DOUBLE TAX CONVENTIONS AND THE EUROPEAN UNION*

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"each time the Community, with a view to implementing a common policy envisaged by the Treaty, adopts provisions laying down common rules, whatever form these may take, the Member States no longer have the right, acting individually or even collectively, to undertake obligations with third countries which affect those rules". (ERTA)

Preliminary remarks

This article examines the relationship between the double tax conventions concluded by the EU Member States and competence in a European Union setting.[2] In 2004, Professor Van den Hurk argued that the ability of the EU Member States to conclude tax treaties may have been chained up.[3] This article demonstrates that this is not the case. Part I introduces the topic and explains what competence is and which Union institutions have competences in the direct taxation field. Part II examines the nature

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2 For a detailed examination of the relationship between EU law and double tax conventions, see: Tom O'Shea, *EU Tax Law and double tax conventions*, (Avoir Fiscal Limited, London, 2008).

3 See Hans van den Hurk, *"Is the ability of the Member States to conclude tax treaties chained up?"* (2004) EC Tax Review, 1, 17-30. Throughout the text "Union" and "Community" are used interchangeably to reflect the post-Lisbon Treaty situation which came into effect at the time of writing of this article on the 1 December 2009.

of Union competences and analyses the relationship between Union competence and national competence, with particular emphasis on the area of Member States' double tax conventions. Part III investigates the Union's doctrine of implied powers and focuses on the ECJ's *AETR* (*ERTA*) line of cases[4] and the notion of "common rules". Part IV briefly examines the division of competences in the Treaty of Lisbon and investigates whether there are any changes of relevance to direct taxation and double tax conventions. Part V provides some conclusions and answers the question: "Is the ability of the Member States to conclude tax treaties chained up?"

Part I: Competence

Competence may be defined as the legal power or ability to take a particular action.[5] Union institutions have been endowed with certain limited powers,[6] which were previously exercised by the Member States. By conferring such powers on the Union, the Member States have agreed to a corresponding limitation in their own rights. Although the Member States omitted almost all reference to "direct taxes" from the original EEC Treaty, it was clear from the Court's *Jean-E. Humblet v Belgian State ("Humblet")* decision of 1960, that the power to tax the salaries of Community officials was restricted to the Community alone, and that the Member States were prohibited from taxing the salaries of such officials. In *Humblet*, the Court recognised that the Treaties had provided for a division of direct taxation powers between the Member States and the Community. The Court stated:

> *"Taken as a whole, the three Treaties….withdraw the remuneration paid to officials of the Community from the Member States' sovereignty in tax matters.(…)[7] This division of reciprocal fiscal jurisdiction must exclude any*

4 See ECJ, 31 Mar 1971, Case 22/70, *Commission v Council, ("ERTA"),* [1971] ECR 263. "*ERTA*" is otherwise referred to as "*AETR*" which is derived from the French translation of the words European Road Transport Agreement.

5 For a very interesting introduction to the topic of "competence" see Udo di Fabio, "*Some remarks on the allocation of competences between the European Union and its Member States"*, CML Rev. 39: 1289-1301, 2002; and in relation to direct taxes see: Luca Cerioni, "*A hypothesis for radical tax reform in the European Union - the implications of the abolition of corporate income taxes" (2007) ET*, 47(8/9), 377-388.

6 Article 5 EC provides that "*The Community shall act within the limits of the powers conferred upon it by this Treaty and of the objectives assigned to it therein" (*now Article 5 TEU*).* Article 7(1) EC provides that "*Each institution shall act within the limits of the powers conferred upon it by this Treaty"* (now Article 13(2) TEU). See the discussion on the TEU below.

7 ECJ, 16 Dec 1960, Case 6/60, *Jean-E. Humblet v Belgian State*, [1960] ECR 559 (English special edition), *paragraph 4.*

> *taxation, direct or indirect, of income which is not within the jurisdiction of the Member States".*[8]

Thus, from the very establishment of the Union, the direct taxation powers/competence of the Member States had been limited to some extent by some provisions of the Treaties and, since 1960, the Member States had a ruling from the ECJ making it very clear that competence in direct tax matters no longer rested solely with the Member States. By joining the Union, each Member State had given up some of its direct taxing rights to the Union.[9]

When the Union legal order was recognised as being a superior legal order to that of the national laws of the Member States,[10] the potential for competence and compliance disputes arose because of the interaction between national laws and EU law as the Member States did not expressly carve-out the direct tax sphere from the scope of Union law, they simply omitted almost all mention of it in the Treaties. Thus, Member States which had been fully competent in relation to double tax conventions and direct tax matters prior to the transfer of powers to the Union, now faced the question as to how this new division of powers operated and what, if any limits, Union law placed on their double tax conventions and more generally on their direct taxation powers.

From the double tax convention perspective, the powers conferred on the Union appear at first glance to be quite limited. Taxation is rarely mentioned in the EC Treaty (now the TFEU[11]) and the Member States have retained competence in direct tax matters. There is little secondary legislation relating to direct tax matters in place

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8 *Humblet paragraph 5.*

9 See Silvere Lefevre, *"The interpretation of Community Law by the Court of Justice in the areas of national competence"*, E.L. Rev. 2004, 29(4), 501-516.

10 ECJ, Case 26/62, *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration ("Van Gend en Loos")*, [1963] ECR 1. See: Pavlos Eleftheriadis, *"The direct effect of Community law: conceptual issues"*, Y.E.L. 1996, 16, 205-221; Ole Spiermann, *"The other side of the story: an unpopular essay on the making of the European Community legal order"*, E.J.I.L. 1999, 10(4), 763-789; Hans Lindahl, *"Acquiring a Community: the acquis and the institution of European legal order"*, E.L.J. 2003, 9(4), 433-450; Alan Dashwood, *"The relationship between the Member States and the European Union/European Community"*, C.M.L. Rev. 2004, 41(2), 355-381; Francis G. Jacobs, *"The evolution of the European legal order"*, C.M.L. Rev. 2004, 41(2), 303-316.

11 The Lisbon Treaty was adopted on the 1 December 2009. Consequently, the Treaty on European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU) became the primary Treaties. Therefore, the term "EC Treaty" will be used throughout the text with TEU or TFEU numbers in brackets.

and there is no multilateral Treaty like the Arbitration Convention[12] dealing with general double tax convention issues.[13] Consequently, it might be argued that the EC Treaty has very little overlap with double tax conventions. However, that statement fails to evaluate the influence of the ECJ in cases like *Avoir Fiscal*,[14] *Wielockx*,[15] *RBS*,[16] *Saint-Gobain*,[17] the *D* case,[18] *Gilly*,[19] *Bouanich*,[20] *FII GLO*,[21] *ACT IV GLO*,[22]

12 Convention 90/436/EEC of 23 July 1990 on the Elimination of Double Taxation in connection with the Adjustment of Profits of Associated Enterprises (OJ L 225, 20 August 1990, at page 10). See J. David B. Oliver, "*The revival of the EC Arbitration Convention*", B.T.R. 2005, 2, 183-185; Gerald Murphy, "*Cross-border tax and the European Arbitration Convention*", Accountancy Irl. 2006, 38(4), 82-83

13 The Member States have agreed a Code of Conduct concerning the implementation of the Arbitration Convention. See COM (2004) 297 final.

14 ECJ, 28 Jan 1986, Case 270/83, *Commission v France, ("Avoir Fiscal"),* [1986] ECR 273.

15 ECJ, 11 Aug 1995, Case C-80/94, *G. H. E. J. Wielockx v Inspecteur der Directe Belastingen, ("Wielockx"),* [1995] ECR I-02493.

16 ECJ, 29 Apr 1999, Case C-311/97, *Royal Bank of Scotland plc v Greece ("RBS"),* [1999] ECR I-02651.

17 ECJ, 21 Sep 1999, Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt, ("Saint-Gobain"),* [1999] ECR I-06161.

18 ECJ, 5 Jul 2005, Case C-376/03, *D. v Inspecteur van de Belastingdienst /Particulieren/ Ondernemingen buitenland te Heerlen, ("D case"),* [2005] ECR I-05821. For analysis see Tom O'Shea, "*The European Court of Justice, its D. Decision, Most-Favoured Nation Treatment and Double Tax Conventions: Comparability and Reciprocity*", in S. van Thiel (Editor), The European Union's Prohibition of Discrimination, Most-Favoured-Nation Treatment and Tax Treaties: Opinions and Materials, Berlin: Confederation Fiscale Europeenne, 2006, 57-76.

19 ECJ, 12 May 1998, Case C-336/96, *Mr and Mrs Robert Gilly v Directeur des Services Fiscaux du Bas-Rhin ("Gilly"),* [1998] ECR I-02793.

