reform Act 2004 | 88 |

| | |
|---|-----|
| 4. Utilization of foreign losses | 91 |
| a. "Exempt" losses of foreign permanent establishments and Sec. 2(8) of the EStG | 91 |
| b. Losses of foreign subsidiaries: The Austrian group taxation and <i>Marks & Spencer</i> | 92 |
| 5. The Austrian participation exemption: Sec. 10(1) v. Sec. 10(2) of the KStG | 95 |
| IV. Summary | 99 |
| The Netherlands | 101 |
| <i>Otto Marres</i> | |
| I. Introduction | 101 |
| II. Referral policy | 101 |
| III. Potential incompatibilities with EC law | 104 |
| A. General | 104 |
| B. Personal income tax | 104 |
| 1. Personal allowances | 104 |
| 2. Exit taxes | 106 |
| C. Corporate income tax | 107 |
| 1. Corporate interest deduction | 107 |
| 2. Exit taxes | 109 |
| 3. Fiscal unity/cross-border loss set-off | 110 |
| D. Dividend tax (and credit of foreign withholding tax) | 111 |
| 1. Outbound dividends (dividend withholding tax) | 111 |
| 2. Inbound dividends (credit for foreign tax) | 113 |
| 3. Tax sparing/most-favoured-nation | 115 |
| IV. Legislative changes per 2007 | 115 |

| | |
|--|-----|
| PART THREE | |
| THE ATTITUDE OF TWO ORIGINAL MEMBER STATES TOWARDS THE ECJ'S RULINGS | |
| Germany | 119 |
| <i>Dr Axel Cordewener, LL.M.</i> | |
| I. Introduction | 119 |
| II. EC law and the German legal system: The constitutional framework | 121 |
| A. The general constitutional perspective | 121 |
| 1. Traditional international treaties | 121 |
| 2. EC law as a special case | 123 |
| B. Identifying the (limited) areas of "opposition" by German courts | 126 |
| 1. The fundamental rights debate: <i>Bundesverfassungsgericht</i> versus ECJ? | 127 |
| 2. The "direct effect" issue: <i>Bundesfinanzhof</i> versus ECJ? | 130 |
| C. The constitutional obligation to respect and apply EC law | 131 |
| III. The ECJ's decisions and their influence on the German tax judiciary | 133 |
| A. The structure of the German (tax) judiciary | 133 |
| B. The increasing importance of EC law | 135 |
| 1. Historical development | 135 |
| 2. Current status | 138 |
| C. The treatment of EC law by the different instances today | 140 |
| IV. Reactions on the part of the German legislature and tax administration: Some recent examples | 147 |
| A. The German legislature | 147 |
| B. The German tax administration | 151 |
| V. Conclusions | 155 |

Table of contents

| | |
|---|-----|
| France | 157 |
| <i>Cécile Brokelind</i> | |
| I. Introduction | 157 |
| II. Constitutional framework | 157 |
| III. Influence of ECJ case law on direct taxation | 160 |
| A. General | 160 |
| B. The legislator's responses to ECJ case law | 161 |
| C. The domestic judges' attitude | 163 |
| IV. Conclusion | 167 |
| PART FOUR | |
| THE SCANDINAVIAN APPROACH TO THE ECJ'S RULINGS | |
| Finland | 171 |
| <i>Kristiina Aima</i> | |
| I. General remarks | 171 |
| A. Constitutional framework | 171 |
| B. Procedural aspects | 171 |
| C. Obligation to apply EC law | 172 |
| D. Comparative law traditions | 172 |
| II. A "leave to appeal" for review of appeal cases to Supreme Courts? | 173 |
| A. General | 173 |
| B. Appeals in tax cases | 174 |
| C. Advance rulings | 176 |
| III. Preliminary rulings in the Finnish court system | 176 |
| IV. The notion of <i>acte clair</i> and the CILFIT doctrine | 178 |
| V. The attitude of the state authorities toward EC tax law | 179 |
| A. Judicial authorities | 179 |
| B. Legislator | 179 |

Table of contents

| | |
|---|-----|
| C. Tax administration | 182 |
| D. State liability in tax cases | 184 |
| E. Record of the courts | 185 |
| F. Practice with regard to indirect taxes | 185 |
| G. Practice with regard to direct taxes | 188 |
| H. The impact of "neighbouring" tax law on the legislator | 188 |
| I. Dividend taxation | 189 |
| J. Interaction between IFRS and taxation | 190 |
| K. Group taxation | 191 |
| L. Group relief or group contribution? | 192 |
| M. Transfer pricing | 195 |
| N. Do tax judges take the ECJ's case law into account before the legislator does? | 196 |
| O. The level of knowledge of EC tax law | 197 |
| P. The tax treatment of non-resident taxpayers | 198 |
| VI. Further areas of potential conflict | 201 |
| A. In general | 201 |
| B. Capital duty | 201 |
| C. Luxembourg SICAVs | 203 |
| D. New securities | 205 |
| E. Valuation of assets | 205 |
| VII. Primary Community law | 205 |
| A. In general | 205 |
| B. Expatriate expenses | 206 |
| C. Household deduction | 207 |
| D. Exemption on capital gains tax | 207 |
| E. Exit taxes | 208 |
| F. Transfer of habitual abode | 209 |
| G. Capital gains tax | 210 |
| H. Transfer of a real seat | 210 |
| 1. Companies | 210 |
| 2. A foreign company's PE | 211 |
| 3. SE and SCE | 211 |
| I. CFC rules | 212 |
| J. Dividend taxation | 213 |
| K. Exempt dividend income | 213 |
| L. Valuation of foreign shares | 214 |
| M. Method for elimination of double taxation | 214 |
| N. Reverse discrimination | 215 |

