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Direct Taxation and Member State Liability in the European Community

The European Court of Justice (ECJ) contemplates many new issues each year. Two areas in which the ECJ has either recently rendered decisions or is currently debating are: (1) taxation between Member States of the European Community (EC), and (2) the collection of damages against Member States in relation to the *Brasserie du Pecheur* case recently decided by the court. This article addresses both these issues.

I. Direct Taxes and European Community Law

The focus of the following inquiry is primarily on whether and the extent to which certain tax laws of the Member States are in compliance with Community law, in particular with the nondiscrimination principle. At this time, the EC does not have the explicit authority to levy direct taxes (e.g., personal or corporate income taxes); only the Member States have this right. Nowhere does the EC Treaty confer express authority to harmonize the direct taxes of the Member States.¹ However, it is well

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1. No provisions in the EC Treaty confer express authority to harmonize the direct taxation of the Member States, as does article 95 in relation to indirect taxation. Case C-279/93, *Finanzamt Köln-Altstadt v. Schumacker*, 1995 E.C.R. I-225, 231, para. 17. However, the Member States' direct tax laws may be harmonized on the bases of article 100 of the EC Treaty. *Note:* For the sake of consistency, reference will be made throughout this article to the European Community (EC) Treaty—previously the European Economic Community (EEC) Treaty—as it was amended at Maastricht by the Treaty on European Union. For the full citation to the EC Treaty, see *infra* note 3.

established that the income tax laws of the Member States must not violate Community law.² In a growing number of cases, taxpayers have challenged the "constitutionality" of certain Member State tax laws, claiming that these laws violate the nondiscrimination principle and certain other provisions of the EC Treaty.

In addition to the specific Treaty provisions, which more directly speak to the principle of nondiscrimination, the goals of the EC set forth in the preamble to the EC Treaty evidence the basic and fundamental role of the nondiscrimination principle in the establishment of the EC. These goals include the establishment of an "even closer union"; the elimination of barriers to ensure economic and social progress; the desire to guarantee steady expansion, balanced trade, and fair competition; and finally, the need to strengthen the unity of the Member State economies and ensure harmonious development by eliminating existing differences.³ These goals could not realistically be conceived without the guiding presence of a principle of nondiscrimination. In order to achieve these goals, however, it is necessary to eliminate the tax differences that exist among the Member States. The Ruding Committee⁴ concluded in its 1992 report that the tax differences among the Member States were unlikely to be reduced through the independent action of the Member States.⁵ Rather, it found that measures agreed to at the Community level would be necessary to eliminate discrimination and to ensure national corporate harmonization.⁶

In addition to analyzing the recent line of ECJ opinions interpreting the Treaty provisions dealing specifically with nondiscrimination, the discussion attempts to shed some light on the implications for the future of the EC and its continued structural development. That is, what effect will these cases have on the future role of the ECJ regarding the harmonization of Member State direct taxation policy? How far will the ECJ go in determining that a Member State's tax legislation is not only overtly discriminatory, but also covertly discriminatory?⁷ The

2. Even though certain matters have been left for the Member States, such as social security, the conditions for the award of university diplomas, and *direct taxation*, the Member States must still adopt rules in those areas that respect the basic principles of freedom laid out by Community law, *i.e.*, the principle of nondiscrimination as established in articles 48, 52, and 59 of the EC Treaty. *Id.* at I-232, para. 24.

3. TREATY ESTABLISHING THE EUROPEAN COMMUNITY, 1992 O.J. (C 224) 31, *reprinted in* [1992] 1 C.M.L.R. 573. These same goals and objectives have been reaffirmed in the opening remarks of the Treaty on European Union, 1992 O.J. (C224) 31, *reprinted in* [1992] 1 C.M.L.R. 719.

4. The Ruding Committee was a committee of independent experts set up by the Commission to inquire into the impact that the differences in taxation would have on the internal market and to propose measures to be taken in order to mitigate or eliminate the distortions. Jan E. Brinkmann & Andreas O. Riecker, *European Company Taxation: The Ruding Committee Report Gives Harmonization Efforts a New Impetus*, 27 INT'L LAW. 1061, 1066-67 (1993).

5. *Id.* at 1068.

6. *Id.*

7. The EC Treaty has been interpreted as prohibiting not only overt or direct discrimination by reason of nationality, but also covert or indirect forms of discrimination, which, through the application of other forms of differentiation, lead in fact to the same result. Case 152/73, *Sotgiu v. Deutsche Bundespost*, 1974 E.C.R. 153, para. 11.

frequent use of the article 177 preliminary ruling procedure is also briefly addressed, as well as its important role in both the ECJ's efforts to harmonize Member State laws and to define a new role for itself. The analysis suggests that the response of the Member States to the judicial activism of the ECJ—with respect to its interpretations of the nondiscrimination provisions—demonstrates Member State acceptance and approval of the changing role of the ECJ and the likely need to work towards the establishment of a more complex EC judicial system similar to the federal system in the United States.

II. Case Law of the ECJ Addressing the Nondiscrimination Provisions

A. HOW COMMUNITY LAW IS ABLE TO IMPACT THE MEMBER STATES

The case law of the ECJ clearly establishes the supremacy of Community law over Member State law.⁸ Therefore, Community law supersedes Member State law whenever the two conflict.⁹ With this in mind, the significance of the recent ECJ decisions essentially declaring Member State tax provisions to be “unconstitutional” and in violation of Community law becomes readily apparent. As one of the fundamental principles of the EC, the principle of nondiscrimination is directly applicable.¹⁰ The “direct effect” that Community law may or may not have can be determinative of the real effectiveness of Community law.¹¹ The ECJ's development of the doctrine of direct effect is said to be one of its most significant accomplishments.¹² In the landmark *Van Gend en Loos* case, the ECJ depicted the EC as a new type of legal order for which the Member States had limited their sovereign rights, and consequently, granted individual citizens rights as subjects of the Community.¹³

B. THE NONDISCRIMINATION PROVISIONS

Because the principle of nondiscrimination has been held to be directly applicable, the ECJ has widely interpreted this principle and applied it strictly.¹⁴ Article 6 of the EC Treaty provides: “Within the scope of application of this Treaty, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited.”¹⁵ However, it is well estab-

8. Case 6/64, *Costa v. Ente Nazionale Per L'Energia Elettrica (ENEL)*, 1 C.M.L.R. 1425 (1964); Case 106/77, *Admin. de fin. de l'Etat v. Simmenthal*, 1978 E.C.R. 629.

9. *Servaas van Thiel, The Prohibition of Income Tax Discrimination in the European Union: What Does It Mean?*, 34 EUR. TAX. 303 (1994).

10. *Id.* at 304.

11. GEORGE A. BERMAN ET AL., *CASES AND MATERIALS ON EUROPEAN COMMUNITY LAW* 182 (1993).

12. Paul P. Craig, *Once upon a Time in the West: Direct Effect and the Federalization of EC Law*, 12 OXFORD J. LEGAL STUD. 453 (1992).

13. *Id.* at 459.

14. *Van Thiel, supra* note 9, at 304.

15. EC TREATY, *supra* note 3, at 591.

lished in the case law of the ECJ that article 6 will apply only if none of the more specialized articles of the EC Treaty come into play.¹⁶ These more specialized articles of the EC Treaty include article 48¹⁷ (free movement of labor); article 52¹⁸ (freedom of establishment); article 58¹⁹ (companies or forms treated as natural persons who are nationals of Member States); article 59²⁰ (free movement of services); and article 67²¹ (free movement of capital).²² The articles concerning free movement were declared to be directly applicable by the ECJ in 1974.²³ That these provisions are directly applicable means that a person whose rights have been violated may seek protection from a national court by applying Community law as opposed to the discriminatory national law.²⁴ The case law

16. Van Thiel, *supra* note 9 (citing *Merci Convenzionali Porto di Genova*, 1991 E.C.R. I-5889, 5927, point 11).

17. Paragraph 2 of Article 48 provides: "Such freedom of movement shall entail the abolition of any discrimination based on nationality between workers of the Member States as regards employment, remuneration and other conditions of work and employment." 1 C.M.L.R. 573, 612 (1992).

18. Article 52 provides in pertinent part:

[R]estrictions on the freedom of establishment of nationals of a member-State in the territory of another member-State shall be abolished by progressive stages in the course of the transitional period. Such progressive abolition shall also apply to restrictions on the setting up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any member-State.

Id. at 613.

19. Article 58 provides in part:

Companies or firms formed in accordance with the law of a member-State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of member-States.

Id. at 616.

20. Article 59 provides in pertinent part:

[R]estrictions on freedom to provide services within the Community shall be progressively abolished during the transitional period in respect of nationals of member-States who are established in a State of the Community other than that of the person for whom the services are intended.

Id. at 617.

21. Article 67 provides in pertinent part:

[M]ember-States shall progressively abolish between themselves all restrictions on the movement of capital belonging to persons resident in member-States and any discrimination based on nationality or on the place of residence of the parties or on the place where such capital is invested.

Id. at 618.

22. Ruud A. Sommerhalder, *Differences in Tax Treatment Between Resident and Non-resident Individuals: In Conflict with EC Treaty?*, 33 EUR. TAX. 101, 102 (1993).

23. Van Thiel, *supra* note 9, at 304 (citing Case 270/83, *Commission v. France*, 1986 E.C.R. 359 (concerning the free movement of workers); Case 2-74, *Reyners v. Belgium*, 1974 E.C.R. 631 (concerning the freedom of establishment)).

24. Treaty rights are available to all persons that have a sufficient connection with the Community. Natural persons must either have the nationality of one of the Member States or be a member of a family of a migrant worker. Legal persons must be incorporated in one of the Member States and have their seat (registered office, central administration or principal place of business) within the Community.

Id. at n.16.

of the ECJ demonstrates that the basic freedoms not only contain a prohibition against discrimination, but also a prohibition against unreasonable and unnecessary restrictions of the individual rights of the citizens of the EC.

C. THE RECENT CASES ADDRESSING THESE ISSUES

The principle of nondiscrimination also plays an important role in cases involving the Member States' tax laws. The case law of the ECJ addressing this principle is now discussed.