20 ECJ, 19 Jan 2006, Case C-265/04, *Margaretha Bouanich v Skatteverket,* ("*Bouanich*")[2006] ECR I-00923.

21 ECJ, 12 Dec 2006, Case C-446/04, *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue, ("FII GLO"),* [2006] ECR I-09521. For analysis, see Tom O'Shea, "*Dividend Taxation Post-Manninen: Shifting Sands or Solid Foundations?"* Tax Notes International, March 5, 2007, 887-918 ("O'Shea – Dividend Taxation").

22 ECJ, 12 Dec 2006, Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v Commissioners of Inland Revenue, ("ACT IV GLO"),* [2006] ECR I-11673. For analysis, see O'Shea – Dividend Taxation in fn 21.

Denkavit Internationaal,[23] *Kerckhaert-Morres*,[24] *Amurta*,[25] *Aberdeen Property*[26] and *Damseaux*[27] where Union law played a major role in the realm of double tax conventions. Understanding the notion of competence and the division of competences from an EU perspective and its relationship with the double tax conventions of the EU Member States therefore, is of major importance in understanding the regulatory framework for tax in the EU.

Part II: The Nature of Union Competences

Introduction

Under the EC Treaty, the Community was granted a number of "express competences" which include powers to implement the fundamental freedoms,[28] such as directives and regulations;[29] powers to adopt provisions for the harmonisation of indirect tax legislation,[30] and jurisdiction to issue directives for the approximation of laws, regulations or administrative procedures that directly affect the establishment and functioning of the common market.[31] The Community was also granted an

23 ECJ, 14 Dec 2006, Case C-170/05, *Denkavit Internationaal BV, Denkavit France SARL v Ministre de l'Économie, des Finances et de l'Industrie,("Denkavit Internationaal"),* [2006] ECR I-11949. For analysis, see O'Shea – Dividend Taxation in fn 21.

24 ECJ, 14 Nov 2006, Case C-513/04, *Mark Kerckhaert, Bernadette Morres v Belgian State, ("Kerckhaert-Morres"),* [2006] ECR I-10967. For analysis, see O'Shea – Dividend Taxation in fn 21.

25 ECJ, 8 Nov 2007, Case C-379/05, *Amurta SGPS v Inspecteur van de Belastingdienst /Amsterdam, ("Amurta"),* [2007] ECR I-9569. For analysis, see Tom O'Shea, *"ECJ Strikes Down Dutch Taxation of Dividends"*, Tax Notes Int'l, Jan. 14, 2008, pp. 103-106

26 ECJ, 18 Jun 2009, Case C-303/07, *Aberdeen Property Finivest Alpha Oy, ("Aberdeen Property"),* [2009] ECR I-0000, (not yet reported). For analysis, see Tom O'Shea, *"ECJ Finds Finnish Withholding Tax Rules Unacceptable in Luxembourg SICAV Case"*, Tax Notes International, July 27, 2009, 305-308.

27 ECJ, 16 Jul 2009, Case C-128/08, *Jacques Damseaux v Belgian State*, ("*Damseaux*"), [2009] ECR I-0000, (not yet reported). For analysis, see Tom O'Shea, *"ECJ Upholds Belgian Dividend Tax Treatment"*, Tax Notes International, August 3, 2009, 354-357.

28 See Derrick Wyatt QC, *"The Growing Competence of the European Community* (2005) *European Business Law Review, 16.* 483-488

29 See the EC Treaty, in particular, Article 42 EC (workers) (Article 48 TFEU), 44 EC and 47 EC (establishment) (Articles 50 and 53 TFEU), 52 EC (services) (Article 59 TFEU) and 57(2) EC and 59 EC (capital) (Articles 64(2) and 66 TFEU) for examples of legal bases for the implementation of the fundamental freedoms. See also, Article 18(2) EC (Article 21(2) TFEU) in relation to EU citizenship matters.

30 Article 93 EC (Article 113 TFEU).

31 Article 94 EC (Article 114 TFEU).

extremely wide "residual power" to take action to achieve a Community objective if the EC Treaty did not provide the necessary powers,[32] and the Commission was given the powers to prevent a distortion of competition in the common market,[33] analogous to the powers it was given in the State aid field.

The Court has also indicated in its jurisprudence that certain implied Community competences existed even though they had not been specified in the EC Treaty.[34]

The Union has also developed a political dimension with many policies relying upon the political cooperation and goodwill of the Member States[35] using Union initiatives, rather than actual Union legislation. This "soft-law", which is not binding on the Member States, carries the necessary "political-weight" combined with "peer-pressure" to ensure that commitments made under the political process are fulfilled. There is increasing use of "soft-law" in the direct tax area because of the unanimity voting requirement in the area of direct taxes.[36] "Soft-law" is, therefore, seen as one solution to the lack of will on the part of the Member States to transfer more competence to the Union in the direct tax area.

Analysing Union Competence

Union competence can be analysed in a number of different ways: (1) as internal and external competence; (2) as vertical and horizontal competence; (3) as express or implied competence, and (4) as shared, concurrent, or exclusive competences.[37]

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32 Article 308 EC (Article 352 TFEU). This power has to be interpreted within the scope of the EC Treaty. It is not equivalent to the inherent power of the Member States to make legislation.

33 See Articles 95 EC and 96 EC (Articles 114 and 116 TFEU) in relation to approximation of laws relating to distortion of competition and Article 88 EC (Article 108 TFEU) in relation to state aids.

34 See Nicholas Emiliou, "*Implied Powers and the Legal Basis of Community Measures"*, E.L. Rev. 1993, 18(2), 138-144; Rass Holdgaard, "*The European Community's Implied External Competence after the Open Skies Cases",* (2003) European Foreign Affairs Review, 8, 365-394

35 The Code of Conduct on Harmful Tax Competition is a good example. See Council Conclusions of 9 March 1998 concerning the establishment of the Code of Conduct Group (business taxation) (98/C 99/01), Official Journal C 099, 01/04/1998 p1-2.

36 The unanimity requirement is often referred to as the "tax veto".

37 See, Rafael Leal-Arcas, "*The European Community and Mixed Agreements",(2001)* European Foreign Affairs Review, 6, 483-513, at 488 et seq. and the secondary materials cited therein; Antonio Goucha Soares, "*The Division of Competences in the European Constitution"*, European Public Law, Vol. II, Issue 4, 603-621; Robert Schutze, "*Dual Federalism constitutionalised: The emergence of exclusive competences in the EC legal order",* E.L. Rev. 2007, 32(1), 3-28.

(1) Internal and External Union Competences

Internal competences are those granted in the TEU/TFEU to the Union to meet a specific Union objective. These can be exclusive to the Union, or they can be shared with the Member States. If they are exclusive to the Union, then the Member States lack the power to act in that particular field of the economy unless they are authorised to do so by the Union, and even then, they must conduct their activity "in the common interest".[38]

External competences usually concern Union powers in relation to international agreements with Third Countries. In certain situations, only the Union is competent to conclude such international agreements, and in such instances, the Union is said to have "an exclusive external competence".[39] In other situations the Union and the Member States have a shared external competence,[40] and therefore, the Union and the Member States must either conclude the international agreement together,[41] or

38 See ECJ, 14 Jul 1976, Joined Cases 3, 4 and 6/76, *Cornelis Kramer and Others. ("Kramer")*, [1976] ECR 1279, paragraphs 44-45.

39 For example, international agreements coming within the Common Commercial Policy in Article 133 EC (Article 207 TFEU).