| | |
|--|------------|
| VIII. Conclusion | 216 |
| A. General court practice | 216 |
| B. Preliminary rulings | 217 |
| C. The other state authorities' approach | 218 |
| D. Future scenarios on the enforcement of EC tax law | 219 |
| | |
| Sweden | 223 |
| <i>Cécile Brokelind and Marc Kanter</i> | |
| I. Introduction | 223 |
| A. Purpose | 223 |
| B. Method | 223 |
| C. Eleven years of EU membership | 225 |
| D. The Swedish courts involved in tax matters | 226 |
| 1. Courts and tribunals | 226 |
| 2. Swedish Board for Advance Rulings | 227 |
| II. General comments on the effects of EC law on Swedish tax law | 229 |
| A. Constitutional framework for recognition of the supremacy of EC law over Swedish law | 229 |
| B. Procedural changes in order to implement Art. 234 of the EC Treaty | 230 |
| C. The duty for courts to apply EC law of their own motion | 231 |
| D. Reference to notable foreign case law in copy-cat cases | 232 |
| E. The leave to appeal to the Supreme Administrative Court and the effective application of EC law | 232 |
| F. Too few cases referred to the ECJ? | 233 |
| G. A peculiar way to understand ECJ case law: Some examples | 234 |
| H. The <i>acte clair</i> doctrine in Swedish tax case law | 236 |
| III. Domestic tax case law | 238 |
| A. Income tax cases dealt with by Swedish courts | 238 |
| 1. A small number of cases | 238 |
| 2. Areas of income tax law at issue in Swedish cases | 240 |
| 3. Some examples of potential challenges of internal Swedish law provisions | 252 |
| B. Some examples of state liability in tax cases | 253 |
| C. Teaching tax judges | 255 |

| | |
|--|------------|
| D. Challenging internal source taxation rules | 255 |
| IV. Conclusion | 257 |
| | |
| Norway | 261 |
| <i>Andreas Bullen</i> | |
| I. Legal background | 261 |
| A. The European Economic Area and its fundamental freedoms | 261 |
| B. Competent courts and administrative bodies in tax matters | 262 |
| II. General questions | 263 |
| A. Changes in the national constitution to recognize supremacy of EEA law over domestic law | 263 |
| B. Changes in domestic procedural rules in order to adapt to Art. 234 of the EC Treaty (Art. 34 SCA) | 264 |
| C. Duty for domestic judges to apply EEA law on their own motion | 265 |
| D. Domestic judges' reference to and use of arguments from foreign case law | 266 |
| E. Leave-to-appeal requirements for appeals to the Supreme Court | 271 |
| F. Whether the EEA authorities have criticized Norway for Norwegian courts referring too few cases to the EFTA Court | 272 |
| G. Whether Norwegian judges have exhibited a "peculiar" approach to the reading of ECJ/EFTA Court case law | 275 |
| H. <i>Acte clair</i> and the CILFIT doctrine | 278 |
| III. Questions more specific to tax law | 279 |
| A. Norwegian tax judges' attitude towards EEA law in general | 279 |
| 1. The attitude of the courts | 279 |
| 2. The attitude of the administrative tax authorities | 284 |
| B. State liability in tax cases | 289 |
| C. Comparison of Norwegian judges' attitude towards EEA law in direct tax and indirect tax cases | 291 |
| D. The Norwegian tax legislator's attitude towards the case law of the ECJ and the EFTA Court | 293 |

| | |
|---|-----|
| E. Whether Norwegian tax judges consider pending cases before the ECJ/EFTA Court | 299 |
| F. Level of knowledge about EC/EEA tax law among domestic judges and tax authorities | 302 |
| G. Amendments of domestic and bilateral tax provisions initiated by the case law of the ECJ/EFTA Court; reflections on trends in the case law of the Courts | 304 |
| Denmark | 309 |
| <i>Søren Friis Hansen and Jeppe Rune Stokholm</i> | |
| I. Introduction | 309 |
| A. The <i>Vestergaard</i> case as a breakthrough | 309 |
| B. The Danish debate on the effect of Community law | 310 |
| C. Indirect taxes | 311 |
| II. Overview of Danish cases | 312 |
| A. Preliminary rulings from Denmark | 312 |
| B. Pending Danish cases | 314 |
| III. General questions | 314 |
| IV. The practical use of Community law in Danish tax law | 316 |
| A. The Danish court system and Community law | 316 |
| B. The Danish government and ECJ case law on direct taxation | 318 |
| C. State liability and procedural remedies | 320 |
| V. Final remarks | 322 |

PART FIVE

THE MEDITERRANEAN APPROACH TO THE ECJ'S RULINGS

| | |
|----------------------------------|-----|
| Italy | 325 |
| <i>Prof. Dr Pasquale Pistone</i> | |
| I. Introduction | 325 |

| | |
|---|-----|
| II. Categorizing the type of influence ECJ decisions have on direct taxes in the European Union | 326 |
| A. Direct influence | 326 |
| B. Indirect influence | 327 |
| C. Improper influence | 329 |
| III. The influence of ECJ decisions on Italian tax law | 330 |
| A. The effects of ECJ rulings on Italian tax courts | 331 |
| B. The missing influence of the rulings of the ECJ on Italian direct taxes | 332 |
| 1. Issues of compatibility concerning the 2004 Tax Reform Act | 332 |
| 2. Issues of compatibility not addressed by the 2004 Tax Reform Act | 336 |
| Portugal | 341 |
| <i>Prof. Dr Ana Paula Dourado</i> | |
| I. Introduction | 341 |
| A. The principle of primacy of EC Law | 341 |
| B. Cooperation between national tax courts and the ECJ | 343 |
| II. The influence of the ECJ decisions on Portuguese tax law | 346 |
| A. The eighties and nineties – a general attitude of indifference | 346 |
| B. The new century – a diligent domestic legislator | 350 |
| C. The <i>Denkavit</i> decision and the various relevant conditions for qualifying as a subsidiary or as parent company | 351 |
| D. Taxation of pension funds | 352 |
| E. Double economic taxation of dividends paid to individuals | 354 |
| F. Thin capitalization | 355 |
| G. Exit taxes | 355 |
| H. Withholding taxes | 355 |
| III. Conclusions | 356 |

| | |
|---|-----|
| Greece | 357 |
| <i>Dr Georgios Matsos, LL.M.</i> | |
| I. EC law and Greek law | 357 |
| A. Introduction | 357 |
| B. The general approach of Greek courts to EC law | 359 |
| C. Two controversial examples of Greek jurisprudence on EC law | 361 |
| 1. The judgment on Greek secondary establishments of foreign universities | 361 |
| 2. The judgment on the public procurement ban for media enterprises | 362 |
| II. Tax law and EC law in Greece | 364 |
| A. Particularities of Greek tax law | 364 |
| B. The Greek approach to EC tax law | 367 |
| C. Implementation of ECJ decisions in Greek tax law | 369 |
| D. State liability in EC tax matters | 371 |
| III. The Greek jurisprudence on EC tax law matters | 372 |
| A. Jurisdiction on tax matters | 372 |
| B. Frequency and quality of referrals to the ECJ | 373 |
| C. Examples from Greek case law | 375 |
| 1. The judgment on the regularizing tax: A political judgment | 376 |
| 2. The bananas judgment: An example of procedural impediments | 377 |
| 3. An interesting judgment on mergers | 378 |
| IV. Conclusion | 380 |