1. *The Avoir Fiscal Case*

In *Commission v. France* (the *Avoir Fiscal* case), the ECJ²⁵ decided for the first time that different income tax treatment of residents and nonresidents could possibly amount to discrimination in violation of the Treaty.²⁶ The ECJ compared France's treatment of a German insurance company and a French insurance company that both invested on the Paris Stock Exchange through French branch offices.²⁷ The provisions in the French income tax provided for equal treatment with respect to dividend income; however, the imputation credit was given only to the French company and not the German-based company.²⁸ Essentially, a French subsidiary of a nonresident corporation could also apply these rules, but agencies and permanent establishments could not.²⁹

The ECJ ruled that the *avoir fiscal* violated the freedom of establishment rule of article 52, as well as that article's explicit language guaranteeing the freedom to choose a legal form under which to do business,³⁰ by essentially requiring the establishment of a French corporation in order to receive certain tax advantages, such as shareholders' tax credits.³¹ Servaas van Thiel points out that the ECJ took great care to avoid stating that *any* distinction on the basis of residence was prohibited.³² Therefore, the general rule established by the ECJ in this case was

25. 1986 E.C.R. 273, 1 C.M.L.R. 401 (1987). *Avoir Fiscal* refers to the tax credit at issue in this case.

26. Van Thiel, *supra*, note 9 at 305.

27. *Id.* at n.25.

28. The second paragraph of article 158 of the *Code General Des Impots* provides that the benefit of the shareholders' tax credit is granted only to persons who have their habitual residence or registered office in France. Furthermore, according to article 242 *quarter* of the *Code General Des Impots*, that benefit may be granted to persons resident in the territory of states that have concluded double-taxation agreements with France. Case 270/83, *Commission v. France*, 1986 E.C.R. 273, 300, para. 4.

29. *Id.* at 300, para. 6.

30. *Id.* at 305, paras. 20-22; see also *supra* note 17.

31. *Id.* at 305, para. 20.

32. Van Thiel, *supra* note 9, at 305. Van Thiel goes on to point out that the ECJ also did not go so far as to state that the different treatment of residents and nonresidents would *never* amount to discrimination. *Id.* In fact, it has become well established in ECJ case law that "[i]n relation to direct taxes, the situations of residents and non-residents in a given State are not generally comparable." See Case 80/94, *Wielockx v. Inspecteur Der Directs Belastingen*, 3 C.M.L.R. 85, 100, para. 18 (1995) (citing Case 279/93, *Finanzamt Köln-Altstadt v. Schumacker*, 1995 E.C.R. I-225, 233, para. 31).

that different income tax treatment of residents and nonresidents *could*, depending on the circumstances, constitute discrimination.³³ Under the facts of this case, the alleged discrimination was found to be unjustified in light of the goals of the internal market.

The ECJ recognized that the fundamental principle underlying article 52 has been directly applicable in the Member States since the beginning of the transition period.³⁴ With this in mind, the ECJ rejected the risk of increased tax avoidance as a justification for covertly discriminatory tax provisions by saying that article 52 did not allow for such an exception to a fundamental Community principle.³⁵ Despite the fact that the disadvantages levied against branches of foreign companies were compensated with certain advantages, such as not having to pay incorporation and registration duties, the ECJ refused to find a sufficient justification for the unequal treatment.³⁶ Even though the possibility remained that certain types of discrimination might be sufficiently justifiable, the ECJ made it clear that despite the lack of harmonization of corporate tax laws among the Member States, discrimination against agencies and branches of insurance companies having their registered office in another Member State would be difficult to justify, and was not justified in this case.³⁷ More is said below on what the ECJ has found to be adequate justification for unequal treatment.

2. *The Daily Mail Case*

While the ECJ seemed to adopt a judicially active approach in its efforts to harmonize and get the Member States to jump on the EC bandwagon, the decision in the *Daily Mail* case³⁸ served as somewhat of a reality check. The case demonstrates a situation where the ECJ refused to apply Community law to an income tax case that it considered to be outside the scope of Community authority.³⁹ At the center of the controversy was the English Income and Corporation Taxes Act of 1970.⁴⁰ Section 482(1)(a) of the Act required a corporation to obtain the consent of the Treasury when seeking to transfer its central management and control from the United Kingdom to another Member State while maintaining its status as a United Kingdom corporation.⁴¹

33. *Id.*

34. *Commission v. France*, 1986 E.C.R. 273, 302, para. 13; *see Reyners v. Belgian State*, 1974 E.C.R. 631.

35. The principle referred to being that of freedom of establishment.

36. 1986 E.C.R. 273, 305, para. 21.

37. *Van Thiel*, *supra* note 9.

38. *Case 81/87, Regina v. H.M. Treasury and Commissioners of Inland Revenue ex parte Daily Mail and General Trust P.L.C.*, E.C.R. 5483, 3 C.M.L.R. 713 (1988).

39. *Van Thiel*, *supra* note 9, at 306.

40. 3 C.M.L.R. at 725, para. 18. The pertinent provision of the English tax code has since been repealed.

41. 3 C.M.L.R. at 722, para. 5.

The basic question addressed by the ECJ was whether to allow a tax planning scheme that relied on directly applicable Community law to invalidate national legislation.⁴² Because the concept of a directly applicable right precludes basing that right on national law of any kind, Van Thiel finds it strange that the ECJ would take the position that the right of emigration depends on the national laws of incorporation.⁴³ One might question why the most pro-European institution of the EC, the Commission, would also state that the application and enforcement of a directly applicable provision of Community law is contingent upon the contents of a Member State's laws. It is well established that the failure of a Member State to live up to its duties under the Treaty does not have an impact on the directly applicable rights conferred to natural and legal persons.⁴⁴ For this reason, the *Daily Mail* decision has been criticized for its failure to abolish what is known as the "seat rule,"⁴⁵ which is viewed by some as a road block to the process of harmonizing corporation laws within the EC.⁴⁶

On the other hand, Ebke and Gockel viewed the *Daily Mail* decision as potentially serving to "revitalize the process of company law harmonization within the EC."⁴⁷ In distinguishing this case from those traditionally considered to fall under articles 52 and 58, the ECJ pointed out that corporations are created under the laws of the individual Member States and that a Member State has the right to regulate the affairs of corporations situated under its laws.⁴⁸ The fact that article 58 confers upon Member States the right to require that domestic companies maintain their corporate headquarters, or central administration, within its territory was of even greater importance in the ECJ's decision.⁴⁹ Ebke and Gockel contend that the ECJ's opinion implicitly concludes:

[I]f secondary Community law⁵⁰ provides for the mutual recognition of companies within the meaning of article 58(2) and the transferability of their seat from one country

42. Servaas van Thiel, *Daily Mail Case: Tax Planning and the European Right of Establishment—A Setback*, 28 EUR. TAX. 357, 360 (1988). For the corporate law background of *Daily Mail*, see Werner F. Ebke & Markus Gockel, *Regional Developments: European Corporate Law*, 24 INT'L LAW. 239 (1990).

43. Van Thiel, *supra* note 42, at 362.

44. *Id.* at 364. This result seems to be the only sensible conclusion due to the fact that, by definition, a directly applicable right does not depend on a Member State taking any legislative action. Rather, a directly applicable right follows from Community law and preempts national legislative measures to the contrary. *Id.*

45. Under the "seat rule," the affairs of a corporation are governed by the law of the state in which the corporation has its primary seat, or principal place of business, instead of by the law of the state of incorporation. For a discussion of the corporate governance implications and the conflicts of corporate laws issues of the *Daily Mail* decision, see Ebke & Gockel, *supra* note 42.

46. Ebke & Gockel, *supra* note 42, at 250 (citing Sandrock & Austmann, *Das Internationale Gesellschaftsrecht nach der Daily Mail—Entscheidung des Europäischen Gerichtshofs: Quo Vadis?* 35 RIW 249 (1989)).

47. *Id.*

48. *Id.* at 249.

49. *Id.*

50. Particularly law within the meaning of articles 54(3)(g) and 220(3).

to another, neither the state of incorporation nor the host country have the right to impose limitations on the recognition of foreign companies or the transfer of a company's seat.⁵¹

However, given the lack of such secondary Community law, the ECJ decided that articles 52 and 58 did not grant corporations the right to transfer their headquarters to another Member State while retaining their corporate status under the Member State of incorporation.⁵² Rather than viewing the ECJ's decision as a setback to the harmonization process and a missed opportunity to abolish the "seat rule," the decision was viewed by some as one that would encourage the harmonization of fundamental rules and principles of law concerning business associations.

Despite the need for both broad and narrow interpretations of the text of the Treaty during the formative years, which continue even to the present, the Member States are still not always eager to relinquish some of their powers to the central authority. Perhaps with this in mind, the ECJ decided that the regulation of business associations is an area in which the ECJ will exercise a certain amount of judicial restraint and place the onus on the Community and the Member States to further harmonization by means of directives or conventions. Nevertheless, van Thiel considers the ECJ's decision to be a highly questionable interpretation of article 220⁵³ of the Treaty, which effectively limits the primary right of establishment for companies contrary to article 58.⁵⁴ Van Thiel contends that because the right of establishment under articles 52 through 58 involves both the right to exit the home Member State and the right to enter the host Member State, it is difficult to reconcile how Great Britain is legally permitted to tax the company's exit from its territory.⁵⁵ The *Daily Mail* decision seems to have provided a possible justification for Member State discrimination with respect to the freedom of establishment and the movement of goods.

In the *Daily Mail* decision, the ECJ revealed its reluctance to allow the use of Community law for the sole purpose of tax minimization. While the situation was likely a case of tax avoidance, not tax evasion, the deference granted the Member State in this situation might indicate a willingness of the ECJ to carve out an exception for discrimination by Member States when they feel their national

51. Ebke & Gockel, *supra* note 42, at 249.

52. *Id.*

53. Article 220 of the EC Treaty provides:

Member-States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals: . . . —the abolition of double taxation within the Community; —the mutual recognition of companies or firms within the meaning of the second paragraph of Article 48, the *retention of legal personality in the event of transfer of their seat from one country to another*, and the possibility of mergers between companies or firms governed by the laws of different countries.

1 C.M.L.R. 573, 711 (1992) (emphasis added).

54. Van Thiel, *supra* note 42, at 364.

55. *Id.* at 365.

legislation serves the purpose of preventing abuse of the openness of the internal market. Under this rationale, until adequate laws exist to assure the protection of shareholders, creditors, and other third parties, and the laws of corporate governance are more uniform among the Member States, a more narrow reading of rights conferred under the Treaty may be given by the ECJ.