40 See the discussion below on the changes made by the Lisbon Treaty.

41 An example is seen in the recent EU-USA "Open Skies" Air Transport Agreement which was concluded by the Union and by the Member States because the Union had acquired certain exclusive external competences and the Member States were also competent in other areas covered by the agreement. Hence, the Union's legislation had not covered the entire "air transport field" merely a part of it. This allowed the Member States to retain a certain level of competence in the air transport area that was not regulated by harmonised rules. Consequently, the Union and the Member States had to be involved in negotiations and conclusion of the "Open Skies" agreement with the USA. For a discussion of the problems involved in the lead up to this agreement with particular relevance to double tax conventions and limitation on benefit clauses in double tax conventions with the USA, see Tom O'Shea, *EU Tax Law and Double Tax Conventions* (Avoir Fiscal Ltd., London. 2008) Chapter 5; Tom O'Shea, *"Limitation on Benefit (LoB) Clauses and the EU – Part I"*, International Tax Report, October, 2008, and Tom O'Shea, *"Limitation on Benefit (LoB) Clauses and the EU – Part II"*, International Tax Report, November, 2008. On the "Open Skies" jurisprudence, generally, see: Henri Wassenbergh, *"The Decision of the ECJ of 5 November 2002 in the 'Open Skies' Agreements Cases"*, Air & Space Law, Vol.XXVII/1 (February 2003), 19-31; Ruwantissa Abeyratne, *"The Decision of the European Court of Justice on Open Skies and Competition Cases"*, World Competition 26(3), 335-362, 2003; Frederick Sorensen and Others, *"ECJ Ruling on Open Skies Agreements v. Future International Air Transport"*, Air & Space Law, Vol. XXVIII/1 (February 2003), 3-18; Rass Holdgaard, *"The European Community's Implied External Competence after the Open Skies Cases"*, (2003) European Foreign Affairs Review,8, 365-394.

the Union must delegate its powers to the Member States who will act in the manner indicated by the Union.[42]

The internal and external competences of the Union play an increasingly intrusive role in the area of double tax conventions. In relation to internal competences, the Union's directives concerning mutual assistance[43] in relation to direct tax matters, and in relation to the recovery of taxes on behalf of other Member States, make redundant the long standing "Revenue Rule" [44] within the European Internal Market[45] and interact with Member States' double tax conventions. Moreover, under the *ERTA* doctrine,[46] where the Union has exercised its internal competences by putting in place harmonised rules, the Member States relinquish the right, acting either individually or collectively, to enter into international agreements, such as double tax conventions, with Third Countries, which might affect those common rules in certain circumstances. Thus, in relation to the rules contained in the Parent-Subsidiary Directive, the double tax conventions of the Member States must comply with the provisions of that Directive, as amended.[47]

As secondary Union rules continue to be adopted, the likelihood of double tax conventions being concluded which may impinge upon Union legislation increases,

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42 An example is the recent agreement between the EU and the USA in relation to Air Transport. As competence in relation to much of this area remains with the Member States, the Member States were also parties to the international agreement. See Tom O'Shea, "*Netherlands-US Air Transport Agreement won't fly, ECJ says"*, (2007) Tax Notes International, May 21, 790-793.

43 ECJ, 11 Oct 2007, Case C-451/05, *Européenne et Luxembourgeoise d'investissements SA v Directeur général des impôts, Ministère public, ("ELISA"),* [2007] ECR I-8251. For analysis, see Tom O'Shea, *"French Rule Obstructs Free Movement of Capital, ECJ Concludes"*, Tax Notes International, January 7th, 2008, 30-33.

44 The "Revenue Rule" dates back to a dictum of Lord Mansfield C.J. in *Holman v. Johnson* (1775) 1 Cowp. 341 at 343; and to *Sydney Municipal Council v. Bull,* [1909] 1 K.B. 7. See also the House of Lords' landmark decision in *Government of India v Taylor* [1955] AC 491. For a discussion on the "Revenue Rule" in a European Internal Market context see Philip Baker, *"Mutual assistance in the recovery of tax claims: no Government of India in the European Union?"* (1999) BTR, 1, 14-15.

45 For example, see ECJ, 7 Sep 2006, Case C-470/04, *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo ("N* case"), [2006] ECR I-7409. There, the Court found that the design of "exit tax" rules by the Member States had to take into account the existence of the Mutual Assistance in the Recovery of Taxes Directive. See Council Directive 2008/55/EC of 26 May 2008 on mutual assistance for the recovery of claims relating to certain levies, duties, taxes and other measures (Codified version), Official Journal L 150 10/06/2008, p28 – 38.

46 See Part III below.

47 See Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, Official Journal L 007 , 13/01/2004 , p41–44.

with the further possibility that at some stage in the future, Member States may be prohibited from entering into such double tax conventions because competence in relation to double tax conventions may have become an exclusive external competence of the Union.[48] However, at the moment double tax conventions continue to form an invaluable part of the regulatory framework for tax in the EU because of the absence of harmonised rules at the Union level dealing with the problems caused by juridical and economic double taxation.[49]

Similarly, it should be noted that the ECJ has determined that where the Union has the internal competence to achieve a particular objective, then it also has the corresponding external powers necessary for the achievement of that purpose,[50] even if there is no express provision in the EC Treaty conferring such a power.[51]

(2) Vertical and Horizontal Competences

Vertical competences[52] are granted to the Union to allow it to effectively manage certain "common policy" areas or sectors of the economy, which cannot be regulated satisfactorily at the national level, if the EU freedoms and non-distortion of competition in the European Internal Market are to be protected.[53] The vertical competences granted to the Union are effectively unlimited in the policy areas to which they apply. The Member States no longer have the power (or competence) to enter these sectors, unless specifically authorised.[54] Thus, Union Regulations, for instance, in agriculture, apply uniformly in all Member States and the Member States cannot take measures to alter the scope of, or add to, those Union provisions.

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48 An analogy with the "Air Transport" cases is interesting, as the ECJ in its "*Open Skies"* judgments has already gone down this road in relation to bilateral aviation agreements between Member States and third countries. The outcome was a single EU-USA Air Transport Agreement to which the EU and the Member States were signatories. For an analysis see, O'Shea, fn 42 above.

49 For a more detailed discussion of the regulatory framework for tax in the EU and the "Triangular Model" see: Tom O'Shea, *"EU Tax Regulatory Framework"*, The Tax Journal, 3 November 2008.

50 See ECJ, 26 Apr 1977, *Opinion 1/76*, [1977] ECR 00741 and ECJ, 15 Nov 1994, Opinion *1/94*, [1994] ECR I-05267.

51 This is known as the Principle of "Parallel Competence" or "parallelism". See Alan Dashwood, *"The Limits of European Community Powers"*, EURLR 1996, 21(2), 113-128.

52 Jürgen Bast, Armin von Bogdandy, *"The European Union's Vertical Order of Competences: The Current Law and Proposals for its Reform", (2002) CMLR, 39*, 227-268.

53 Examples include the Common Commercial Policy, Transport and Agriculture.

54 For example, see ECJ, 1 Mar 1973, Case 62/72, *Paul G. Bollmann v Hauptzollamt Hamburg-Waltershof ("Bollmann")*, [1973] ECR 00269.

The rationale behind this scheme is the uniform application of Union law in all Member States.[55]

Similarly, in relation to international agreements involving the Union, vertical competences granted to the Union come into play when the Union does not have the capacity or the legislative instruments to administer all aspects of an international agreement in a field which otherwise comes within its exclusive competence; in such circumstances, the Member States have to be involved in those aspects of the international agreement that fall within its exclusive competence.[56] In the future, this type of situation could apply to double tax conventions where some aspects of a double tax convention fall within the exclusive competence of the Union. In such a case, a Member State, acting alone, is not competent to negotiate and conclude the entire double tax convention because the Union will have to be involved in the negotiation of those aspects of the double tax convention which fall within its exclusive competence.

Horizontal competences differ considerably from vertical competences. Instead of applying to only one sector of the economy, horizontal competences extend laterally and can apply to any, or nearly all, policy spheres, including double tax conventions and direct tax matters. Horizontal competences are not limited by any reserved domain of Member State power, and when they are exercised, Member State regulatory competence in the relevant field is displaced in favour of the Union's harmonisation measures.[57] Whilst vertical competences include all the powers necessary for the management of a particular sector of the economy, horizontal powers are much more widely drawn and are not sector specific.

A good example is seen in Article 94 EC (Article 115 TFEU) where the Council is granted the competence to issue approximation directives relating to "the establishment and functioning of the common market". Such a competence can affect any number of policy areas, including direct taxation and double tax conventions, as long as there is a sufficient common market objective achieved by the relevant approximation or harmonisation measure. In other words, a horizontal competence invariably affects one or more policy areas and has a market integration impact at the same time. It removes obstacles to trade or distortions to competition and simultaneously adopts harmonised Union measures, which replace the national rules in the policy field in question.

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55 For example, see ECJ, 18 Jun 1970, Case 74/69, *Hauptzollamt Bremen-Freihafen v Waren-Import-Gesellschaft Krohn & Co.("Waren-Import"),* [1970] ECR 00451.

56 In *Opinion 1/94, t*he ECJ held that certain aspects of the WTO Agreement did not come within the exclusive vertical competence of the Community's Common Commercial Policy.

57 See the Opinion of Advocate General Fennelly in ECJ, 5 Oct 2000, Case C-376/98, *Federal Republic of Germany v European Parliament and Council of the European Union,* ("the *Tobacco Advertising Directive case"),* [2000] ECR I-08419.