PART SIX

NEW MEMBER STATES' APPROACH TO THE ECJ'S RULINGS:
THE EXAMPLE OF POLAND

| | |
|---------------------------|-----|
| Poland | 383 |
| <i>Dr Adam Zalasiński</i> | |
| I. Introduction | 383 |

| | |
|---|-----|
| II. Polish constitutional framework concerning the EU law's effectiveness in the Polish legal order | 384 |
| III. The Polish system of remedies applicable in the case of taxation in violation of EC tax law | 387 |
| A. Legal framework | 387 |
| B. Attitude of the Polish judiciary | 389 |
| IV. Fields of possible conflicts between the internal market requirements (as interpreted by the ECJ) and Polish direct tax law | 393 |
| V. Attitude of the lawmaker | 398 |
| VI. Conclusions | 400 |
| Setting out the contours of future research | 401 |
| <i>Cécile Brokelind</i> | |
| Table of cases | 407 |

PORTUGAL

Prof. Dr Ana Paula Dourado

I. Introduction**A. The principle of primacy of EC Law**

Art. 8 of the Portuguese Constitution of 1976, in its original version, provided that rules and principles of international law were part of the Portuguese legal system (Art. 8 Para. 1). Rules of tax treaties regularly ratified or approved entered in force in the domestic legal system after being published in the official journal and as long as they bound internationally the Portuguese State (Art. 8 Para. 2).

In 1982, the Constitution was amended in order to adapt the Portuguese constitutional and infra-constitutional system to the EEC (Portugal became a Member State in 1986). A Para. 3 was added to Art. 8, providing that rules enacted by competent organs of international organizations of which Portugal is a member, are directly in force in the domestic legal system, in case the founding treaties expressly mention it. In 1989 the last part of Para. 3 was amended and the word “expressly” was eliminated. As has been remarked in the Portuguese tax literature, Art. 8, Para. 3 of the Constitution seemed to refer to direct applicability, but even if it recognized primacy, it would only refer to secondary Community law, taking into account the fact that EC Treaty law was mentioned under Art. 8, Para. 2.¹

No explicit reference was therefore made to the principle of supremacy. European Community law was treated as international law: as according to Art. 8, Paras. 1 and 2 of the Constitution, infra-constitutional domestic law may not override any treaty rules that are in force in the domestic legal system – which means that infra-constitutional rules are not valid if they override EC law or any other treaty rules – supremacy of EC law was recognized in respect of infra-constitutional domestic law.

In 1993 Art. 7 (International Relations) was amended and a Para. 6 was introduced. It reads that Portugal may agree on a reciprocal basis, according to the principle of subsidiarity and economic and social cohesion, on the

1. Fausto de Quadros, *Direito da União Europeia*, Coimbra (2004), at 411.

common exercise of the necessary powers for the construction of the European Union. The last part of Para. 6 seems to have been inspired by the French Constitution (as amended in 1992). It was, however, criticized by the Portuguese literature, as it neither mentions an authorization regarding the transfer of sovereign powers to the European Union, nor a clause of limitation of state sovereign powers.²

On the basis of the above-mentioned provisions, it was the prevailing view that the primacy of EC law did not cover the Portuguese Constitution. This understanding was based on the competence of the Constitutional Court to verify the constitutionality of any rule in force within the Portuguese legal system. Domestic rules, treaty rules (including the EC Treaty or primary rules), and EC secondary rules were subject to the test of their compatibility with the Portuguese Constitution. However, the Constitutional Court has not expressly mentioned its view on the principle of primacy.

Against the prevailing view, some authors are of the opinion the Constitutional Court has implicitly recognized the primacy of EC law over constitutional law (and therefore over all Portuguese internal law) in a case (decision No. 184/89), where it did not judge unconstitutional a domestic administrative regulation directly founded on an EC Regulation, although, according to the Constitution, the subject should be exclusively dealt with by law.³

I even consider that the several amendments to the Portuguese Constitution, in order to adapt it to the Maastricht, Amsterdam and Nice Treaties mean the recognition of the primacy of the EC Law in relation to the constitutional law: simultaneous “developing constitutional proceedings” (at the Community level and at the state level) probably mean the primacy of EC Law.⁴ In any case, by 2004, the Portuguese Constitution had not been amended to recognize supremacy of EC law over domestic law.

In 2004 the Portuguese Constitution was amended again (Constitutional Law 2004/1, July 24), in order to bring it in conformity with the draft of the European Constitution. According to Art. 8, Para. 4 of the Portuguese Constitution now in force, “the rules of the EU Treaties and the rules enacted by the EU institutions in the exercise of their competence are applic-

2. Fausto de Quadros, cit., at 410 ff.

3. Fausto de Quadros, cit., at 415-416; Paulo Otero, *Legalidade e Administração Pública*, Coimbra (2003), at 743-744.

4. Gomes Canotilho, *Direito Constitucional*, 7.a ed., Coimbra (2003), at 826-827; Fausto de Quadros, cit., at 408.

able in Portugal, as defined by the EU law, as long as they are compatible with the fundamental principles of the democratic state governed by the rule of law” [author’s translation].

Art. 7, Para. 6 was also amended and now reads as follows: “Portugal may, in reciprocal conditions, in respect of the principles of the Rule of Law in a democratic State and the principle of subsidiarity, and taking into account realization of economic, social and territorial cohesion, and a space of liberty, security and justice, as well as the definition and implementation of an external policy, common security and defence, agree on a common exercise, in cooperation with or by the institutions of the European Union, the necessary powers to the construction and deepening of the European Union” [author’s translation].