The fallback explanation for the decision of the ECJ, though a realistic and pervasive consideration, involves the magnitude of the changes taking place and the vast cultural differences that exist between the different Member States. The fact that the laws governing the establishment and operation of business associations continue to be far from uniform is likely attributable to many of these differences. Although the ECJ may be eager to push forward and further the recognition of rights conferred under the Treaty, when the protection of a right may in turn open the door for substantial abuses not yet accounted for by Community law, the ECJ will be less willing to find a violation of that right.

3. *The Bachmann and Werner Cases*

There are those, however, who prefer not to continue referring to the fallback explanation whenever the ECJ upholds what appears to be a discriminatory national provision.⁵⁶ Two more recent decisions of the ECJ are demonstrative of situations in which a Member State would be justified in derogating from the fundamental freedoms of articles 48, 52, 58, and 59. The 1992 *Bachmann*⁵⁷ case and the 1993 *Werner*⁵⁸ case provided situations in which the ECJ refused to apply Community law to income tax cases. The derogations from the fundamental freedoms permitted in these cases, however, seem much easier to reconcile with the overall objectives of the Community and to have been important aspects for the ECJ to clarify.

In *Bachmann*, the ECJ held that a Member State's need to maintain a coherent fiscal system was a justification for discriminatory income tax provisions.⁵⁹ The Belgian law at issue was article 54(2) of the Belgian Income Tax Code, which provides that payment for supplementary life, health, or disability insurance can be deductible from taxable income only if these payments are made to a company established or having its place of management in Belgium.⁶⁰ Such a provision would certainly seem to discriminate covertly based on nationality and therefore be in violation of Community law, and the ECJ found this to be the case. Nevertheless, the ECJ allowed the restriction.

56. Nevertheless, these concerns will often prove to be obstacles that must be overcome and taken into consideration any time the Member States are asked or required to sacrifice some element of their sovereignty to the Community.

57. Case 204/90, *Bachmann v. Belgian State*, 1992 E.C.R. I-249, 1 C.M.L.R. 785 (1993).

58. Case 112/91, *Werner v. Finanzamt Aachen-Innenstadt*, 1993 E.C.R. I-429.

59. *Bachmann*, 1992 E.C.R. at I-283, para. 28.

60. Paul E. Bookhorst, *Tax Discrimination Permitted for Reasons of Coherence of Tax System*, 32 EUR. TAX. 284 (1992); see 1992 E.C.R. at I-278, para. 3.

The ECJ, in dismissing the possibility that consumer protection or the need for effective tax control were sufficient justifications to allow for the infringement of fundamental Community freedoms, went on to hold that the need to maintain a coherent national tax system was a matter of public policy sufficient to justify excluding the deductions.⁶¹ The ECJ found it necessary to allow the Belgian tax authorities to refuse the deduction of premiums paid to companies not established in Belgium because there was no way to be certain that the capital sum or annuities paid in consideration would ever be taxed in Belgium.⁶² Such a holding seems to have been unavoidable given the lack of harmonization of Member State tax laws concerning such insurance payments.⁶³ Until the time of total harmonization of tax laws, or perhaps an EC-implemented tax system, such public policy exceptions will be permitted as a practical necessity.

Another reason why it would be impossible to have an absolute bar on discrimination in such a complex system stems from the diverse backgrounds and histories of the EC Member States. While the double-taxation agreements⁶⁴ between individual Member States provide temporary solutions concerning the maintenance of coherent fiscal systems, it will take time to work out their differences and come to a point where the Member States believe that the advantages of uniformity and harmonization outweigh the desire to maintain cultural identity and legal sovereignty. In the meantime, the ECJ in *Bachmann* held that Member States do retain their sovereignty in this regard so long as: (1) there is a lack of harmonization in the law; (2) there is a public policy concern of maintaining the coherence of its national tax system; (3) the violation of the nondiscrimination clause is proportional to the public policy goal; and (4) the national measure does not consist of overt discrimination.⁶⁵

61. Boekhorst, *supra* note 60, at 286; see *Bachmann*, 1992 E.C.R. at I-283-84, paras. 28-29.

62. Case 80/94, *Wielockx v. Inspecteur der Directs Belastingen*, E.C.R. I-2493, 2516, para. 23, 3 C.M.L.R. 85 (1995) (citing *Bachmann*, 1992 E.C.R. I-249). In *Wielockx*, the ECJ distinguished *Bachmann*, finding that cohesion of the fiscal system does not justify discrimination where the debtor in relation to the pensions—the undertaking—remains established in the Netherlands. This scenario was found to provide an adequate safeguard that would enable the State to collect tax on the pensions. *Wielockx*, 1995 E.C.R. at I-2506, paras. 64-65.

63. *Bachmann*, 1992 E.C.R. at I-283, paras. 26-27. The ECJ held that

“[t]he cohesion of such a tax system, the formulation of which is a matter for each Member State, therefore presupposes that, in the event of a state being obliged to allow the deduction of . . . contributions paid in another Member State, it should be able to tax sums payable by insurers.”

Id. at I-282, para. 23.

64. Under agreements similar to the Model Double-Taxation Convention on Income and on Capital, Report of the Committee on Fiscal Affairs of the OECD, 1977, the Member States have generally agreed to obtain cohesion

“at another level: the State taxes all pensions received by residents in its territory, whatever the State in which the contributions were paid. Conversely, it waives the right to tax pensions received abroad even if they derive from and are made in consideration of contributions paid in its territory which it treated as deductible.”

Wielockx, 1995 E.C.R. at I-2505, paras. 53-54.

65. Boekhorst, *supra* note 60, at 286.

Another case in which the ECJ refrained from intervening in national tax matters was the *Werner* case.⁶⁶ In this case the ECJ held that the freedom of establishment of article 52 does not preclude a Member State from taxing its own nationals at a higher rate if they decide to live in another Member State.⁶⁷ Werner, a German dentist residing in the Netherlands, sought protection under the nondiscrimination rules of the EC Treaty because he was taxed by Germany as a nonresident and was therefore deprived of certain benefits granted to residents.⁶⁸

Rather than addressing the substance of this case, the ECJ merely regarded the case as a domestic affair.⁶⁹ The ECJ did not consider *Werner* to be an interstate case probably because the taxpayer was a German citizen who was subject to German income taxation (with respect to the income he derived from German sources). However, Sommerhalder does not find this decision to be in line with the judgment of the ECJ in the *Biehl* case, where the ECJ held that nationality and residence can be effectively linked.⁷⁰ The *Biehl* case is discussed further below; however, the decision in *Werner* can be viewed as a decision by the ECJ not to intervene when it is not entirely clear that the allegedly discriminatory national tax provisions will have any intra-Community ramifications. This case was, after all, one in which the national was claiming that his own nation was discriminating against him. For this reason, the ECJ found no discrimination within the meaning of the EC Treaty⁷¹ and therefore saw no need to address the substantive issues of the matter.⁷²

From this decision, it appears that the ECJ is not yet ready to intervene in the domestic affairs of its Member States in order to prevent what seems to be, as Sommerhalder points out, discrimination within the meaning of the EC Treaty. The ECJ seems to be saying that it is tolerable to discriminate against your own nationals.⁷³ The decision in *Werner* sends a strong message with respect to the separation of powers: if a matter is domestic in nature, the ECJ will refrain from intervening.

66. *Werner*, 1993 E.C.R. I-429.

67. Sommerhalder, *supra* note 22, at 101.

68. *Id.*

69. Van Thiel, *supra* note 9, at 306-07.

70. Sommerhalder, *supra* note 22, at 104.

71. *Id.*

72. Arguably another reason why the *Werner* case was not considered to be an interstate case invoking the provisions of the EC Treaty was the presence of the double taxation agreement concluded between Germany and the Netherlands on June 16, 1959. *Werner*, 1993 E.C.R. at I-469. That such agreements recognize a distinction between residents and nonresidents (*see id.* at I-449)—in granting a state the ability to fully tax the income of nonresidents who derive all or substantially all of their income in that state—enabled the ECJ to conclude that "[t]he only factor which takes [Werner's] case out of a purely national context is the fact that he lives in a Member State other than that in which he practises his profession." *Id.* at I-470.

73. Sommerhalder points out the irony of a nonresident being placed in a more burdensome position than nonresidents who are nationals of other Member States. He finds it quite clear that the freedom of establishment principle has been violated for the German nonresident and finds no arguments of public policy that would justify such a violation. Sommerhalder, *supra* note 22, at 104.

4. *The Schumacker and Wielockx Cases*

The issues in the *Schumacker*⁷⁴ case, though somewhat similar to those in the *Werner* case, carried one major distinction that enabled the ECJ to reach a substantive decision on the matter: the distinction being that it involved the discrimination of a Member State against a nonnational. The *Schumacker* case involved a Belgian national who resided in Belgium, but who worked in Germany and earned almost all his income there.⁷⁵

The intra-Community ramifications of the ECJ's decision are readily apparent in this case. Therefore, the ECJ held that article 48 must be interpreted as capable of limiting the conditions a Member State can lay down concerning the tax liability of a national of another Member State, as well as how it goes about levying taxes on the income received by these nonnationals within its territory.⁷⁶ The rationale of the ECJ strictly adhered to the nondiscrimination principle. The ECJ continued:

Article 48 does not allow a Member State, as regards the collection of direct taxes, to treat a national of another Member State employed in the territory of the first State in the exercise of his right of freedom of movement less favorably than one of its own nationals *in the same situation*.⁷⁷

Holding true to its decision in the *Werner* case, the ECJ stated that a Member State's failure to grant a nonresident certain tax benefits that it does grant to a resident is not, as a rule, discriminatory, because those two categories of taxpayers are not similarly situated.⁷⁸ However, in the instant case, the taxpayer was not able to claim the benefits of "splitting"⁷⁹ in Belgium, because he had virtually no taxable income there, whereas under German tax laws, he could not take advantage of the "splitting" provisions of Germany's Income Tax Code because his wife's income was not taxable in Germany due to the fact that she was a nonresident.⁸⁰ The ECJ went on to find that discrimination does arise in such a situation in which a nonresident receives the major part of his income and nearly all of his family income in a Member State other than that of his residence.⁸¹ The reason for this conclusion is that personal and family circumstances, which would normally be considered by a person's state of residence, are not, in this situation, taken into account by either his state of residence (because he has no

74. *Finanzamt Köln-Altstadt v. Schumacker*, 1995 E.C.R. I-225, 2 C.M.L.R. 450 (1996).