As with "vertical competences", international agreements can involve "horizontal" issues. An example of this arises when the Member States and the Union share norm-setting powers for an international agreement because either the Member States retain powers of their own or Union rules do not completely "occupy the field" covered by the international agreement thus indicating that the Member States have a role to play in the negotiation, conclusion and implementation of the agreement.[58]

An example of this type of situation was seen in the "*Open Skies*" litigation where the Union rules relating to air transport did not occupy the entire field; the Member States had retained considerable competence in the air transport sector. As such, both the Union and the Member States were entitled to be involved in the negotiation and conclusion of the EU-USA Air Transport Agreement (ATA).[59] It should be noted that at the moment, from a double tax convention perspective, the Union does not have an exclusive competence in the double tax convention area and, consequently, lacks the competence to participate in the negotiation and conclusion of double tax conventions of the Member States; competence in relation to double tax convention matters remains within the purview of the Member States subject to their compliance obligations with Union law.

(3) Express and Implied Competences

Express competences are those set out in the TEU and TFEU. They can be exclusive to the Union or shared with the Member States, and are granted to meet specific Union objectives. For example, Articles 44 and 52 EC (Articles 50 and 59 TFEU) provide the Council, respectively, with the power to act by means of directives in order to attain either freedom of establishment as regards a particular activity or the liberalisation of a specific service (excluding transport). Similarly, Article 308 EC (Article 352 TFEU) provides a "residuary" power to the Union to take the "appropriate measures" if the EC Treaty has not provided a necessary power to achieve a Union objective.

"Express" competences should be contrasted with "implied" competences, which are a creation of the ECJ and are not mentioned in the TEU and TFEU but occur when the TEU or TFEU gives the Union a particular objective or task and the necessary power to carry out that task is not expressly provided for in those Treaties. In such a situation the ECJ has interpreted the EC Treaty in such a way as to imply the necessary powers for achieving that Union objective. The ECJ has also held that when the Union has an internal competence to achieve a certain objective, express or

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58 See, for example, Nanette A. Neuwahl, *"Shared Powers or Combined Incompetence? More on Mixity", CMLR 1996, 33(4), 667-687.*

59 The EU-USA ATA was signed by the EU and the EU Member States in April 2007 and replaced the series of bilateral air transport agreements between the USA and the individual Member States.

implied, it also has the external competence necessary for achieving that Union objective.[60] The significance of implied powers in the double tax convention area is explored in more detail in the discussion concerning the *ERTA* doctrine.

(4) Exclusive and Shared Competences

"Exclusive competence" of the Union means that the Union alone is competent to take action.[61] Exclusive competence[62] leaves no room for the Member States to take action unless authorised by the Union, or unless powers are delegated by the Union to the Member States. On the other hand, if the Union and the Member States share competence,[63] the Member States are permitted to continue to legislate and take action in the appropriate fields until Union rules in that field are adopted as long as the rules adopted by the Member States comply with Union law.

An example of an exclusive Union competence situation is seen in *Commission v Ireland ("MOX case")* where Ireland brought arbitration proceedings against the United Kingdom in a dispute relating to the MOX plant at Sellafield instead of bringing the matter before the ECJ. The ECJ held that the UN Convention on the Law of the Sea provisions on the prevention of marine pollution relied upon by Ireland to bring the arbitration proceedings fall within the scope of Union competence "which the Community has elected to exercise by becoming a party to the Convention".[64] The Court went on to explain that "exclusive jurisdiction of the Court is confirmed by Article 292 EC, by which Member States undertake not to submit a dispute concerning the interpretation or application of the EC Treaty to any method of settlement other than those provided for therein".[65] In this situation, the Court determined that the dispute at issue concerned an interpretation or application of the EC Treaty and as such fell within the scope of Article 227 EC (Article 259

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60 See ECJ, 26 Apr 1977, *Opinion 1/76*, [1977] ECR 741, paragraph 3, citing *Kramer:* "Whenever Community law has created for the institutions of the Community powers within its internal system for the purpose of obtaining a specific objective, the Community has authority to enter into international commitments necessary for the attainment of that objective even in the absence of an express provision in that connection."

61 For example: in the fields of agriculture, fisheries and the common commercial policy.

62 The former Advocate General Sir Francis Jacobs has noted that the "Court has been cautious in investing the Community with exclusive competence". See Francis G. Jacobs, "*The Evolution of the European Legal Order"*, CML Rev. 41: 303-316, 2004 at 311.

63 Under the EC Treaty, there is a presumption that a competence is shared unless the wording of the Treaty provision clearly confers an exclusive power on the Community. The TFEU makes this much clearer. See the discussion below.

64 See ECJ, 30 May 2006, Case C-459/03, *Commission v Ireland, ("MOX case"),* [2006] ECR I-4635, paragraph 120 et seq.

65 *MOX case* paragraph 123. Article 292 EC is now Article 344 TFEU.

TFEU). Therefore, an international agreement such as the Convention on the Law of the Sea "cannot affect the exclusive jurisdiction of the Court in regard to the resolution of disputes between Member States concerning the interpretation and application of Community law".[66] It was a matter for the ECJ to identify the elements of the dispute "which fall outside its jurisdiction".[67] The Court concluded by stating that the pursuit of the arbitration proceedings involved "a manifest risk that the jurisdictional order laid down in the Treaties and, consequently, the autonomy of the Union legal system may be adversely affected".[68]

Examples of shared competence are seen in the direct tax (and double tax convention) area where the Union has put in place certain harmonised rules (such as the Parent Subsidiary Directive) but the Member States may still conclude double tax conventions (and domestic tax rules) which offer an equivalent or better result than that achieved under the directive provided that Union rules are not affected.

In the area of double tax conventions, if the Union has acquired an exclusive external competence, the Member States lack the necessary competence to negotiate double tax conventions in the field of the Union's external competence, either individually or collectively, because an exclusive external competence permits the Union alone to enter into such agreements or to take a possible action beyond the territory of the 27 Member States. In such circumstances, the negotiation of double tax conventions would become, most likely,[69] a joint action between the Union on the one part and the Member States on the other part, each co-ordinating their actions, with the Member States respecting the exclusive external competence of the Union.[70]

In relation to the direct tax directives which currently exist,[71] it should be noted that such directives are "minimum harmonisation directives" and do not grant an

66 *MOX case* paragraph 132.

67 *MOX case* paragraph 135.

68 *MOX case* paragraph 154.

69 Although, the Member State in question could be authorised to act on behalf of the Union. In such circumstances, the Member State might appear to the non-member state to be negotiating the double tax convention on its own, but in reality it will have coordinated its double tax convention policy with the European Commission and will at all times respect the Union's interest contained in the exclusive external competence of the Union.

70 See, by way of analogy, the EU-USA "Open Skies" Agreement 2007.

71 Namely, the Parent-Subsidiary Directive 90/435/EEC as amended by Directive 2003/123/EC; the Merger Directive 90/434/EEC as amended by Directive 2005/19/EC; the Interest and Royalties Directive 2003/49/EC; the Interest Savings Directive 2003/48/EC; the Mutual Assistance Directive 77/799/EEC as amended by Directive 2003/123/EC; and the Mutual Assistance in the Recovery of Taxes Directive 76/308/EEC as amended by Council Directive 2001/44/EC, Commission Directive 2002/94/EC and Commission Directive 2004/79/EC.

exclusive competence to the Union to take action.[72] Consequently, Member State action is not ruled out entirely. Member States must ensure that their double tax conventions comply with such directives but their competence to negotiate and conclude them has not been moved to the Union level.[73]

"National Competence": Competence retained by the Member States

The Member States retain any competences which they have not transferred to the Union, subject to fulfilling their Union law compliance obligations.[74] This means that in relation to shared competences, any inaction on the part of the Union legislature to legislate, or to take action, means that the Member States can continue to legislate until a shared competence is exercised by the Union.[75] Thus, even though competence in relation to certain European Internal Market matters is shared with the Member States and this may cover certain double tax convention matters, the Member States can still negotiate and conclude double tax conventions with other Member States and with Third Countries without the Union's involvement (until aspects of those double tax conventions come within the Union's exclusive external competence). In the interim, the Member States must simply comply with their Union law obligations and ensure that the provisions of their double tax conventions do not breach Union law.[76]

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72 In relation to Union external competence and bilateral investment agreements entered into by the Member States with third countries, see Thomas Eilmansberger, *"Bilateral Investment Treaties and EU Law"*, CMLR 46: 383-429, 2009.