Even if Arts. 7 and 8 could or should have been drafted in a clearer way, by means of a general clause accepting the limitation of state sovereign powers – and the scope of Art. 8 should not be limited to “rules”⁵ –, it is now difficult to deny that Art. 8 expressly recognizes supremacy of EC law over domestic law, including the Portuguese Constitution, as long as fundamental principles of a democratic state governed by the rule of law are observed.⁶ The Administrative Supreme Court (ASC) has already recognized the supremacy of EC law over constitutional law (“the principle of supremacy is a structural EC law principle”), referring to the new version of Art. 8 of the Constitution.⁷

Besides, incompatibility of an infra-constitutional domestic rule with an EC rule is now itself unconstitutional and therefore subject to the examination of the Constitutional Court. Direct effect of EC rules is also now expressly recognized by Art. 8, Para. 4 of the Portuguese Constitution.⁸

B. Cooperation between national tax courts and the ECJ

If there has been a diligent attitude in adapting the Constitution to some of the principles of EC law, namely the direct effect and primacy, procedural rules have not been adapted to Art. 234 of the EC Treaty. The Portuguese

5. See the criticism in Fausto De Quadros, cit., at 417.

6. Miguel Gorjão-Henriques, *Direito Comunitário*, 3.a ed., Coimbra (2005), at 243-244.

7. Administrative Supreme Court, 2nd Chamber, No. 1871/03, 16 March 2005.

8. Miguel Gorjão-Henriques, *Direito Comunitário*, cit., at 244.

Constitution has several provisions on the control of constitutionality of domestic rules, but no reference is made to cooperation between domestic courts and the ECJ.

I may say that an express reference to such cooperation was not felt necessary as there is no controversy relating the direct effect of Art. 234 EC Treaty. Nevertheless, domestic judges' scarce use of Art. 234, and even its misinterpretation, does not follow the recognition of its direct effect. There have been several claims to the Administrative Supreme Court (its 2nd Chamber has competence on tax matters) – 185 on the website (www.dgsi.pt) – and to the Supreme Court of Justice (which is competent for civil and criminal cases) – 12 on the same website – which required an ECJ judgment under Art. 234 of the EC Treaty, but only a few of them have reached the ECJ.

It is worth mentioning that the second chamber of the ASC often mentions that domestic rules are being interpreted in the light of ECJ doctrine. For example, several decisions of the ASC still related to the *Modelo SGPS* case⁹ make reference to the ECJ doctrine regarding Art. 234 of the EC Treaty. After the above-mentioned ECJ decision, taxpayers subsequently requested the reimbursement of charges collected for drawing up acts attested by notary, regarding an increase in share capital or a change in a company's name or registered office (as these charges were considered prohibited under the Council Directive 69/335/EEC of 17 July 1969, as amended by Directive 85/303/EEC, 10 June 1985). The domestic procedural rules do not provide for an automatic reimbursement in these cases. However, taxpayers and courts do not agree on the right procedure (and respective deadlines) for the above-mentioned request.

The Administrative Supreme Court held that, as EC law does not provide a deadline for requesting the reimbursement, the domestic law deadlines are applicable: four years when the claim is directed to the tax administration,¹⁰ plus 90 days to claim to tax courts, when the object of the administrative claim is not achieved; or 90 days when the taxpayer opts for claim-

9. ECJ C-56/98, 29 September 1999. In this case, the ECJ clarified that "indirect taxes on the raising of capital, as aimed by the Council Directive 85/303/EEC of 10 June 1985, must be interpreted as meaning that charges constitute charges for the purposes of the directive where they are collected for drawing up notarially attested acts recording a transaction covered by the Directive, under a system where notaries are employed by the State and the charges in question are paid in part to that State for the financing of its official business".

10. Cf. Art. 94, 1, b), Tax Procedure Code; Art. 78, 1 and 6, General Tax Law.

ing directly to court. Other kinds of procedure (such as administrative claim for recognition of a right) are refused by the ASC.

According to the ASC, the above-mentioned deadlines respect the guidelines drawn by the ECJ, namely: (1) the deadlines apply in the same way to actions for repayment, which are based on Community law and to those based on domestic law and (2) the conditions do not make it impossible or extremely difficult to exercise the right to repayment. The same is true, according to the Administrative Supreme Court, when the taxpayer directly appeals to tax courts, instead of asking the administration, in a first step, for reimbursement. Even if the *acte clair* doctrine was correctly interpreted in the case just mentioned, it is frequently misunderstood.

The ASC often mentions the *acte clair* doctrine by using the following expression: "the ASC should not refer to the ECJ under Art. 234 of the EC Treaty, when the ECJ jurisprudence is stable and uniform on a certain aspect of EC Law" [author's translation]. Moreover, the ASC often mentions that "entire identity of subject is not necessary" in order to avoid referring to the ECJ.¹¹ Instead of searching for a positive formulation (when should the ASC refer to the ECJ under Art. 234 of the EC Treaty), the Administrative Supreme Court interpretation of the *acte clair* is mainly aimed at defining its limits, and, in this way, it subverts a main objective of Art. 234 of the EC Treaty and of the above-mentioned doctrine: the uniform interpretation of EC law.

Serious problems have recently arisen in the opposite direction, regarding interpretation of VAT rules: A few cases have been referred to the ECJ,¹² and in one of them the ECJ considered that some of the issues raised were already clear under its doctrine (for example, the meaning of "activities or operations exercised in the quality of public authorities", Art. 4, No. 5 Para. 1 of the Sixth VAT Directive; and of "meaningful activities" under Para. 3, No. 5 of the same article¹³); in another one the ECJ rejected the

11. Cf. among others, Administrative Supreme Court, 2nd Chamber, cases: No. 1871/03, 16 March 2005; No. 899/02, 23 October; No. 26233/01, 12 December 2001; 40051/03, 8 May; 1331/03, 17 March 2004. The following ECJ cases are cited by the ASC: case 68/79, 27 February 1980; case 826/79, 10 July 1980; case C-90/94, 17 July 1997; case C-228/96, 17 November 1998; case C-343/96, 9 February 1999; case C-225/2000, 24 September 2002.