75. *Id.* at I-254-55, para. 15.

76. *Id.* at I-256, para. 24.

77. *Id.* (emphasis added).

78. *Id.* at I-260, para. 34.

79. Under a "splitting" tax regime, of which only married employed persons who are not permanently separated can take advantage, the total income of the spouses is aggregated, attributed 50 percent to each spouse, and then taxed accordingly. See *Schumacker*, 2 C.M.L.R. at 471, para. 7. The purpose of the "splitting" regime is to mitigate the progressive nature of the income tax rates by making the taxable income of each spouse the same. *Id.*

80. *Id.* at 472, paras. 15-17.

81. *Id.* at I-261, para. 38.

income there and is therefore not liable to pay taxes there) or his state of employment (because he is not a resident there).⁸²

It is through the required accounting efforts that the ECJ really intervenes and has an effect on the tax procedures of the Member States.⁸³ In a situation such as Schumacker's, the ECJ recognizes that it is difficult for the state of residence to take account of the taxpayer's personal and family circumstances, because the tax payable in that state is insufficient.⁸⁴ Here, the principle of equal treatment requires that the state of employment take into account the personal and family circumstances of a nonnational, nonresident, and grant that person the same tax benefits that it would to a resident national.⁸⁵ Germany quickly responded to the ECJ's decision by allowing nonresident taxpayers certain tax benefits, at least under certain circumstances.⁸⁶

In the spirit of *Bachmann*, the ECJ also looked for a justification for the distinctions, such as the need to maintain a coherent tax system.⁸⁷ The ECJ, however, did not find such a justification.⁸⁸ The Finanzamt (Germany's Internal Revenue Service) argued that the distinctions were justified by the administrative difficulties that would stem from requiring the state of employment to discover the income that nonresidents working in its territory received in their state of residence.⁸⁹ In response to this argument, the ECJ pointed out that Council Direc-

82. *Id.* The argument put forth by Sommerhalder above can now be better appreciated. The label "resident" distinguished Werner from Schumacker. The fact that Werner maintained his residence in Germany permitted the German tax authorities to discriminate against him absent any EC Treaty violations. Because the issue in *Schumacker* is focused on the covert discrimination against a nonnational, the EC Treaty discrimination protection devices apply and the ECJ comes to the rescue. Does this seem right?

83. *Id.* at I-262, para. 41.

84. *Id.*

85. *Id.*

86. See *Jahressteuergesetz 1996* (Oct. 11, 1995), BGBl. 1995 I 1250. This statute revised section 1, paragraph 3 of Germany's Income Tax Law (*Einkommensteuergesetz 1990*, published in BGBl. 1990 I 1898, corrected BGBl. 1991 I 808) to entitle a nonresident EC citizen, upon application, to be taxed in Germany like a resident taxpayer if 90% of his or her income is subject to income taxation in Germany or if his or her income not subject to income taxation in Germany does not exceed DM 12,000 (approx. US\$8,000). The amount is doubled (*i.e.*, DM 24,000) in the case of a married taxpayer. *Id.* Married taxpayers may also now opt for tax "splitting" even if the spouse of the nonresident EC taxpayer subject to income taxation in Germany is not residing in Germany. BGBl. 1995 I 1250, § 1a. For an explanation of "splitting," see *supra* note 79. This new law allows the nonresident taxpayer to receive the same tax benefits (*e.g.*, tax splitting) as resident taxpayers. Under the old law, such benefits were not available to nonresident taxpayers. However, as Professor Ebke points out, the ECJ's decision of June 27, 1996, in the case of *P.H. Asscher v. Staatssecretaris von Financien*, Case 107/94, 7 *EUROPAEISCHES WIRTSCHAFTS- UND STEUERRECHT* 285 (1996), the 90%/DM 12,000 rule also seems to be inconsistent with the EC Treaty. Electronic-mail transmission from Werner F. Ebke, Associate Editor of *The International Lawyer*, at the University of Konstanz, Germany (Oct. 31, 1996).

87. *Schumacker*, 2 C.M.L.R. at I-261-62, paras. 40-41.

88. *Id.* at I-262, para. 42.

89. *Id.* para. 43.

tive (EC) 77/799 [1977] concerning mutual assistance of the Member States provides for ways of obtaining this information.⁹⁰

The ECJ concluded that article 48 requires equal treatment at the procedural level for nonresident Community nationals and resident nationals.⁹¹ Therefore, a provision of Member State law on direct taxation under which the benefits of certain procedures and deductions are available only to residents, and excludes nonresidents who are employed there and receive income, is precluded.⁹²

The ECJ recently followed the *Schumacker* decision in the *Wielockx*⁹³ case. Mr. Wielockx, a resident and national of Belgium, was a partner in a physiotherapy practice in the Netherlands and received *all* of his income in the Netherlands.⁹⁴ Wielockx attempted to deduct from his taxable income contributions he made to a voluntary pension-reserve, but was refused the deduction by the tax authorities.⁹⁵ The Act⁹⁶ establishing the pension-reserve enabled self-employed persons to set aside a portion of the profits from their business as a pension-reserve, while allowing the amounts set aside to stay in the business.⁹⁷ The reserved funds are liquidated upon the retirement of the taxpayer at the age of sixty-five, at which time the reserve is treated as income.⁹⁸ Because under Dutch law, only residents, but not nonresidents, may deduct the amounts contributed to the pension-reserve, the ECJ was asked to determine whether the pension-reserves were compatible with article 52 of the EC Treaty.⁹⁹

In arriving at its decision, the ECJ reiterated its well-established position that discrimination arises when those similarly situated are treated differently, or those situated differently are treated the same.¹⁰⁰ Referring to *Schumacker*, the ECJ found that the nonresident Wielockx was objectively in a similar fiscal situation as a resident due to the fact that all of his income was earned in the Netherlands—his state of employment.¹⁰¹ In this type of situation, the different treatment of residents and nonresidents can amount to discrimination.¹⁰² Therefore, the Court concluded that “a nonresident taxpayer who . . . receives all or

90. *Id.* at I-263, para. 45. More particularly, the ECJ points out that the tax agreement between Germany and the Netherlands already works essentially the same way as the ECJ is proposing in this case that Germany avoid discriminating against nonnationals that work on its territory. Account must be taken in that agreement of the personal and family circumstances of the frontier workers. *Id.* at I-263, para. 46.

91. *Id.* at I-266, para. 58.

92. *Id.* at para. 59.

93. Case C-80/94, G.H.E.J. Wielockx v. Inspecteur der Directs Belastingen, 1995 E.C.R. I-2493, 3 C.M.L.R. 85 (1995).

94. *Id.* at I-2496, para. 9.

95. *Id.* at I-2512, para. 11.

96. Nederlandse wet op de inkomstenbelasting 1964, *Staatsblad* [Stb] 612 (1964).

97. *Wielockx*, at I-2495, para. 3.

98. *Id.* at I-2495, para. 4.

99. *Id.* at I-2511-12, paras. 7, 12.

100. *Id.* at I-2515, para. 17.

101. *Id.* at 100, para. 20.

102. *Id.* at 91, para. 23.

almost all of his income in the State where he works but who is not entitled to set up a pension reserve qualifying for deductions under the same tax conditions as a resident taxpayer suffers discrimination.’’¹⁰³ The discrimination occurs because the nonresident’s overall tax burden will be greater than that of a similarly situated resident taxpayer due to the nonresident’s inability to take the deduction.¹⁰⁴

The tax authorities of the Netherlands then attempted to argue that the discrimination was justified on the grounds of fiscal cohesion as set forth in *Bachmann*.¹⁰⁵ More specifically, the Court was asked to consider whether the disallowance of the deduction was justified in light of the existence of a double-taxation agreement between the Netherlands and Belgium.¹⁰⁶ Under this agreement, the payments received from the pension by the taxpayer at the age of sixty-five would be taxed by the state of residence and not the state of employment—from which the deductions are currently sought to be made.¹⁰⁷

The ECJ found that the provisions of the double-taxation agreement eliminated the need for a strict correlation between the deduction of contributions and the taxation of payments received from the pensions later on.¹⁰⁸ The Member States, through the double-taxation agreement, essentially “shifted [fiscal cohesion] to another level, that of the reciprocity of the rules applicable in the Contracting States.”¹⁰⁹ The ECJ concluded that because the double-taxation agreement between the Netherlands and Belgium served to provide fiscal cohesion (though at “another level”), the “principle [of fiscal cohesion] may not be invoked to justify the refusal of a deduction such as that in issue.”¹¹⁰

While accepting the rationale of the Court, the Advocate General suggested that the Court interpret these double-taxation agreements with caution, before inferring that a Member State intentionally waived its desire to have a strict, personal correlation between deductions taken and taxes paid.¹¹¹ The Advocate General then provided an alternate rationale distinguishing the situation in the instant case with that in *Bachmann*—where the discriminatory provision was found to be justified.¹¹² He found the fact that the assets of the pension reserve remain in the state of the undertaking until liquidation provided a more substantial safeguard against a pension beneficiary taking the deductions, but avoiding the payment of taxes upon receipt of the income.¹¹³ Nevertheless, “the rights con-

103. *Id.* at 100, para. 22.

104. *Id.* para. 21.

105. *Id.* para. 23.

106. *Id.* at 99, para. 14.

107. *Id.*

108. *Id.* at 100–101, para. 24.

109. *Id.* at 101, para. 54.

110. *Id.* para. 25.

111. *Id.* at 96, para. 56.

112. *Id.* at 96–97, paras. 59–68.

113. *Id.* at 96–97, paras. 61, 65.

ferred by article 52 of the Treaty are *unconditional* and a Member State cannot make respect for them subject to the contents of an agreement concluded with another Member State.¹¹⁴ For this reason, a tax provision discriminating against a similarly situated nonresident cannot be justified on grounds that two Member States have agreed to tax income received from a pension in the state of residence.