73 For an interesting analysis of the Court's jurisprudence involving the interaction between double tax conventions and the Mutual Assistance Directive, see: Tom O'Shea, *"French Rule Obstructs Free Movement of Capital, ECJ Concludes"*, Tax Notes International, January 7th, 2008, 30-33; and Tom O'Shea, *"Swedish Tax Treatment of Third-Country Dividends"*, January 9th, 2008, Worldwide Tax Daily, 2008 WTD 6-10

74 Member States' rules and legislation (including their double tax conventions) cannot conflict with Union law even though the Member States have the competence to act. This has been made clear in almost all the direct tax cases of the ECJ since *Schumacker*. In ECJ, 15 Jan 2002, Case C-55/00, *Elide Gottardo v Istituto nazionale della previdenza sociale (INPS), ("Gottardo")*, [2002] ECR I-413, the ECJ held in paragraph 33, that "when giving effect to commitments assumed under international agreements, be it an agreement between Member States or an agreement between a Member State and one or more non-member countries, Member States are required, subject to the provisions of Article 307 EC, to comply with the obligations that Union law imposes on them". Article 307 EC is now Article 351 TFEU.

75 See Roland Bieber, *On the Mutual Completion of Overlapping Legal Systems: The Case of the European Communities and the National Legal Orders, E.L. Rev. 1988, 13(3), 147-158.*

76 For a recent example concerning bilateral investment treaties entered into by Austria with Third Countries containing provisions which restricted the free movement of capital and which were maintained in breach of Austria's obligations under Article 307 EC (Article 351 TFEU), see ECJ, 3 March 2009, Case C-205/06, *Commission v Austria ("BITs case")*, [2009] ECR I-0000 (not yet reported).

Union Competence and National Competence

The relationship between national competences of the Member States and Union "vertical" and "horizontal" competences is worth further analysis because the Court's case law has revealed that "vertical" and "horizontal" Union competences can usurp Member States' competences in the tax area provided that the Union measures fulfil their stated Union objectives.

An example of a vertical competence is seen in the field of agriculture where the Union obtained "taxing" powers through the introduction of an "agricultural levy" despite the fact that competence in taxation remained with the Member States.[77] The Court recognised that when the Member States conferred powers on the Union, they agreed to a corresponding limitation in their sovereign rights. The Court said:

> *"Since the levy is based on the Treaty and not on national law, is applicable simultaneously in all Member States (…), acts as a regulatory device for markets not in a national context but in a common organisation, is defined with reference to a price level fixed in the light of the objectives of the common market (…) it therefore appears as a charge regulating external trade connected with a common price policy, whatever similarities it may have to a tax or a customs duty".*[78]

The Court found that:

> *"to the extent to which this concerns fiscal sovereignty, such a result is perfectly in accordance with the system of the Treaty".*[79]

An example of a "horizontal competence" may be seen at play when harmonised rules are introduced that have as their object, the establishment and functioning of the European Internal Market. Similarly, the Union's horizontal "common market" competence under Article 94 EC (Article 115 TFEU) or "internal market" competence under Article 95 EC (Article 114 TFEU) cuts across any Member State competence, including direct taxation and double tax convention matters, as long as the Union measures pursue common market or internal market objectives.[80] Therefore, many areas of Member State competence including direct taxation that one might have assumed to have been exclusively reserved to the Member States

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77 See ECJ, 13 Dec 1967, Case 17/67, Firma Max Neumann v Hauptzollamt Hof/Saale, *("Firma Max Neumann"),* [1967] ECR 441 (English special edition).

78 *Firma Max Neumann* page 453.

79 *Firma Max Neumann* page 453.

80 See ECJ, 13 May 1997, Case C-233/94, *Federal Republic of Germany v European Parliament and Council of the European* Union, (*"Deposit Guarantees"),* [1997] ECR I-02405, for an informative discussion on the internal market competence.

when the Union was established were, in actual fact, conferred upon the Union by the Treaties. This occurred because of the nature of horizontal competences. These competences are conferred to achieve broadly drawn, functional objectives and their exercise-

> *"simultaneously affects matters which normally fall within the competence, defined ratione materiae,*[81] *of the Member States and/or of the Community"*.[82]

Therefore, when approximating or coordinating measures, like the Parent Subsidiary Directive, are adopted, Union rules are substituted for the national regulatory provisions. This override of Member State competences is not allowed in all circumstances, because the Union has not been conferred with a general legislative competence; it is only allowed to the extent that it achieves the appropriate Union objective specified in the Treaties.[83]

The Member State's policy areas and the Union's objectives are, therefore, two separate objectives. They are not in competition with one another and one is not ancillary to the other. They exist independent of each other and are of different legal orders.

> *"They can be pursued simultaneously, or indissociably, with as much intensity as the [Community] legislator wishes (or feels obliged) to provide for, provided that the operational objectives of the internal market are served by the measure adopted"*.[84]

Union Competence and Member States' double tax conventions

A Member State may be prevented from entering into a double tax convention if the Union has an exclusive competence for a particular sector of the economy, or if the Union has an exclusive competence for a particular aspect of a double tax convention and it has not delegated that competence to the Member State involved. In the latter case, both the Member State and the Union should participate in the negotiation and conclusion of the double tax convention.

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81 This means that it is defined by subject-matter.

82 See the Opinion of Advocate General Niall Fennelly in the *Tobacco Advertising Directive* case for an excellent discussion.

83 In this example, it helps achieve the "establishment or functioning of the common market" and also to remove an obstacle (double taxation of dividends) for company groups operating in more than one EU Member State.

84 See fn 82 above.

Generally, the Union has competence in relation to double tax convention matters provided that the objective of the proposed Union-legislation is one or more of the following: (i) Implementing the fundamental freedoms; [85] (ii) Approximating national rules which directly affect the functioning of the common market; [86] (iii) Eliminating distortions of competition in the common market; [87] and (iv) Achieving a Union objective if the EC Treaty has not provided the necessary powers.[88]

The Union may take action affecting certain double tax convention matters under its own competence, for example, if it decides that a Member State's double tax conventions are directly affecting "the establishment or functioning of the common market", then the Union is entitled to take action subject to the unanimity requirement contained in Article 94 EC (Article 115 TFEU).[89] Similarly, it is arguable that the Union has the power to take action if the provisions of double tax conventions between two Member States distort "the conditions of competition in the common market" and the Commission feels that the distortion needs to be eliminated.[90] However, in matters of direct taxation, competence is not exclusive but shared and little Union legislation has been put in place relating to the matters contained in double tax conventions. The Court has made this abundantly clear in its jurisprudence, reminding the Member States on a regular basis, pointing out that:

> *"In the absence of any unifying or harmonising Community measures, Member States retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation, particularly with a view to eliminating double taxation… [and it] is for the Member States to take the measures necessary to prevent situations of double taxation by applying, in particular, the criteria followed in international tax practice".*[91]

In Part III, the Union's implied powers/competences are examined with particular

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85 See, for example, Articles 40 EC (Article 46 TFEU), 44 EC (Article 50 TFEU), 52 EC (Article 59 TFEU), 57 EC (Article 64 TFEU), 59 EC (Article 66 TFEU), and 60 EC (Article 75 TFEU).

86 For example, Article 94 EC (Article 115 TFEU).

87 For example, Articles 96 EC and 97 EC (Articles 116 and 117 TFEU).

88 For example, Article 308 EC (Article 352 TFEU).

89 Under Article 94 EC (Article 115 TFEU).

90 See the Consultation procedure provided in Articles 96 EC (Article 116 TFEU) and 97 EC (Article 117 TFEU) involving the Commission and the Member States. Note that the Council has the competence to issue directives, and that the Council and the Commission may take any other appropriate measures. This includes bringing the matter before the ECJ for failure to fulfil Union obligations.

91 See *Damseaux* paragraph 30.

emphasis on the *AETR (ERTA)* line of cases and the impact that this doctrine of implied powers has on Member States' double tax conventions. In 2004, Professor Van den Hurk[92] asked the question – "Is the ability of the Member States to conclude tax treaties chained up?" As the analysis in Part III will demonstrate, the Court's case law shows that this question should be answered in the negative given the present state of Union law.

Part III: The Doctrine of Implied Powers and Double Tax Conventions

Introduction

The doctrine of implied powers arises from the dynamic nature of the Union and from the Court's jurisprudence. The Union and each Union institution must act within the limits of the powers conferred upon it by the TEU/TFEU.[93] These powers have been interpreted by the ECJ in a very broad and fluid way. The Court has acknowledged that, although the Union only has powers which are conferred upon it, such powers-

> *"may arise from express provisions of the constituent Treaties and also flow implicitly from the organisation and scheme of the Treaties".*[94]

The Court has therefore tempered the inflexible regime of conferred powers through the use of implied powers to assist the Union's institutions in achieving the tasks entrusted to them by the Treaties.

The concept of implied powers has also been applied by the Court in the field of external relations, in situations where it was necessary for the Union to intervene in relations with Third Countries in order to implement the internal powers vested in the Union.[95] This "*ERTA*" (otherwise "*AETR*") doctrine enters the area of Member States' double tax conventions involving Third Countries because of the its potential capacity to prevent Member States from negotiating and concluding double tax conventions with Third Countries whenever the Union has acquired an external exclusive competence.