12. See, ECJ cases: C-446/98, 14 December 2000; C-77/01, 29 April 2004; C-536/03, 26 May 2005.

13. C-446/98, 14 December 2000, §§ 15 ff., 25 ff.

case as it did not contain enough elements for a useful answer under Art. 234.¹⁴

All in all, on income tax issues, the ASC sent only one case to the ECJ under Art. 234 of the EC Treaty: the *Epson* case (ECJ C-375/98, 8 June 2000), which regarded the interpretation of Art. 5, Para. 4, of the EEC Directive 90/435 (it was asked whether the Directive only covered the Portuguese corporate income tax or any other withholding tax, independently of its nature or name). This means that the Administrative Supreme Court has not made a contribution in referring cases to the ECJ concerning the most unclear question in income tax matters: the interpretation of the fundamental freedoms in the EC Treaty and their meaning and scope regarding domestic income tax legislation and bilateral tax treaties.

II. The influence of the ECJ decisions on Portuguese tax law

A The eighties and nineties – a general attitude of indifference

In 1997, I wrote that “the impact of the Community law non-discrimination principle on Portuguese tax law was practically non-existent. In fact, if I searched for recent changes that had been made to domestic tax law, I would not find any connection with the referred principle, but mainly with objectives of budgetary policy, like taxing imported investment as much as possible and tax avoidance clauses. Alterations related to EC law had only been a result of harmonising directives”.¹⁵

At the time, I was able to find several provisions that were or might be incompatible with decisions of the ECJ or the EC Treaty. They regarded some of the aspects mentioned in the following paragraphs.¹⁶

One of them concerned economic double taxation. Taxation of permanent establishments of companies resident in another Member State did not re-

14. C-536/03, 26 May 2005, §§ 15 ff.; the same had happened in C-154/01, JO C289, 8.

15. Ana Paula Dourado, “Impact of non-discrimination principle on Portuguese income tax law”, *EC Tax Review* 1 (1997), at 10.

16. They are a summary of what I wrote in “Impact of non-discrimination principle...”, cit., at 11-18.

spect the *Avoir Fiscal* decision¹⁷ – i.e. the branches and agencies situated in Portugal of companies whose registered office was in another Member State were not granted the benefits of shareholders’ tax credits in respect of dividends paid to such branches or agencies by Portuguese companies. In contrast, resident companies in their quality of shareholders were granted tax credits for dividends paid by Portuguese companies.. I may add that corporate income tax code remained fully incompatible with the subsequent *Saint-Gobain* decision¹⁸ until the Parent-subsidiary Directive was amended and transposed to the domestic legislation.¹⁹ Two other issues can be raised. The obvious one is whether the *Saint-Gobain* judgment does not go further than the new version of the Parent-Subsidiary Directive, when EC nationals are subject to economic double taxation of dividends. The difficult one is whether triangular situations involving a company resident in a third state R, with a portfolio investment in a company of a Member State S effectively connected to a PE situated in another Member State PE is covered by the *Saint-Gobain* case and ultimately by Art. 56 of the EC Treaty.²⁰

The regime of group taxation also leads me to doubt, as it was designed for associated companies with their office or effective management in the Portuguese territory. The later *ICI* decision²¹ and the recent *Marks & Spencer* decision²² seem to confirm those worries.

Another group of provisions that caught my attention at the time were the CFC clauses. Like that in most of the other OECD states, the Portuguese tax legislation contains CFC clauses, which provide for an exception to the rule that a Portuguese resident company is not taxed on the profits made by a subsidiary established abroad as they arise. The legislation was designed to apply when the non-resident subsidiary is subject to a “clearly more favourable tax regime”, as defined in the same tax code, when the shareholder has a relevant participation, also defined in the code, and when a number of other conditions are met.

Moreover, in the case of payments to resident entities in countries with a “privileged tax regime”, deductions are allowed if the taxpayer proves that

17. ECJ case 270/83, 28 January 1986.

18. ECJ case C-307/97, 29 April 1999.

19. Law No. 55-B/2004, 30 December 2004.

20. See, giving this triangular example, Pasquale Pistone, “The Impact of European Law on the relations with Third Countries in the field of direct taxation”, *Intertax* 5 (2006), at 235.

21. ECJ case C-264/96, 16 July 1998.

22. ECJ case C-446/03, 13 December 2005.

those payments corresponded to "genuine operations carried out" and that they did not have an "abnormal character" or "the amount was not excessive". Such a regime was introduced in the beginning of the nineties, it is still in force, and taking into account the *Cadbury Schweppes* decision,²³ the issue is whether the criteria are proportionate to the anti-abuse aim of the CFC clause (i.e. if it only applies to "wholly artificial arrangements intended to circumvent national law"), and therefore adequate to justify the restriction of a fundamental freedom.

Restrictions to the transfer of income obtained within the Portuguese territory by non-residents were (and still are) also part of the corporate income tax code: non-resident entities, including permanent establishments of non-resident companies, subject to corporate income tax could not transfer income unless payment of tax due is proved or its future payment assured. The compatibility of this regime with the free movement of capital seems to have been answered by the *Bordessa*²⁴ and the *Sanz de Lera* decisions,²⁵ as these concerned national conditions for the export of money from a Member State and the ECJ considered that a claim on declaration was not incompatible with EC law. In any case, the issue falls under the free movement of capital as this covers all types of cross-border transfers of assets – it is clear from the examples given in Directive 88/361/EEC that movement of capital is to be interpreted in a very broad sense, covering portfolio investments across states and different types of direct investment and establishment, including transfers related to insurance contracts, establishment of branches and subsidiaries.²⁶

An issue that so far has not been considered by the ECJ as falling under its concept of discrimination of non-residents and/or restriction of fundamental freedoms is the definition of the rules on the allocation of rights. But although it is settled case law that in the absence of EC-harmonized regimes those rules are under the competence of the Member States, it is also settled that such competence must be exercised in compliance with Community law, i.e. also in compliance with the provisions on free move-