The determining characteristic in *Schumacker* and *Wielockx* seemed to be the similarity of the situations between the nonresident and resident, both of whom made most or all of their income in the same taxing state.¹¹⁵ In these cases, the ECJ determined that discrimination can be found upon the unequal treatment of a nonnational, nonresident. However, as we saw in the *Werner* case, there was no discrimination in a situation involving a German national, who was established in Germany as a dentist, but who happened to reside in the Netherlands, and was denied certain German tax benefits because he was being taxed as a nonresident.¹¹⁶ The holding was that a state could differentiate among the tax treatment of its own nationals, more specifically, between those who choose to live within its borders and those who choose to live elsewhere.¹¹⁷ This rationale supports the notion that it is impossible for a Member State to discriminate against its own nationals, even though their situation is similar to that of a nonresident, nonnational.¹¹⁸ Is not residency effectively connected to nationality in such a situation? To address this question, the *Biehl* decision is considered.

5. The Biehl Case

In the *Biehl*¹¹⁹ case, a German worker, who had left Luxembourg before the end of the year, was not able to obtain a refund of excess withheld wages tax because he had become a resident of Germany.¹²⁰ The refund was denied Biehl because the Luxembourg tax laws required that in order to receive a refund, a taxpayer must be a resident throughout the entire year.¹²¹ The ECJ held, with respect to the EC Treaty principle prohibiting overt and covert discrimination based on nationality,¹²² that there is covert discrimination if there is a danger that the tax provisions are disadvantageous to taxpayers who are nationals of other Member States.¹²³ The ECJ went on to find the Luxembourg tax law discriminatory.¹²⁴

114. *Id.* at 97, para. 67 (quoting *Commission v. France*, 1986 E.C.R. 273, para. 26 (emphasis added by Advocate General)).

115. *Schumacker*, 1995 E.C.R. I-225, para. 37.

116. Sommerhalder, *supra* note 22, at 101.

117. *Id.*

118. *Id.* at 104 (refer again to Sommerhalder's argument in note 73 *supra*).

119. Case 175/88, *Biehl v. Administration des Contributions du Grand-Duché*, 1990 E.C.R. I-1779.

120. *Id.* paras. 3-4.

121. *Id.* para. 6.

122. EC TREATY art. 48(2).

123. Boekhorst, *supra* note 60, at 285.

124. *Id.*

The reasoning of the Court was that the residence criterion mainly affected those of another nationality, because they were the ones most likely to return to their home state after leaving employment in the previous state.¹²⁵ Under these circumstances, the ECJ found residence and nationality sufficiently linked so as to amount to discrimination based on nationality.¹²⁶ The ECJ solidified its prior case law, notably the *Avoir Fiscal* decision, in that it refused to allow a covertly discriminatory tax provision to be justified by the risk of increased tax avoidance.¹²⁷ The Court again rejected, as it did in *Avoir Fiscal*, the Member State's concern that the balance of its system of progressive taxation would be upset.¹²⁸

The ECJ's decision in *Biehl* helped demonstrate, among other things, the ECJ's reluctance to allow Member States to justify the implementation of covertly discriminatory tax provisions. Similar taxing requires the same access to tax advantages that stem from the payment of those taxes, regardless of whether the taxpayer claims the particular Member State as his residence.¹²⁹ The ECJ's decision in *Biehl*, considered by tax experts to be the fundamental and correct stance of the ECJ on income taxation,¹³⁰ would seem to extend far enough to have saved the German national taxpayer, though a nonresident, in the *Werner* case. While Sommerhalder's contention, discussed above, that the *Werner* decision cannot be reconciled with *Biehl* stands recognized, the unavoidable distinction is that *Werner* was a national in the state in which he was treated differently for tax purposes. At first glance, this situation may appear to be an obvious example of overt discrimination based on nationality. Nevertheless, it is necessary to keep in mind the big picture. The ECJ has made it clear that it, but more likely the Member States, is not yet ready to move to the point where the Community can infringe on the sovereignty of the Member States regarding internal tax matters. However, the burden placed on Member States in justifying discriminatory tax treatment is a heavy one. The efforts at harmonization, nevertheless, have been significant, as demonstrated by the next case discussed.

6. *The Commerzbank Case*

The ECJ's decision in the *Commerzbank*¹³¹ case could, in the mind of at least one tax expert, "have far-reaching implications throughout the EC and could spell the end of discrimination in tax matters."¹³² The vast impact the decision has already had on U.K. law, and will very likely have on the tax law of other

125. Van Thiel, *supra* note 9, at 306.

126. Sommerhalder, *supra* note 22, at 103.

127. *Biehl*, [1990] E.C.R. I-1779, paras. 15 and 16.

128. *Id.* para. 15.

129. *Id.* paras. 12, 14.

130. Van Thiel, *supra* note 9, at 305.

131. Case 330/91, *R v. Inland Revenue Commissioners, ex parte Commerzbank AG*, 1993 E.C.R. I-4017, 3 C.M.L.R. 457 (1993).

132. Les Secular, *Discrimination within the EC—Is This the End?*, 33 EUR. TAX. 345 (1993).

Member States, can be attributed to the ECJ's broad interpretation of the equal treatment and nondiscrimination principles under Community law. The decision seemed all but to eliminate the possibility of a Member State's being able to provide a satisfactory justification for utilizing discriminatory tax provisions.

Commerzbank, a bank incorporated under German law, maintained a branch in the United Kingdom through which it granted loans to a number of U.S. companies.¹³³ Commerzbank paid tax on the interest it received from those companies.¹³⁴ The bank then sought repayment of the tax from the Inland Revenue under the provisions of a double taxation agreement between the United Kingdom, Northern Ireland, and the United States.¹³⁵ That agreement provided that interest paid by a U.S. company to only a U.K. company or a company resident for tax purposes in the United Kingdom would be taxable in the United Kingdom.¹³⁶ Because Commerzbank was not a U.K. resident for tax purposes, it received a refund of the overpaid tax.¹³⁷ However, Commerzbank did not stop there. It then made a claim for repayment under section 825 of the Income and Corporation Taxes Act 1988.¹³⁸ The U.K. tax authorities refused this claim on the ground that Commerzbank was not a resident company of the United Kingdom and, therefore, did not qualify for the repayment.¹³⁹ Referring to its decision in the *Avoir Fiscal* case, the ECJ held:

Articles 52 and 58 EC prevent the legislation of a member-State from granting repayment supplement on overpaid tax to companies which are resident for tax purposes in that State whilst refusing the supplement to companies which are resident for tax purposes in another member-State. *The fact that the latter would not have been exempt from tax if they had been resident in that State if [sic] of no relevance in that regard.*¹⁴⁰

The final sentence of this holding enables the ramifications of this decision to be potentially widespread. The message seems to be that discrimination is discrimination. Even though the discrimination may appear to be reasonable and justified, based on the different situations of the resident and nonresident companies with respect to the repayment of taxes, the distinction was found by the ECJ to amount to unequal treatment.¹⁴¹ The rule was discriminatory despite "[t]he fact that the exemption from tax which gave rise to the refund was available only to non-resident companies."¹⁴²

133. *Commerzbank*, 1993 E.C.R. I-4017, at 471, para. 4.

134. *Id.*

135. *Id.* at 471, para. 5.

136. *Id.*

137. *Id.*

138. *Id.* at 471, para. 6.

139. *Id.* at 472, para. 8.

140. *Id.* at 474, para. 20 (emphasis added).

141. *Id.* at 474, para. 19.

142. *Id.*

The broad interpretation of the ECJ is clearly indicative of an increasing effort to harmonize Member State tax laws. The decision could reasonably be viewed as an effort to minimize and eventually eliminate the need for Member State double-taxation agreements with one another. The greater the harmonization, the less need there will be for such agreements. As Secular points out, much litigation will likely ensue from this decision, as an array of potentially discriminatory Member State tax laws are brought into question in light of the *Commerzbank* decision.¹⁴³

As we have already seen in the *Schumacker* decision, the German tax authorities have significantly softened their position with regard to granting tax advantages to individuals who make most of their income from employment in Germany. The changes the U.K. Inland Revenue has already implemented are striking and provide a much-needed demonstration of pro-EC enthusiasm from the often-hesitant United Kingdom.¹⁴⁴ Other areas of nondiscrimination in which the *Commerzbank* decision could have an impact include: nonresident exclusions from a number of personal allowances in Belgium; a French real property tax levied on foreign companies and a thin capitalization provision to which only foreign companies are subject; and the nonresident exclusions from personal deductions and beneficial tax rates in the Netherlands.¹⁴⁵ It will only be a matter of time before these and other likely discriminatory Member State tax provisions are brought for review before the ECJ.

III. The ECJ's Changing Role

While the potential methods the EC may implement in an effort to harmonize further Member State tax laws is beyond the scope of this Comment,¹⁴⁶ the more frequent use of the article 177 procedure¹⁴⁷ in conjunction with the case law of the ECJ establishing the supremacy of Community law over national law indicates that the role of the ECJ is changing. In the United States, the U.S. Supreme Court serves primarily in an appellate role for constitutional issues that it must resolve in the interests of legal certainty and equality—two general principles of Community law.¹⁴⁸

143. Secular, *supra* note 132, at 346.

144. Within months of the ECJ's *Commerzbank* decision, the Inland Revenue issued a press release extending a repayment supplement to individuals and companies for a year of assessment in which the individual or company is resident in a Member State other than the United Kingdom on the same basis as payments are made to U.K. residents and encouraging them to make a claim for such a repayment supplement. *Id.* at 345 (Editor's Note), 346.

145. *Id.* at 347.

146. See Brinkmann & Riecker, *supra* note 4, for a discussion of the findings of the Ruding Committee in this regard.

147. The more frequent use of the article 177 procedure is perhaps due to the ECJ's more restricted use of the procedures outlined in articles 173 and 215. See generally Paul P. Craig, *Legality, Standing and Substantive Review in Community Law*, 14 OXFORD J. LEGAL STUD. 507 (1994).