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92 See footnote 3 above.

93 Articles 5(2) TEU and 13(2) TEU.

94 See footnote 30 of the Opinion of the Advocate General in ECJ, 11 Jan 2001, Case C-1/99, *Kofisa Italia Srl v Ministero delle Finanze, Servizio della Riscossione dei Tributi - Concessione Provincia di Genova - San Paolo Riscossioni Genova SpA, ("Kofisa Italia Srl")* citing the *ERTA* case.

95 ECJ, 31 Mar 1993, Joined Cases C-89/85, C-104/85, C-114/85, C-116/85, C-117/85 and C-125/85 to C-129/ 85, *A. Ahlstrom Osakeyhtio and others v Commission, ("Woodpulp case")*, [1993] ECR I-1307.

The next section provides the results of an investigation of the *ERTA* line of cases.

The *ERTA* Doctrine

In the *Commission v Council ("ERTA")* case, the European Commission, in a dispute with the Council of Ministers, argued that it had acquired the competence to negotiate an international agreement entitled the *European Road Transport Agreement* in place of the Member States. This argument was based on a number of factors which included the common transport policy provisions of the EC Treaty which had been implemented by a Union Regulation.[96] The Commission took the view that Article [71] EC[97] conferred on the Union wide powers to implement the common transport policy and that these powers applied to international agreements generally, not simply in the European Internal Market sphere,[98] as otherwise the full effect of the EC Treaty provisions on the common transport policy would be jeopardised.

The Council, on the other hand, argued that an express provision in the EC Treaty was required to grant the necessary competence to the Union. The competing arguments of the two institutions were determined by the ECJ in a landmark decision where the Court determined that -

> *"In the absence of specific provisions of the Treaty relating to the negotiation and conclusion of international agreements in the sphere of transport policy – a category into which the AETR falls – one must turn to the general system of Community law in the sphere of relations with third countries".*[99]

Further, the Court found that the Community had the capacity to enter into international agreements related to Community objectives, expressed in the EC Treaty, and that regard had to be had to the "whole scheme of the Treaty" as well as its substantive provisions when an issue concerning Union competence had to be determined.[100] It concluded that the Community's authority to enter into international agreements could arise not only from an express provision of the EC Treaty but also-

> *"from other provisions of the Treaty and from measures adopted, within the framework of those provisions, by the Community institutions".*[101]

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96 See Regulation 543/69.

97 It was Article 75 of the EEC Treaty at the time of the case. Article 91 TFEU.

98 *ERTA* paragraph 6.

99 *ERTA* paragraph 12.

100 *ERTA* paragraph 15.

101 *ERTA* paragraph 16.

The Court explained that-

> *"In particular, each time the Community, with a view to implementing a common policy envisaged by the Treaty, adopts provisions laying down common rules, whatever form these may take, the Member States no longer have the right, acting individually or even collectively, to undertake obligations with third countries which affect those rules."*[102]

Moreover, the Community must negotiate and conclude the agreements with Third Countries "as and when such common rules come into being" because

> *"the Community alone is in a position to assume and carry out contractual obligations towards third countries affecting the whole sphere of application of the Community legal system".*[103]

Consequently, the Court held that

> *"to the extent to which Community rules are promulgated for the attainment of the objectives of the Treaty, the Member States cannot, outside the framework of the Community institutions, assume obligations which might affect those rules or alter their scope".*[104]

A number of matters in the *ERTA* case may have some significance for Member States' double tax conventions, but before exploring these issues in more detail it is appropriate to fully understand the context of the Court's *ERTA* decision. First, the EC Treaty rules at issue, and the subsequent Regulation 543/69,[105] all referred to "third countries". Article [71] EC specifically refers to international transport "to or from the territory of a Member State". This is significant because not all EC Treaty rules, or secondary legislation, refer to Third Countries. This includes the directives operating in the direct tax sphere.

Second, the Court found that the ERTA came within the scope of Regulation 543/69. This was noteworthy because "coming within the scope of" the Union's rules generated an exclusive Union competence issue. Consequently, the Union's competence to enter into the ERTA was an exclusive one, excluding the Member States since-

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102 *ERTA* paragraph 17.

103 *ERTA* paragraph 18.

104 *ERTA* paragraph 22.

105 The Court noted that Article 3 of Regulation 543/69 prescribed that: "The Community shall enter into negotiations with third countries which may prove necessary for the purpose of implementing this regulation".

> *"any steps taken outside the framework of the Community institutions would be incompatible with the unity of the common market and the uniform application of Community law".*[106]

This finding was in line with the Court's previous case law on the direct applicability of Regulations in the territory of the Member States. In *Bollmann*, for instance, the Court had found that as Regulation 22/62 was directly applicable in all Member States, and that the Member States:

> *"unless otherwise expressly provided, are precluded from taking steps, for the purposes of applying the Regulation, which are intended to alter its scope or supplement its provisions. To the extent to which Member States have transferred legislative powers in tariff matters with the object of ensuring the satisfactory operation of the common market in agriculture they no longer have the powers to adopt legislative provisions in this field".*[107]

Third, the Court recognised that the negotiations entered into by the Member States were designed to be binding on the Union's institutions and would ultimately be reflected in the Union's Regulation which would have to be amended to take into account certain derogations negotiated by the Member States. This would have brought about-

> *"a decisive change in the allocation of powers between the Community and the Member States on the subject-matter of the negotiations".*[108]

Thus, by proceeding through inter-governmental channels, the Commission could not perform a task entrusted to it. Consequently, the Court held that-

> *"In the absence of specific provisions in the Treaty applicable to the negotiation and implementation of the [ERTA]…the appropriate rules must be inferred from the general tenor of those articles of the Treaty which relate to the negotiations…"*[109]

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106 *ERTA* paragraph 31.

107 See *Bollmann* paragraph 4. Similarly, in *Waren-Import*, paragraph 8, the Court reiterated this thinking and expanded it to say, in the context of goods which were not described in the Union Regulation, that "The descriptions of the goods …must have the same scope in all the Member States. Such a requirement would be called into question if (…) each Member State could itself fix this scope by way of interpretation".

108 *ERTA* paragraph 66.

109 *ERTA* paragraph 72.

The Court, therefore, examined the common transport policy rules[110] and the rules governing the conclusion of international agreements by the Union;[111] and, reading these together, it decided that the right to conclude the ERTA was vested in the Council, saying-

> *"whenever a matter forms the subject of a common policy, the Member States are bound in every case to act jointly in defence of the interests of the Community".*[112]

However, the Court noted that this distribution of powers between the Union institutions would only have been required if the powers vested in the Union had taken effect, either by virtue of the Treaty or by virtue of measures taken by Union institutions; in other words, as a result of primary or secondary Union legislation. As a considerable part of the ERTA negotiations took place before powers were conferred on the Union by Regulation 543/69, the Member States retained competence to negotiate with Third Countries during this period. Consequently, as the ERTA was concluded after Regulation 543/69 took effect, the Union institutions had to cooperate with a view to ensuring the most effective defence of the interests of the Union. As the Member States had conducted the negotiations in the manner agreed with the Council, in the absence of both proposals from the Commission and a request for it to negotiate on behalf of the Union, the Court found that the Member States acted in the interest and on behalf of the Union in accordance with their Treaty obligations.[113]

Impact of the *ERTA* case on double tax conventions?

The potential impact of the *ERTA* decision in the area of Member States' double tax conventions with Third Countries is enormous. The Union has the capacity to conclude international agreements with Third Countries over the whole field of "objectives defined by the Treaty". Since *Gilly*, it is clear that the abolition of double taxation within the Union, expressed in Article 293 EC, is a Union objective similar to those which are set out in Articles 2 and 3 EC. As such, the Union may need to have the competence to negotiate and conclude double tax conventions with Third Countries if such is necessary to achieve the Union objective of abolishing double

110 The Court looked at Article 75(1) of the Treaty (Article 71 EC), (Article 91 TFEU).

111 The Court referred to Article 228(1) of the Treaty (Article 300 EC), (Article 260(1) TFEU).

112 *ERTA* paragraph 77.

113 *ERTA* paragraphs 88-90

taxation "within the Community" or removing double taxation as an obstacle to the proper function of the European Internal Market.[114]

Furthermore, the Union competence to conclude such agreements "may equally flow from (…) measures adopted by the Community institutions".[115] The *ERTA* decision indicates that from the date that "common rules" come into being the Union may have an exclusive external competence to assume and carry out aspects of, or entire, international agreements with Third Countries.[116] Potentially, this means that Member States may be precluded from negotiating or concluding double tax conventions with Third Countries if such agreements contain provisions which "affect" the common rules, "fall within the scope of the common rules" or "alter their scope".[117]

The next sections examine these issues in more detail. In some situations, the Union may have to be involved with a Member State in negotiating and concluding the double tax convention in situations where the Union's external competence comes into play.