23. ECJ case C-196/04, 12 September 2005.

24. Joined cases C-358/93 and C-416/93, 1995 ECR I-361.

25. Joined cases C-163/94, C-165/94 and C-250/94, 1995, ECR I-4821.

26. Kristina Stahl, "Free Movement of Capital between Member States and third countries", *EC Tax Review* (2004), at 48; Wolfgang Schön, "Der Kapitalverkehr mit Drittstaaten und das internationale Steuerrecht", *Körperschaftsteuer, Internationales Steuerrecht, Doppelbesteuerung, FS für Franz Wassermeyer zum 65. Geburtstag*, Hrsg. Gocke, Gosch, Lang (München, 2005), at 489 ff.

ment.²⁷ Besides, the second sentence of Para. 30 of the *Gilly* case reads that "[i]t flows, in the absence of any unifying or harmonising measures adopted in the Community context under, in particular, the second indent of Article 220 of the Treaty, from the contracting parties' competence to define the criteria for allocating their powers of taxation as between themselves, with a view of eliminating double taxation".

My question is whether a too broad a definition of source (taxation of non-resident companies with no permanent establishment in Portugal) in domestic law, which obviously has no aim of eliminating double taxation, is not contrary to the fundamental freedoms. The same doubts occur to me, regarding too broad a concept of residence (persons belonging to the household were always treated as residents if any one of the persons resided in Portugal, and this restricted the free movement of persons). An answer to these questions would require a development of the meaning and scope of the fundamental freedoms, in a direction that has not yet been followed by the ECJ, and that is not under the object of this chapter.

Three other regimes that seemed to me incompatible with the EC law may still be mentioned: one regards the deduction of pension or insurance contributions, which has been changed following the Commission's action. Deductions were subject to the condition that the beneficiary entities were resident or had a permanent establishment in Portugal. The *Bachmann* case²⁸ had already been decided, but *Jessica Safir*,²⁹ *Danner*³⁰ and *Skandia*³¹ came later on. The second one concerns deductions from global income and non-residents in a situation similar to that of residents. Non-residents have so far not been treated as residents in situations similar to the *Schumacker* and *Wielockx* decisions, and independently of the nature of deductions – taxpayer-related deductions or income-related deductions (which may constitute tax benefits). The third one has to do with withholding taxes. Non-residents were not allowed to be taxed on their net income, as they are subject to a final withholding tax (at flat rates) generally applic-

27. *Gilly*, C-336/96, 12 May 1998, § 30; *Schumacker*, C-279/93, 14 February 1995; *Wielockx*, C-80/94, 11 August 1995; *Royal Bank of Scotland*, C-311/97, 29 April 1999; *Verkooijen*, C-35/98, 6 June 2000; *Weidert/Paulus*, C-242/03, 15 July 2004; *Manninen*, C-319/02, 7 September 2004; *Laboratoires Fournier*, C-39/04, 10 March 2005; *Bouanich*, C-265/04, 19 January 2006.

28. C-204/90, 28 January 1992.

29. C-118/96, 28 April 1998.

30. C-136/00, 3 October 2002.

31. C-422/01, 26 June 2003.

able on gross income, which may be contrary to the holding in the *Gerritse* case.³²

Despite this long list of provisions, the compatibility of which with EC law seemed doubtful to me (even if some of them might be justified), both legislator and taxpayers seemed to be indifferent to the ECJ judgments on non-discrimination and free movement and their influence on the domestic tax regime. It is also true that, in most of the cases, there was still no ECJ case law on the subject and the Commission was neither writing Communications nor sending formal requests (reasoned opinions) for the amending of legislation.

B. The new century – a diligent domestic legislator

Since the beginning of this century, tax authorities and lawmakers (government and parliament) have been regularly amending domestic tax law in order to keep it compatible with the ECJ jurisprudence. The tax authorities are normally involved in the law-making process, as they suggest amendments to tax legislation and the government has competence to present proposals of decree-laws and ask for authorization for enacting decree-laws in tax matters (Art. 197, Para. 1d), Art. 165, Paras. 1i) and 2 of the Constitution). The government has also exclusive competence to propose the State Budget (Art. 161g) of the Constitution), which, contrary to what happens in other Member States (e.g. Germany, Italy, Spain) may contain tax provisions (Art. 165, Para. 5 of the Constitution) and is in fact annually used to amend tax codes. I may say that tax authorities, government and parliament are at the moment more sensitive to the effects of the ECJ decisions – and indirectly to the meaning and scope of the *acte clair* doctrine – than tax courts, probably because the European Commission has been very active in sending communications and reasoned opinions. In spite of paying attention to the ECJ case law, the Portuguese legislator may not yet be considered a perfect model, as the Commission/Portugal case³³ on the exemption of capital gains accruing from home sales, exemplifies.

If I look at the tax codes' amendments targeted at adapting domestic law to ECJ decisions, I may again list a number of them, along with some others

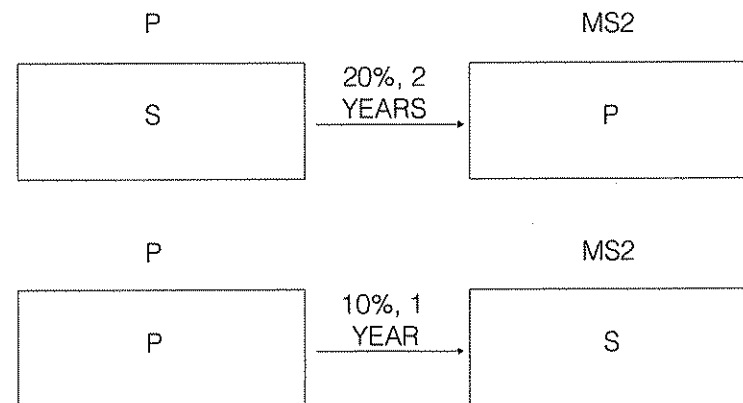
32. C-234/01, 12 June 2003.

33. C-345/05 of 26 October 2006.

that raise doubts of compatibility with ECJ decisions.³⁴ Among other possibilities, I have chosen the examples mentioned below to comment on in brief.