148. DERRICK WYATT & ALAN DASHWOOD, *EUROPEAN COMMUNITY LAW* 91-97 (3d ed. 1993).

An interesting theory advanced by Rasmussen suggests that a similar role may be a goal that the ECJ has in mind for the future.¹⁴⁹ The ECJ's interests in establishing such a system—which would likely expand the role of the existing court of first instance or other yet-to-be-established lower courts—are thought to be greater than a citizen's interest in having direct access to the ECJ.¹⁵⁰ Rasmussen points to other equally restrictive EC Treaty provisions (175 and 215) to support the notion that the ECJ seeks to establish itself as the high appellate court for the Community.¹⁵¹ He also points to the court of first instance to relieve the ECJ of certain cases, such as those concerning staff, and more generally, to allow itself to concentrate on matters of law, to be a step in this direction.¹⁵² And of particular relevance to this Comment, the encouragement of the use of the indirect route to the ECJ through article 177 also suits the appellate objectives of the ECJ.¹⁵³ While Craig challenges Rasmussen's theories as to why the ECJ has been restrictive in terms of citizen access to the ECJ and has encouraged the use of the article 177 procedure, his challenges are not convincing.¹⁵⁴ Rasmussen's theory is very forward looking in its demonstration of the ECJ's desire to take on a role more similar to that of the U.S. Supreme Court, while a more expansive system develops below it to allow for the more efficient and efficacious workings of the EC as a whole.

IV. Some Final Comments Concerning Discrimination in the Direct Taxation Context

The principle of nondiscrimination, as well as the other general principles of the EC,¹⁵⁵ is a necessary tool for the interpretation of laws and in determining whether those laws coincide with the spirit and objectives of the EC Treaty and the general interest of the EC. The ECJ's actions in this regard seem to indicate a desire to take on a new role, while in the meantime realizing that much work remains to be done. The development of such a complex "federal" legal system is a slow process. The inclusion of nations of such various histories and cultures into one Community requires flexibility in the early stages. Though taking account of these differences, the ECJ has, nevertheless, stuck to the primary objective of the EC: "an ever closer union."¹⁵⁶

The effects that a Member State's tax laws have on the internal market and the movement of nationals across the Community frontiers is significant. The decisions of the ECJ, in its efforts to curtail the negative impact that these national

149. Craig, *supra* note 147, at 521 (citing Hjalte Rasmussen, *Why is Article 173 Interpreted Against Private Plaintiffs?* 5 EUR. L. REV. 112, 122).

150. *Id.*

151. *Id.* at 521–22.

152. *Id.* at 521.

153. *Id.* at 522.

154. *Id.* at 521–22.

155. WYATT & DASHWOOD, *supra* note 148, at 88–103.

156. EC Treaty preamble, *supra* note 3.

laws may have on the workings of the internal market, demonstrate the Community-wide need for greater harmonization and uniformity of laws. However, until further harmonization or uniformity of laws becomes the status quo, differences will persist, and with those differences will arise situations in which it may appear that a particular EC citizen is being discriminated against. The decisions of the ECJ, in its efforts to harmonize further the tax laws of the Member States and lay down "the law of the land," have been surprisingly well received by the Member States and must be considered a step in the right direction.

V. Liability of Member States and the Possibility of Damages under the *Brasserie du Pecheur* Case

The following review highlights the ECJ's intolerance regarding Member States' "unconstitutional" provisions in violation of Community law. Whether within the taxation context or within the general civil context, the ECJ clearly recognizes and rules against Member States guilty of such violations. Without such judgments the unification of the EC system would be impossible. Whether damages may be collected presents an issue of first impression in the EC system. The progression of Community law indicates that liability of violating Member States includes damages to injured parties.

A. MEMBER STATE LIABILITY FOR FAILING TO IMPLEMENT A REGULATION—THE *FRANCOVICH* PERSPECTIVE

1. Overview of Francovich

A discussion regarding the applicability of damages against a Member State must begin with an overview of a seminal case decided by the ECJ, *Francovich v. The Republic (Italy)*.¹⁵⁷ The ECJ in *Francovich* considered a claim against Italy involving the nonimplementation of a directive,¹⁵⁸ the question presented being whether Member States should have created guaranty funds for employees when employers went bankrupt.¹⁵⁹ The issue was whether in the spirit of EC law, a government has to pay damages in a case where it failed to implement an EC directive.¹⁶⁰ The ECJ found that Member States that fail to implement a directive are liable to an injured party if three prerequisites are met: (1) the goal

157. Joined cases 6/90 & 9/90, 1991 E.C.R. I-5357, [1993] 2 C.M.L.R. 66 (1991).

158. *Id.* at 108-09.

159. *Id.* at 109.

160. Melanie Ogren, *Francovich v. Italian Republic: Should Member States be Directly Liable for Nonimplementation of European Union Directives?* 7 TRANSNAT'L LAW. 583, 589 (1994). The three prerequisites established in *Francovich* are based on Community law as opposed to the Member States' laws. When discussing the first element of the rights of an individual, it is important to note a term of art, "*subjektives öffentliches Recht*," which translates to a "subjective public claim." As opposed to a claim against a private individual, this subjective public claim is required almost as an element of "standing" in the German courts. Such "standing" is required in order to sue Member

of the directive is to grant legal rights to individuals; (2) the rights must be clear and easily ascertained from the directive; and (3) there must be a causal connection between the infringement of the Member State obligation to comply with the directive and the actual damage to the individual.¹⁶¹ The directive provision in question must not give Member States a choice as to how the provision is to be implemented.¹⁶²

The ECJ's three prerequisites requiring enforcement of liability in this case complied with article 5 of the EC Treaty, which states: "Member States shall take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of this Treaty or resulting from action taken by the institutions of the Community. They shall facilitate the achievement of the Community's tasks."¹⁶³

B. *BRASSERIE DU PECHEUR*

1. *Facts of the Case*

In *Francovich* the ECJ established the principle that the failure of a Member State to conform its law to an EC directive can result in liability of that Member State towards an individual.¹⁶⁴ In the case of *Brasserie du Pecheur*, the plaintiff, a French brewery, demanded 1.8 million deutschmarks (approximately 1.2 million U.S. dollars) in damages from the Federal Republic of Germany.¹⁶⁵ The plaintiff brewery asserted that its beer exports to Germany were stopped in 1981 because the French beer did not comply with the German beer purity laws.¹⁶⁶ The plaintiff relied on the 1987 ECJ decision that found the German law regarding beer purity in noncompliance with Community law based on Germany's prohibition of the sale of beer legally produced and marketed in another Member State if it was

States or entities for not complying with the contents of a subjective public claim. Additionally, the second requirement almost equates a requirement for *preciseness* in the directive. The directive must be sufficiently precise to assign certain rights to an individual and the rights must be determined on the basis of the directive. See Martin Zenner, *Europarecht Volkerrecht, Studien und Materialien, Die Haftung der EG-Mitgliedstaaten für die Anwendung europarechtswidriger Rechtsnormen*, KONSTANZ UNIV. DISSERTATION 26-43 (1995).

161. EC TREATY art. 5; Ogren, *supra* note 160, at 600. The stated task of the EC Treaty is found in article 2, which states:

The Community shall have as its task, by establishing a common market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it.

EC TREATY art. 2.

162. *Id.*

163. *Francovich v. The Republic (Italy)*, [1993] 2 C.M.L.R. at 86.

164. *Brasserie du Pecheur Sa v. Bundesrepublik Deutschland*, 1992 Bundesgerichtshof [BGH], *EUROPAISCHE ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT* [EUZW] 226.

165. *Id.*; see *Biersteuergesetz*, v. 14.3.1952 (BGBl. I.S. 1449) regarding beer purity restrictions/qualifications.

166. *Brasserie du Pecheur Sa v. Bundesrepublik Deutschland*, 1992 BGH at 227.

not brewed in accordance with the purity law.¹⁶⁷ The court of appeals in Germany had rejected the plaintiff's claim and the German Federal Supreme Court (GFSC), according to article 177 of the EC Treaty, wanted the ECJ to clarify if and how a cause of action for damages can be derived from the Community law.¹⁶⁸

2. *Questions Raised by the German Federal Supreme Court*

The first issue that the GFSC requested the ECJ to resolve was whether the principle of Member State liability obligates the Member State to pay damages to an individual who might have suffered damages due to infringements of Community law, for which the Member State was responsible. The court found that the German beer purity law was not adjusted to the EC law, which is supreme, and therefore was not in compliance with article 30 of the EC Treaty.¹⁶⁹

The second issue raised by the GFSC was whether it is possible to apply Member State law to determine that a cause of action for damages is subject to the same restrictions applicable in the case of an infringement of Member State law or supreme national law.¹⁷⁰

The third issue raised by the GFSC was whether it is possible for Member State law to make the cause of action for damages dependent upon some additional element of fault, intention, or negligence on the part of the responsible public servants or people in charge.¹⁷¹

The fourth and final issue raised by the GFSC hinged on the resolution of the first two issues. If the first issue is affirmed and the second issue is denied: (1) can the obligation for damages be restricted according to Member State law to the recovery of damages to certain individual rights (property) or are damages such as lost profits recoverable; and (2) is it necessary that the obligation extends to those damages that existed before the 1987 ECJ judgment finding section 10 of the German Beer Tax Act in noncompliance with article 30 of the EC Treaty.¹⁷²

3. *Discussion of the Application of Member State Law in the Context of Community Law—Findings of the GFSC*

The cause of action brought in this case was not recognized by the GFSC under German domestic law. The GFSC found the asserted wrong, which con-

167. *Id.*; the GFSC places special emphasis on whether a principle of Community law exists that obligates Member States to such damages.

168. *Brasserie*, 1992 BGH at 227.

169. *Id.*; article 30 of the EC Treaty states: "Quantitative restrictions on imports and all measures having equivalent effect shall, without prejudice to the following provisions, be prohibited between Member States." EC TREATY, *supra* note 3, art. 30.

170. *Brasserie*, 1992 BGH at 227. The court provides an example such as in the case of an infringement of a simple parliamentary act against the German Constitution (questioning if the same principles of state liability due to nonconformance with the German Constitution apply under Community law). See the following discussion of the "supremacy of primary remedies."