"Common rules"

Interestingly, the Court has not defined the expression "common rules" to date,[118] but it has referred to them in the sense of secondary Union legislation.[119] Thus, the main "common rules" with some relevance to double tax conventions include the tax directives and, in particular, the Mutual Assistance Directive and the Mutual Assistance in the Recovery of Taxes Directive. However, other "rules" with some relevance for double tax convention matters include the rules provided in the *Code*

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114 Whilst Article 293 EC is not a competence granting provision, competence to abolish double taxation may be found, for instance, *inter alia* in Article 94 EC (Article 115 TFEU), with a view to improving the functioning of the internal market, and also in Article 308 EC (Article 352 TFEU) under the general "sweep-up" clause. Article 293 EC has not been included in the TFEU. The repeal of Article 293 EC in the Lisbon Treaty does not appear to change things. The contra view is taken by Eric Kemmeren, *"After repeal of Article 293 EC Treaty under the Lisbon Treaty: the EU objective of eliminating double taxation can be applied more widely"*, EC Tax Rev. 2008/4, 156-158. See also Luc Hinnekens, *"The Uneasy Case and Fate of Article 293 Second Indent EC"*, INTERTAX, 37, 11, 602-609.

115 *ERTA* paragraph 17.

116 *ERTA* paragraph 18.

117 *ERTA* paragraph 22.

118 The Court refers to "internal legislative acts" in *Opinion 1/94* paragraphs 90-94.

119 A reading of *Kramer* indicates that the rules contained in an Act of Accession also play a role in determining the compliance obligations of the Member States. See *Kramer paragraph 19.*

of Conduct on Business Taxation[120] and the rules contained in the *Code of Conduct for the Implementation of the Arbitration Convention*,[121] but to date the Court has not expressed its opinion as to whether such rules are "common rules". However, it seems clear that they are "political" rules which have a legislative flavour but are not, as such legislative rules.

In the *ERTA* case, the Court explained that the "common rules" were provisions adopted by the Union with a view to implementing a "common policy (…) whatever form these might take".[122] The Court is, therefore, referring to Union legislative measures, and the reference to "whatever form these might take" may imply that the format that these rules take might be more extensive than simply Union legislation. This arguably leaves open the possibility that the Code of Conduct rules and the rules contained in the Arbitration Convention might be interpreted as being "common rules", even though they are not Union legislative measures as such.[123]

Types of "common rules": "Minimum harmonisation rules" or more?

The type of "common rule" under scrutiny is very important. This is clear from the Court's judgment in *Opinion 2/91*, where it confirmed that if the Union has

120 The Code of Conduct on Business Taxation is a "Resolution" of the Council covering "business taxation" and including measures which "may affect the location of business activity in the Community". "Business activity" includes all activities carried out within a group of companies. The tax measures covered by the Code include both "laws or regulations and administrative practices". See Paragraph A of the Code of Conduct Resolution. The Code is, therefore, of relevance to double tax conventions because the Code recognises that anti-abuse measures "contained in tax laws and in [double tax conventions] play a fundamental role in counteracting tax avoidance and evasion". See the Code of Conduct Resolution paragraph L.

121 Convention 90/436/EEC of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises ('Arbitration Convention') OJ L 225, 20 August 1990, at p10. The Arbitration Convention concerns the elimination of double taxation in relation to certain transfer pricing disputes and is thus linked to double tax conventions, particularly by Article 9 of the OECD Model Tax Convention and the arm's length principle.

122 Significantly, in ECJ, 19 Mar 1993, *Opinion 2/91, paragraph 10*, the Court pointed out that the Community rules do not have to come under a common policy. The Court clarified its *ERTA* ruling saying that "the decision in that case cannot be restricted to instances where the Community has adopted Community rules within the framework of a common policy. In all the areas corresponding to the objectives of the Treaty, Article 5 thereof requires Member States to facilitate the achievement of the Community's tasks and to refrain from any measure which could jeopardise the attainment of those objectives, which could precisely be the case if Member States were to enter into international commitments containing rules that interfered with those adopted by the Community".

123 The sixth recital to the Preamble of the Code of Conduct on Business Taxation Resolution emphasises that the Code is a "political commitment and does not affect the Member States' rights and obligations or the respective spheres of competence of the Member States and the Community resulting from the Treaty".

competence to enter into an international agreement to meet a Union objective, that competence may be exclusive in nature but is not always so.

This is significant for double tax conventions because if some "common rules" do not trigger an exclusive Union competence, it is important to understand the distinction between the various types of "common rules": if the Union's competence is exclusive, whether under the provisions of the TEU/TFEU or by virtue of the Union's rules, the Member States may be excluded from entering into double tax conventions.

Significantly, the Court clarified its *ERTA* ruling in *Opinion 2/91* by stating that the "common rules" do not have to come under a common policy;[124] but, perhaps more importantly, the Court analysed at length the relationship between the international agreement and the Union's rules and examined the nature of the Union's competence. As there are valuable lessons to be drawn from this analysis for the double tax convention area, it is worthwhile exploring the judgment in more detail.

Opinion 2/91 involved ILO Convention No. 170 which concerned safety in the use of chemicals at work. At the time of the case, social policy was largely within the competence of the Member States. The ECJ found that Union rules in this area were of two types: (a) rules laying down minimum requirements; and (b) rules which go beyond minimum requirements. The different scope of such rules plays a role in determining whether the Union's competence is exclusive in nature and is thus of significant interest for Member States' double tax conventions.

Minimum harmonisation rules allow Member States the opportunity to adopt more stringent measures, and are thus not exclusive in nature so as to exclude the Member States from the field.[125] The Court gives an example of rules adopted in the Community under Article [94] EC.[126] Such rules do not grant an exclusive competence to the Union because they only lay down minimum requirements; they permit the Member States to take more stringent action than that laid down in the

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124 See *Opinion 2/91*, paragraph 10. The Court noted that "the decision in that case cannot be restricted to instances where the Community has adopted Community rules within the framework of a common policy. In all the areas corresponding to the objectives of the Treaty, Article 5 thereof requires Member States to facilitate the achievement of the Community's tasks and to refrain from any measure which could jeopardise the attainment of those objectives, which could precisely be the case if Member States were to enter into international commitments containing rules that interfered with those adopted by the Community". Here, the Court's understanding of "affecting the common rules" appears to equate with "interfering with" those rules.

125 For example, see the *ELISA* case in fn 43 above.

126 See *Opinion 2/91*, paragraph 21. Note that the Court referred to Article 100 of the Treaty (Article 94 EC), (Article 115 TFEU).

Union legislation, subject to compliance with Union law.[127] Consequently, in the external relations sphere, Union competence is not exclusive.[128]

By contrast, where the Union's rules are more extensive and go beyond setting out minimum requirements, Member State action may affect these common rules within the context of the *ERTA* judgment. Thus, in *Opinion 2/91*, the Court highlighted some Union rules which conferred better protection on workers than that accorded by the *ILO Convention*. In such circumstances, even though there was no contradiction between the Member States' rules and those of the Union's directives, the Member States' rules concerned an area "covered to a large extent"[129] by Union rules. The Court held that such rules in the *ILO Convention* were likely to-

> *"affect the Community rules laid down in those directives and that consequently Member States cannot undertake such commitments outside the framework of the Community institutions".*[130]

The significance of this judgment for double tax conventions and the "direct tax directives" is immense because the "direct tax directives", like the Parent-Subsidiary Directive, were adopted by the Union under Article 94 EC (Article 115 TFEU) and, consequently, do not grant an exclusive external competence to the Union as the rules contained in the direct tax directives are "minimum harmonisation rules". This means that the Member States retain the competence to conclude double tax conventions with Third Countries subject to compliance with Union law. This is a compliance obligation rather than a competence question. Moreover, the Union does not obtain an exclusive external competence in the area of double tax conventions between the Member States and Third Countries.

Adoption of "common rules"

From the *ERTA* case, it is clear that the competence of the Member States may be restricted from the time that the Union adopts provisions laying down common rules – "whatever form these may take"[131] and it is the Union's responsibility to negotiate

127 For instance, ECJ, 30 Nov 1995, Case C-175/94, *R v Secretary of State for Health, ex parte Gallagher*, [1995] ECR I-04253, concerned Community rules requiring the labelling of cigarette packets with health warnings covering "at least 4%" of the packet; the UK introduced rules requiring that the health warning cover at least 6% of the packet; the UK rules were found to be compatible with Community law because the Community rules only established minimum requirements.