C. The *Denkavit* decision and the various relevant conditions for qualifying as a subsidiary or as parent company

Let me begin with one example illustrating the efforts to comply with ECJ case law. In order to comply with the *Denkavit* decision, the Portuguese law was (recently) amended. Tax on dividends paid by subsidiaries resident in Portugal is withheld if the relevant participation (15% in the budget law for 2007 and 20% since 2005, as the Parent-Subsidiary Directive requires) of a parent company or a permanent establishment in a Member State (MS 2) is not kept for a period of two consecutive years before distribution of profits; but if the two-year period is achieved after the payment of the profits, the tax withheld may be reimbursed within two years, since the relevant conditions are met and proved (Art. 89 of the Corporate Income Tax Code (CITC) vs. Art. 1 Paras. 3 ff. CITC). On the other hand, when the parent company is resident in Portugal, and qualifies under the Parent-Subsidiary Directive (I wonder, however, whether the doctrine of the *Saint-Gobain* decision is completely achieved), a credit will be given to eliminate economic double taxation if the participation is held for a period of one year and the participation reaches 10%.



34. See many of the below mentioned regimes, reported by Ricardo Borges/Pedro Sousa, "Portugal, Legislation", *EC Tax Review* 2 (2006), at 125 ff.

The difference in the minimum period of participation means that if MS 2 demands a two-year period, it will withhold tax on dividends distributed before the two years have been reached, and Portugal will give a credit under the directive, which is no different from giving a credit to payment of dividends under a double tax convention (DTC).

The 10% participation requirement also leads to equivalent results as the ones that would have been achieved under a DTC, if MS 2 requires a participation of 20%. But in case MS 2 requires a participation of 10% and a minimum of one year for a subsidiary qualifying for the Directive, Portuguese parent companies have benefited from a more favourable regime than Portuguese subsidiaries of parent companies (and PEs) of another Member State.

This regime is not discriminatory, as resident subsidiaries of resident parent companies are treated equally, but it illustrates that in the absence of a (more) complete tax harmonization, the domestic legislator has a large margin of discretion to provoke non-neutral consequences.

In relation to resident companies, whose participation is held for less than one year or which does not reach 10%, only 50% of paid dividends are included in the taxable base and are taxed, provided that the company paying the dividends is resident in the Portuguese territory, is subject to corporate tax and not exempt. From this resulted a discriminatory tax treatment of EC-based companies non-resident in Portugal, paying dividends to a company resident in Portugal, but this provision has been amended in the budget law for 2007 and will include the entities covered by the Parent-Subsidiary Directive.

D. Taxation of pension funds

In 2001 the Commission identified the elimination of tax obstacles to the cross-border provision of occupational pensions as a priority and presented a legal analysis of the problem regarding non-personal income tax deduction for pension contributions paid by workers resident in a Member State to their (foreign) original scheme (as they were resident in another Member State and nationals of a Member State) (Communication of 19 April 2001).³⁵

35. European Commission, IP/03/1756, Brussels, 17 December 2003, at 1.

Until 2005 pension contributions paid to foreign funds were not deductible while contributions to domestic funds were. Domestic law accepted the deduction of contributions to pension funds, as long as they had been constituted and governed by domestic funds, according to the relevant domestic legislation.³⁶ Entities subject to corporate income tax could deduct as costs, up to a certain limit (15% or 25%), amounts paid to pension funds or the equivalent, as long as, among other conditions, the contracts had been concluded with companies resident or with a permanent establishment in Portugal and the pension funds had been constituted according to the Portuguese legislation.³⁷

This preferential treatment for domestic pension funds was incompatible with the free movement of workers, services and capital in the EC Treaty, as resulted from *Wielockx*, *Jessica Safir*, *Danner* and *Skandia*.³⁸ On the one hand, these cases seemed to indicate (and this was the interpretation of the Commission) that different rules regarding domestic and foreign funds were no longer defensible according to a coherence argument as argued in the *Bachmann* case. Besides, the efficacy of the pension fund Directive 2003/11, providing for centralization of occupational pensions arrangements into one scheme for all employees within the European Union, was restricted by the tax regime, as the Commission argued in the above-mentioned Communication.

Although, according to Portugal, the domestic regime just described created a link between tax deductibility of contributions and taxation of pensions in the case of Portuguese pension funds, and between the non-tax deductibility of contributions and the non-taxation of pensions in the case of foreign pension funds similar to the one argued in the *Bachmann* case, such a link did not seem to exist in the Portuguese legislation.

In fact, the Belgium legislation did not tax pension income, rents, or any capital upon sale, refund or redemption amount, paid within contracts previously subscribed (in foreign funds) (Paras. 10, 21 and 22 of the ECJ decision, 28 January 1992, C-204/90), – i.e. the amounts were exempt from Belgium tax whenever there was no deduction in Belgium. The Portuguese income tax code, in contrast, taxed that income independently of the residence of the funds (Art. 2, Para. 3b)3) Personal Income Tax Code (PITC))

36. Art. 25, 3 PITC (2001).

37. Art. 40, 4f) CITC (2001).

38. C-422/02, 26 June 2003.

– although, in practice, it may be difficult to tax income paid by foreign funds, even taking into account the exchange of information mechanism.

As a result of the reasoned opinion sent by the Commission asking for a non-discriminatory tax treatment of pension funds contributions, the regime was amended from 1 January 2003: these and other complementary regimes of social security are no longer deductible as personal expenses, but a certain amount (either 25% or 30%, depending on the type of the risks covered) is deductible after the tax rate has been applied to the net income, and independently of the residence of the companies with whom the contracts have been concluded (Art. 86 PITC).

The CITC (Art. 40 Para. 4f) has also been amended in order to comply with EC law: Entities subject to corporate income tax may now deduct as costs, until a certain limit (15% or 25%), amounts paid as pension funds or equivalent, as long as, among other conditions, the contracts have been concluded with companies resident or with a permanent establishment in Portugal, or with entities that are authorized to operate within the Portuguese territory through free movement of services, and the pension funds have been constituted according to the Portuguese legislation or are managed by institutions of profession pension plans to which Directive 2003/41/EC is applicable.

If with regard to taxation of pension funds, the Commission exercised some pressure on the Portuguese government, other amendments in tax codes have been introduced spontaneously, in order to comply with the ECJ jurisprudence.