171. *Id.*

172. *Id.*

sisted of an omission of the federal legislators (noncompliance or nonadjustment of former section 10 of the German Beer Tax Act with supreme regulations of Community law), did not violate any official obligations in relation to section 839 BGB and was therefore not actionable under German law.¹⁷³

The GFSC attempted to draw an analogy in this case between a concept similar to the American concept of "eminent domain" in German law, which gives a cause of action and a right to recover damages if a state or government takes an individual's *tangible* property.¹⁷⁴ A German doctrine developed by scholars and acknowledged by German courts as an "eminent domain-like" cause of action applies if an individual suffers a loss by the state or state action (not real property).¹⁷⁵ In the *Brasserie* case, the GFSC denied application of this "eminent domain-like" doctrine for recovery of damages.¹⁷⁶ As a result, the court questioned to what end an individual is entitled to lost profit due to a state action under this doctrine whether through limitations, requirements, or prerequisites.¹⁷⁷

In its analysis of whether a direct cause of action derived through European law, the court reiterated the holding in *Francovich* affirming the direct liability of Member States towards an individual for noncompliance of an EC directive.¹⁷⁸ In submitting certain questions to the ECJ for a preliminary ruling under article 177 of the EC Treaty, the GFSC set forth the general principles of state liability found in *Francovich* as follows: (1) the EC Treaty set up its own legal system that has been implemented in the national legal systems of the Member States and is to be applied by Member State courts; and (2) legal subjects (natural persons holding rights) in the sense of German legal doctrine are not only Member States, but the individuals of Member States and the rights arising therefrom can apply if there are obligations imposed on the Member States with respect to the individual.¹⁷⁹ As in *Francovich*, the Member States' national courts must warrant full effectiveness of those provisions and must protect the rights of the individuals being assigned by the EC Treaty.¹⁸⁰ If individuals do not have the

173. *Id.*; see Buergerliches Gesetzbuch [BGB] § 839. The official obligations of public servants or people in charge serve the interests of the Community (interests of all people) termed a general interest. Under German law this interest as previously discussed as a "subjective public right" is a requirement for a cause of action. Without this special relationship between these official duties and certain groups of individuals, it is not possible for third parties to recover damages. Certain exceptions termed "individual acts/measure acts" identify certain interests of individuals that may be effected. Those can be regarded as third persons in the sense of § 839 BGB. The plaintiff in this case was not a third party and therefore does not raise a "subjective public right" and the procedural rule necessary for state liability requiring the cause of action be in the interest of general people is not met. *Id.*

174. *Brasserie*, 1992 BGH at 227; GRUNDGESETZ [CONSTITUTION] [GG] art. 14 (F.R.G.).

175. *Id.*

176. *Id.*

177. *Id.*

178. *Brasserie*, 1992 BGH at 227.

179. *Id.*

180. *Francovich v. The Republic (Italy)*, [1993] 2 C.M.L.R. 66, 86 (1991).

possibility to demand damages based on a cause of action that their rights were violated by an infringement of EC law by a Member State, the full effectiveness of those European provisions would be restricted and the protection would be diminished.¹⁸¹

C. THE ECJ'S DECISION

1. *Member State Liability—Generally*

On March 5, 1996, the ECJ released its decision in the *Brasserie* case.¹⁸² The ECJ began its decision with a brief look at the possibility of a Member State's obligation to compensate individuals for violations of Community law attributable to a Member State's legislative action.¹⁸³ As previously discussed, *Francovich* and other cases have indicated the ECJ's consistent belief that effective provisions of the EC treaty are a minimum guarantee of rights to an individual in an attempt to "ensure that provisions of Community law prevail over national provisions."¹⁸⁴ Rights directly conferred by a Community provision that provides redress to an individual before the national courts must be followed with a right to reparation for any damages sustained.¹⁸⁵ The division of powers within each Member State must not affect an individual's right to reparation. Therefore, the ECJ found that regardless of the "organ" of the state that caused the violation, the principle of state liability to individuals remains.¹⁸⁶

2. *Conditions for Liability*

In situations in which wide discretion is provided to the Member State (such as the restriction of beer in the *Brasserie* case), uniformity must be established as to when Member States will incur liability.¹⁸⁷ In cases of wide discretion,

181. *Id.* at 86. Therefore, in the case of an omission of Member States, an individual can go to the courts and claim rights assigned to them by Community law. As in *Francovich*, the court identifies article 5 of the EC Treaty and the obligation of the Member States to take all suitable measures of a general or special nature to fulfill their obligations under Community law. Among those obligations is the duty to provide a remedy for the unlawful consequences of an infringement of Community law.

182. *Brasserie du Pecheur Sa v. Bundesrepublik Deutschland*, [1996] 1 C.M.L.R. 889.

183. *Id.* at 983–86.

184. *Id.* at 985.

185. *Id.* Community liability for the exercise of legislative activities is based on two considerations: (1) the Community interests may override individual interests, and the legislature should therefore not be restricted from acting; and (2) the legislature generally acts on behalf of the entire community, and therefore only grave and manifest disregard for the limitations on the legislative powers may result in community liability.

186. *Id.* at 986 (stating that the rules relating to liability for legislative measures include "the complexity of the situations to be regulated, difficulties in the application or interpretation of the texts and, more particularly, the margin of discretion available to the author of the act in question.")

187. *Id.* at 989. For a more recent decision following the ECJ's decision, see *The Queen and Ministry of Agriculture, Fisheries and Food, ex parte Hedley Lomas (Ireland) Ltd.*, Case 5/94 1996 WL J0005.

three conditions must be met prior to an individual's right to reparation: "the rule of law infringed must be intended to confer rights on individuals; the breach must be sufficiently serious; and there must be a direct causal link between the breach of the obligation resting on the state and the damage sustained by the injured parties."¹⁸⁸ To determine the manifest and grave disregard for discretionary limits, the ECJ may consider factors including any available excuses, whether a Community institution contributed to the omission, whether the authorities had broad discretion, whether the violation was intentional, and whether the rule violated was sufficiently clear to the Community.¹⁸⁹ The ECJ indicated that any subsequent violation following a judgment would clearly denote a serious infringement of an individual's rights.¹⁹⁰ Likewise, a Member State's failure to adopt and comply with measures passed by the EC would be a clear indicator of a serious breach of Community law.¹⁹¹

Since the determinations regarding violations are made by the national courts, some existing national laws may restrict the type or amount of reparation a state must make to an individual.¹⁹² These limitations may cause problems when dealing with Member States in which the domestic laws of the State restrict noncontractual liability, therefore limiting the individual's right to reparations guaranteed under Community law.¹⁹³ Any such domestic law that violates or inhibits an individual's rights under Community law must be set aside in order to insure the effectiveness of Community law.¹⁹⁴

3. *The Element of Fault*

The variations between the Member States' approach to state liability demonstrates the lack of uniformity in the collection of damages as well as the laws of each government regarding torts.¹⁹⁵ The varying approaches raise a question

188. *Brasserie*, [1996] 1 C.M.L.R. at 985.

189. *Id.*

190. *Id.* at 990 ("A breach will be sufficiently serious if it has persisted despite being the subject of a court ruling or it is clear in the light of settled case law. The German purity law was thus not an excusable error in the light of earlier decisions of the European court." *Law: EU States Liability Ruling—European Court*, FIN. TIMES, Mar. 12, 1996 at 14).

191. *Brasserie*, [1996] 1 C.M.L.R. at 990.

192. *Id.*

193. *Id.* at 992.

194. *Id.*

195. Walter Van Gerven, *Bridging the Gap Between the Community and National Laws: Towards a Principle of Homogeneity in the Filing of Legal Remedies?* 32 COMMON MKT. L. REV. 679, 696 (1995).

Thus, in various countries, some of which belong to the common law group (England, Ireland) whereas others belong to the Romanistic group (Belgium, Luxembourg and the Netherlands), state liability is governed by the same rules as the liability of individuals and is based on fault or negligence, breach of statutory duty, etc. In other countries (like France, Greece, Italy and Spain) the liability of the State is engaged in principle by virtue of an objective illegal act, or of harm done to property as a subjective right, or (as in Germany) by virtue of intentional or negligent exercise of public office.

as to an additional element of *fault* in such causes of action.¹⁹⁶ Naturally, most Member States argue that an additional requirement of fault is desirable in an attempt to shield governments from liability under Community law provisions.¹⁹⁷ In a recent case before the ECJ, the Advocate General observed,

“A serious fault, defined as the breach of a clear provision of Community law (or of a provision already interpreted by the court) or a repeated breach—or repeated despite a judgment declaring that there has been a failure to fulfil obligations ought, without doubt, to involve the State in liability.”¹⁹⁸

As applied to the *Brasserie* case, the element of fault could have been raised in the context of the German government's failure to adjust its beer purity laws to the Community standards or in the customs' officer's failure to interpret the relevant laws with a view to the pertinent provisions of the EC Treaty.¹⁹⁹ Issues that might have been germane to such a determination of fault would include the level of awareness of the German government as to the violation of Community law, whether such inconsistencies were previously raised and disregarded, and possibly the rationalization that the German government could provide for implementing a provision in violation of Community law.

4. *Applicability of Article 215 of the EC Treaty*

Arguably, article 215 provides a provision of noncontractual liability for the ECJ to rely on in support of requiring an element of fault in a cause of action for damages.²⁰⁰ The problem of government liability was addressed in the *Francovich* decision by Advocate General Mischo, who stated:

[T]he grant of damages by a national court for breach of Community law by a Member State should be subject to the same conditions as an award of damages by the Court of Justice for infringement of that same Community law by a Community institution. This would make it possible to avoid a situation where, pursuant to Community law, a Member State might incur liability for breach of Community law by one of its authori-

196. *Id.*

197. Michael Pimm, *EU: Law—State Liability for Legislation in Breach of EC Law*, Reuter Textline Lloyd's List, Dec. 2, 1994. Similarly, in an action for damages against the Commission, damage arising from actions connected with fault are recoverable. K.P.E. LASOK, *THE EUROPEAN COURT OF JUSTICE PRACTICE AND PROCEDURE*, 546-48 (2d ed. 1994).

198. Peter Duffy, *European Briefing—Damages Against the State*, SOLIC. J., July 7, 1995, at 655.

199. *Brasserie*, [1996] 1 C.M.L.R. at 889. A question exists as to whether Germany was actually aware of the violation of Community law. Should a distinction be drawn between a Member State that establishes discriminatory norms in violation of Community law? Assuming the Member State was unaware of the violation, shouldn't this lack of knowledge in some way mitigate or change the damages issue?

200. EC TREATY, *supra* note 3, art. 215. Article 215 states:

The contractual liability of the Community shall be governed by the law applicable to the contract in question. In the case of non-contractual liability, the Community shall, in accordance with the general principles common to the laws of the member-States, make good any damage caused by its institutions or by its servants in the performance of their duties.

ties in circumstances where the non-contractual liability of the Community for breach of Community law by one of its institutions would not arise. That seems to me to be particularly necessary as the rules laid down in this regard by the Court on the basis of the second paragraph of article 215 of the Treaty are said to flow from the general principles common to the laws of the Member States.²⁰¹

As previously stated, the *Francovich* decision detailed three requirements for Member State liability for nonimplementation of Community law that excluded a prerequisite in noncontractual liability of Community institutions under article 215 of a "fundamental breach of a superior rule of law."²⁰² The prerequisites articulated in *Francovich* appear to be beneficial to claimants, while the prerequisite under article 215 does not afford the same benefits if the cause of action is against a Community institution.²⁰³ The ECJ addressed the issue of fault in reparation determinations. The ECJ found that since each individual has a right to reparation founded in Community law, any additional requirement of fault would countermand the authority established by the Community. Therefore, the ECJ determined that an additional element of fault would be unnecessary when determining whether an individual is entitled to reparation for injuries or damages caused by a Member State or its legislative body.²⁰⁴ The standard of a sufficient breach of Community law will be applied to such cases rather than an analysis of fault.²⁰⁵

D. DAMAGES RECOVERABLE AND MITIGATION OF DAMAGES

1. *Application of the Francovich Prerequisites*

The *Francovich* prerequisites establish the requirements of state liability specifically in the context of the nonimplementation of a directive.²⁰⁶ With the wide latitude provided to broaden existing remedies of their national laws, Member States may attempt to create a uniform application of their laws and Community rules.²⁰⁷ Perhaps in an attempt to fulfill the Member States' obligations under article 5 of the EC Treaty and "secure the uniform application of Community law in all Member States," the outlined *Francovich* prerequisites should have been applied in the *Brasserie* case.²⁰⁸

201. Roberto Caranta, *Judicial Protection Against Member States: A New Jus Commune Takes Shape*, 32 COMMON MKT. L. REV. 703, 723 (1995).

202. *Id.*

203. *Id.* at 724.

204. *Brasserie*, [1996] 1 C.M.L.R. at 993.

205. *Id.* at 993-94.

206. *Francovich*, 2 C.M.L.R. at 86.

207. Van Gerven, *supra* note 195, at 693. Walter Van Gerven, *Bridging the Gap Between the Community and National Laws: Towards a Principle of Homogeneity in the Field of Legal Remedies?* 32 COMMON MKT. L. REV. 679, 693 (1995).

208. Van Gerven, *supra* note 207, at 692. Such uniformity would provide an element of predictability in the recovery of damages.

2. Additional Prerequisites

One might conclude that the ECJ's delineation of three prerequisites in *Francoovich* prescribes part or all of the requirements necessary to enforce Member State liability.²⁰⁹ If this proposition is correct, then the assumption may be raised that any remaining prerequisites, since not found in the Community law, must be taken from the procedural and substantive law of the Member States.²¹⁰ "A clear-cut choice underlies the questions: either liability is to be governed in its details by national law, or the Court has to develop the seminal conditions set out in *Francoovich* to an ever greater detail, therefore widening the *jus commune* emerging in the field of governmental liability."²¹¹

3. Damages Recoverable—Generally

Differing opinions abound as to what damages should be recoverable under a cause of action similar to the *Brasserie* case. One commentator has suggested that if the state is liable in its legislative capacity, the injured party is entitled to a type of restitution damages compensating the party in full and placing the party in the same position it would have been but for the violation of Community law.²¹² Cases dealing with compensation in the context of article 215 consider whether the injured party was able to pass on claimed damages to its customers.²¹³ Other commentators reiterate this general restitution proposition including damages such as material damage or loss and lost profits.²¹⁴

In *Brasserie*, the ECJ determined that calculations of the amount of reparation for each individual's loss or damage require that the loss or damage from a violation of Community law be "commensurate with the loss or damage sustained so as to ensure the effective protection for [the individual's] rights."²¹⁵ Should the Community law not provide a calculation for the damages, each Member State's legal system must establish the criteria for reparation.²¹⁶ Since Member States may be tempted to avoid any reparation at all, the criteria established for violations of Community law must not be any less favorable to the individual than the criteria applied to similar claims under the Member States' domestic law.²¹⁷ A Member State may not make reparation impossible or overly difficult to obtain.²¹⁸

209. Zenner, *supra* note 160, at 43.

210. *Id.* If such state liability is applied, however, the law must be interpreted in the spirit of the Community law.

211. Caranta, *supra* note 201, at 770.

212. Duffy, *supra* note 198.

213. Case 238/78, *Federal Republic of Germany v. Council and Commission of EC*.

214. Zenner, *supra* note 160, at 69.

215. *Brasserie*, [1996] 1 C.M.L.R. at 994.

216. *Id.*

217. *Id.*

218. *Id.*

4. *Mitigation of Damages—Supremacy of Primary Remedies*

Injured parties may recover through two alternative routes, primary remedies and secondary remedies.²¹⁹ Primary remedies can be provided by challenging an administrative decision rather than suing the Member State directly.²²⁰ Secondary remedies, however, attempt to collect damages via a cause of action demanding damages.²²¹ Such a distinction between remedies has an effect in those jurisdictions that recognize a supremacy of primary remedies in the recognition of mitigation and calculation of damages.²²²

In the ECJ, no general supremacy of Member State primary legal protection or remedies is recognized.²²³ However, German state liability law, section 839 BGB, is dominated by a general supremacy of the primary legal protection or remedies.²²⁴ As a result, if an injured party could avoid damages by filing an administrative action, the failure to do so is considered a failure to mitigate.²²⁵ Injured parties are therefore forced to go through primary remedies first and, if they fail to do so, are not entitled to damages that they could have avoided.²²⁶ Had the ECJ chosen to recognize such a supremacy of primary remedies or protection in cases of administrative wrongs, the calculation of damages in the *Brasserie* case could have been altered by the plaintiff's failure to exhaust administrative remedies prior to secondary remedies under *Francovich*.²²⁷

The ECJ in *Brasserie* determined that mitigation of damages may be considered when determining the amount of reparation appropriate for an individual's damages or loss. National courts may consider "whether the injured person showed reasonable diligence in order to avoid the loss or damage or limit its extent and whether, in particular, he availed himself in time of all the legal remedies available to him."²²⁸ This provision for mitigation mirrors a principle common to the Member States in which injured parties risk bearing the loss himself absent demonstrating an attempt to limit the loss or damage through reasonable diligence.²²⁹ In *Brasserie*, the ECJ was careful to point out that damages from lost profits would not be excluded.²³⁰ Specifically in the cases of economic or commercial

219. Zenner, *supra* note 160, at 146.

220. *Id.* Such a remedy generally can avoid damages if the party obtained enough protection by going through the administrative agency process.

221. *Id.* Such a cause of action would be analyzed as per the *Francovich* prerequisites in addition to the respective Member State's prerequisites. *Id.* at 314.

222. *Id.* at 146.

223. *Id.* at 150.

224. *Id.* at 154.

225. *Id.*

226. *Id.* at 182.

227. *Id.* at 77. The plaintiff in *Brasserie* could have tried to revoke the provision directly under an administrative procedure for violation of article 30.

228. *Brasserie*, [1996] 1 C.M.L.R. at 994.

229. *Id.*

230. *Id.*

litigation, the complete exclusion of such damages would not comply with the court's requirement that reparation not be unduly difficult or impossible to obtain.²³¹ Similarly, an award of exemplary damages is not precluded in instances in which a Member State's domestic law provides for such damages in similar claims or actions.²³²

5. *Mitigation of Damages—Application of the Sabena Case in Determining the Period of Time for the Calculation of Damages*

The ECJ in the *Sabena* case discussed the calculation of past damages prior to the institution of a suit in the context of a sex discrimination suit against a Belgian airline.²³³ The ECJ held that "[i]mportant considerations of legal certainty affecting all the interests involved, both public and private, make it impossible in principle to reopen the question of pay as regards the past," thereby effectively removing any recourse for damages prior to the institution of the suit.²³⁴ The court in *Brasserie* chose not to limit the damages that a plaintiff may recover.²³⁵

F. CONCLUSION

Applying the principles of *Francovich* and the goals of article 5 of the EC Treaty, a compromising solution was appropriate for the ECJ in the *Brasserie* case. As discussed in the first half of this article, Member States may be held liable for tax violations under the ECJ. This type of liability infers the collection of damages against a Member State. Therefore, the *Brasserie* decision will have far-reaching implications in the field of damages.

The resolution of several difficult issues was imperative in the court's decision: (1) whether the ECJ would create what is to be termed a "uniform law" fashioned after the prerequisites of the *Francovich* decision; (2) whether an additional element of *fault* or other prerequisites may be added to determine Member State liability; (3) what actions on the part of both parties will be considered in the mitigation of damages; and (4) to what extent damages will be limited by the 1987 ECJ decision that found a violation of article 30.

231. *Id.*

232. *Id.* at 995.

233. See Case 43/75, *Gabrielle Defrenne v. Société Anonyme Belge de Navigation Aérienne Sabena*, 1976 E.C.R. 455.

234. *Id.*

235. The court extended the period covered by reparation to any time where it can be proved that the damage was sufficiently serious. It added that the criteria for receiving damages could not be different than those currently applied to domestic claims. But it said the key issue was a citizen's right to a day in court.

Community Law: EU Court Upholds Individual's Rights Against Member States, EUR. REP., Mar. 9, 1996.

The ECJ clearly indicated that uniformity is imperative among the Member States in the determination of reparation to individuals for Member State violations of Community law. Eliminating the element of fault, the ECJ based the award of damages to an individual upon a serious violation of Community law. Although the ultimate calculation of damages is left to the individual Member States and the applicable domestic law, the ECJ clearly established that Member States must not discriminate between violations of domestic or Community laws. Even exemplary damages, if available in the Member State, may be awarded to an individual. One clear premise is evident from the ECJ's decision: Member States must comply with Community law or face reparations for noncompliance.