E. Double economic taxation of dividends paid to individuals

Since 2002 dividends paid by resident companies to resident individuals are subject to global and progressive taxation in 50% of their amount. Following the *Verkooijen* and the *Manninen* decisions, since 2005 the above-mentioned regime is extended to dividends paid by companies resident in other EU Member States, meeting the conditions of Art. 2 of the Parent-Subsidiary Directive (Art. 40-A PITC). Since 1 January 2006, if there is a paying agent operating in the Portuguese territory, resident individuals may opt to be taxed at a final withholding rate of 20%, which is also applicable to non-residents (Arts. 101, Para. 2b) and 71 Para. 1 and 72 Para. 5 PITC).

F. Thin capitalization

Also in order to comply with the *Lankhorst-Hohorst* decision (Case C-324/00), thin capitalization rules have not been applicable to EU resident entities (besides not being applicable to Portuguese resident entities) since 2006 (Art. 61 CITC).

G. Exit taxes

In the case of termination of activity due to the transfer abroad of the head office and place of effective management, the taxable profit for the fiscal year includes the difference between the market value and the accounting value of the assets of the company at the time of the termination of activity.³⁹

In order to (try to) comply with the requirements of ECJ decision *Lasteyrie du Saillant* (Case C-9/02), the legislator does not automatically tax capital gains when the residence is transferred abroad, but only when the activity in Portugal comes to an end. In fact, situations where the assets remain effectively attached to a permanent establishment located in the Portuguese territory and as long as the assets contribute to the PE's taxable profit, are safeguarded. This means that the taxpayer may prove that the transfer of residence does not correspond to the end of the activity – to the transfer of assets – in line with the new version of the Merger Directive. If the transfer of assets occurs, the taxing rights belong to Portugal, as the state of residence, and therefore the regime does not seem incompatible with EC law. It is, however, more difficult to justify taxation of shareholders of companies that transfer their residence abroad (taxation on the difference between the net assets and the acquisition cost of the participation in the company),⁴⁰ even if the aim is to assure the neutrality of the tax regime.

H. Withholding taxes

The Commission notified Portugal on the tax discrimination against mortgage interest paid to foreign financial institutions. The question is whether the 20% withholding tax on mortgage interest paid to non-resident entities (Art. 80, Para. 2c) CITC) on gross income – whereas the mortgage interest

39. Arts. 76-A, 76-B CITC, in force since 1 January 2006.

40. Art. 76-C CITC.

paid to resident entities is not subject to a withholding tax, but only to taxation of its net profits – is discriminatory and restricts the free movement of services. The case seems quite similar to the one in *Gerritse*, and will probably be decided in the same direction, if it is referred to the ECJ. Nevertheless, some thoughts could be dedicated to the following aspects: on the one hand, taxation by the source state is not in itself discriminatory (*Futura Participations*);⁴¹ on the other hand, taxation by the source state is directly connected with the taxing rights rules of a Member State (*Gilly*) and a non-resident entity is not in a comparable situation to a resident (*Asscher*⁴² and *Royal Bank of Scotland*); besides, the relevant rules in this case are not the domestic rules, but the rules in the DTCs concluded between Portugal and the other Member States (again they are rules on allocation of taxing rights). Moreover, consideration of the global income and of the personal situation should be under the competence of the state of residence (*De Groot*,⁴³ *Schumacker*, indirectly *ICI*,⁴⁴ and the Opinion of the Advocate General in *ACT Class IV* points 62 ff.).⁴⁵

III. Conclusions

If I try to reach some conclusions on the effect of the ECJ rulings on the Portuguese income tax law, I have to recognize that there is good awareness of ECJ case law in the Portuguese tax administration and entities with legislative competence. In fact, comparing the income tax law provisions in the eighties and the nineties with the amendments introduced since the beginning of this century, I easily find a diligent domestic legislator eliminating tax provisions incompatible with the EC law, i.e. with the EC decisions. This is connected with the fact that the principles of primacy and direct effect of EC law are recognized by the Portuguese constitution and not controversial.

However, there is an evident lack of cooperation between the national tax courts and the ECJ. The courts seem to be indifferent to the meaning and scope of the *acte clair* doctrine, and this is illustrated by the fact that, so far, only one case regarding income tax issues was referred by the Administrative Supreme Court to the ECJ under Art. 234 of the EC Treaty.

41. C-250/95, §§ 20-22.

42. ECJ, C-167/94, 27 June 1996.

43. ECJ, C-385/00, § 98, 12 December 2002.

44. ECJ, C-264/96, 16 July 1998.

45. C-374/04, 23 February 2006. See also, on the principle of cohesion, Frans Vanistendael, Cohesion: the phoenix rises from his ashes, *EC Tax Review* 4 (2005), at 212 ff.

GREECE

Dr Georgios Matsos, LL.M

I. EC law and Greek law

A. Introduction

Since the adoption of the Constitution of 1975 Greece recognizes the supremacy of international law over all ordinary Greek laws. International law does not prevail, in the case of conflict, except over the Greek Constitution (*Syntagma*) Greek law already knew, thus, a *lex superior* range of international law before its accession to the European Communities in 1981. Consequently, Greece entered the European Community fully aware of the fact that it was conceding an important part of its legislative sovereignty to a transnational body.

It is, however, not clear yet whether Greece is ready to accept supremacy of the European law over the Greek Constitution. The arguments on the issue are, more or less, similar to the ones developed in Member States with strong constitutional traditions like Germany and France.

The basic legal text regulating the relationship of Greek law towards both international law and European Community law is Art. 28 of the Greek Constitution. Art. 28(2) provides the following:

In order to serve important national interest and to promote cooperation with other states, state powers provided in the Constitution can be recognized, through International Convention or Agreement, to organs of International Organizations. The law, which ratifies this Convention or Agreement must be approved by a vote of three fifths of all incumbent Members of Parliament (author's translation).

Further, Art. 28(3) provides in addition to Sec. 2:

Greece can freely proceed to limitations of its national sovereignty through law voted by an absolute majority of all incumbent Members of Parliament, provided that this is required by an important national interest, it does not affect human rights and the foundations of the democratic regime and it takes place based on the principles of equality and under the condition of mutuality (author's translation).