128 *Opinion 2/91* paragraphs 17-26, for a general discussion.

129 *Opinion 2/91* paragraph 25.

130 *Opinion 2/91* paragraph 26.

131 *ERTA* paragraph 17.

and conclude international agreements "as and when such common rules come into being".[132] The "common rules" referred to in this paragraph are those which go beyond the minimum harmonisation referred to in the previous paragraph. The Court has made it clear, in *Kramer* that since the Union had not adopted such rules the Member States retained the power to enter into international commitments and had the right to ensure the application of those commitments "within the area of their jurisdiction".[133]

The Court has also encountered the situation where the "common rules" only came into effect at the time an international agreement was adopted.[134] This occurred in *Opinion 1/76* which involved an inland waterway international agreement relating to vessels operating in certain European rivers. Prior to that agreement, no common rules were in place because it was necessary to include Switzerland in the scheme at the same time as the other Member States.

The Court determined that although the common rules were only adopted at the time the international agreement was concluded, in other words, even though the rules were not adopted prior to the international agreement,

> *"the power of the Community vis-à-vis third countries nevertheless flows by implication from the provisions of the Treaty creating the internal power in so far as the participation of the Community in the international agreement is, as here, necessary for the attainment of one of the objectives of the Community".*[135]

This finding of the ECJ begs the question whether common rules must be in place *prior* to the Union having an implied power to conclude double tax conventions with Third Countries. In *Opinion 1/76*, which concerned an international agreement establishing a European laying-up fund for inland waterway vessels, the Court highlighted two problem areas: the first was the substitution of several Member States in place of the Union in the controlling organ;[136] and the second was the alteration of the relationships between Member States within the context of the Union.[137]

In relation to the first problem, the Court indicated that as the matter came within the common transport policy which was expressly reserved to the Community by

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132 *ERTA* paragraph 18.

133 *Kramer* paragraph 17.

134 See *Opinion 1/76*, for example.

135 *Opinion 1/76*, paragraph 4.

136 *Opinion 1/76*, paragraph 11(A).

137 *Opinion 1/76* paragraph 11(B).

Article 3 EC, the Member States could not take such action. As regards the second problem, the Court made two important observations: (i) the Preamble to the EC Treaty, more particularly, the second recital required that "the objectives of the Community must be attained by 'common action' ";[138] (ii) under Article 7 EC,[139] the "common action" must be carried out by Community institutions.

These observations of the Court may have major significance for double tax conventions. Does this indicate an exclusive Union competence or one that is shared with the Member States? As the principle of subsidiarity had not been enshrined in the EC Treaty at the time of the *Opinion 1/76* decision, does the principle of subsidiarity impact upon the Court's interpretation of the EC Treaty?

The answer would appear to be in the affirmative because the EC Treaty must be construed in the light of the entire body of Community law. The EC Treaty must be read in the light of all its provisions[140] and, as the principle of subsidiarity now plays a major role in determining whether or not the Union should take action when it does not have an exclusive competence, it seems clear that the rather vague reference to "common action" in the Preamble to the EC Treaty has to be interpreted in the light of a clear statement concerning subsidiarity in Article 5 EC. Under such an interpretation, as the Member States retain competence in direct tax matters, they retain the competence to negotiate and conclude double tax conventions subject to their compliance with Community law.[141]

If the "common rules" (which go beyond minimum harmonisation) are adopted after the conclusion of a double tax convention either between two or more Member States, or between a Member State and a Third Country, the issue of "subsequent exclusive competence" arises because the "common rules" may render the double tax convention incompatible with Union law.

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138 In fact, the words used in the second recital of the Preamble to the EC Treaty differ. The actual wording is: "RESOLVED to ensure the economic and social progress of their countries by common action to eliminate barriers which divide Europe".

139 This was Article 4 of the Treaty, at the time of the case.

140 See ECJ, 6 Oct 1982, Case 283/91, *Srl CILFIT and Lanificio di Gavardo SpA v Ministry of Health, ("CILFIT"), [1982] ECR 03415,* paragraph 20: "every provision of Community law must be placed in its context and interpreted in the light of the provisions of Community law as a whole, regard being had to the objectives thereof and to its state of evolution at the date on which the provision in question is to be applied".

141 *Gottardo* paragraph 33. In this judgment the Court made it clear that all international agreements whether between two or more Member States or between a Member State and a Third Country must comply with Union law unless the Article 307 EC (Article 351 TFEU) "prior agreement" exception applies. In which circumstances the Member State is obliged to make that incompatible agreement compatible with Union law whether that is achieved by amendment or by termination.

In a Member State-Member State double tax convention situation, the "common rules" clearly take precedence.[142] In a Member State-Third Country double tax convention situation, the international law rights of the Third Country remain unaffected.[143] However, if the double tax convention contains any provisions which are incompatible with Union law, the Member State concerned is under an obligation to amend or terminate the double tax convention.[144] If the "common rules" create an exclusive competence for the Union then the Member States cannot enter into international commitments that might "affect" the common rules and the Union would have to be involved in the negotiation and conclusion of the double tax convention with the Third Country.

"Common rules" must be adopted

In order for the "common rules" to trigger an exclusive Union competence, "common rules" which could be affected by the double tax convention must actually "come into being" or be adopted.[145]

A good example is seen in *Commission v Germany ("Open Skies")*,[146] concerning the air transport agreement between Germany and the USA, where the Court noted that Article 84(2) EC[147] provided a power for the Union to take action. However, the provision of such a power in itself could not confer an exclusive external competence upon the Union. The power had to be exercised either at the time the international agreement was entered into, because it could not be exercised at an earlier time as the involvement of the Third Country in the Union scheme was an absolute necessity to achieve the Union objective;[148] or exercised prior to the negotiation and conclusion of the international agreement by the Union, in which case the Union may have an exclusive external competence pursuant to the *ERTA* decision depending on the type of internal rules put in place within the European Internal Market.

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142 The double tax convention provisions must be interpreted in the light of the directly applicable "common rules"; if the "common rules" have direct effect, the provisions of the DTC must not be applied and the directly effective "common rule" must be fully implemented by the national court.

143 See, for example *Saint-Gobain* and *Gottardo*.

144 See Article 307 EC (Article 351 TFEU) concerning "pre-Community agreements" and *Gottardo*. This type of situation occurred in the *"Open Skies"* cases.

145 In *Kramer*, the Court emphasised that the powers granted to the Community must be "exercised".

146 The "Open Skies" series of ECJ cases concerned bilateral air transport agreements entered into by a number of EU Member States with the USA which contained provisions contrary to Union law and which also infringed the competences of the Union in certain situations.

147 Article 80(2) EC (Article 100 TFEU).

148 This was seen in *Opinion 1/76.*

In "*Open Skies*", the Court found that the Union had put in place common rules under Article 84(2) EC. If the Member States were allowed to enter into bilateral agreements, that action might jeopardise the attainment of the objective pursued by those rules[149] where such rules could be affected by the bilateral agreements, on the lines of its *ERTA* judgment.

Similarly, in *Kramer*, although the Union had the internal power to take measures relating to the conservation of the biological resources of the sea, and because the conservation responsibilities assigned to the Union's institutions could only be effective through a system of rules binding on all States concerned, including Third Countries, the Union had the competence to enter into international agreements for the conservation of the resources of the sea.[150] However, since at the time of the case, the Union had not adopted any regulations relating to the sea-fishing industry, in other words, the Union had not adopted "common rules" as in *ERTA*, the Member States retained the power to enter into international commitments and the right to ensure the application of those commitments "within the area of their jurisdiction".[151]

The Court, however, did impose a rider on these Member State powers. First, the powers could only be exercised by the Member States during the six-year transitional period allowed under the Act of Accession or until the Union adopted common rules, whichever occurred first.[152] Second, the Member States were bound to proceed by common action within the Union institutions and framework once the transitional period came to an end.[153]

In *Opinion 2/92*,[154] concerning the OECD's *Third Decision on National Treatment ("Third Decision")*,[155] the Opinion of the Court was sought in relation to the division of powers between the Member States and the Union to conclude an agreement with certain Third Countries. As only intra-EU establishments came

149 See ECJ, 5 Nov 2002, Case C-476/98, *Commission v Germany ("Open Skies")*, [2002] ECR I-9855, paragraph 105.

150 *Kramer* paragraph 14.

151 *Kramer* paragraph 17.

152 *Kramer* paragraph 19.

153 See *Kramer* paragraph 20, where the Court explained that Article 116 of the Treaty (at that time) imposed this obligation on Member States "in respect of all matters of particular interest to the Common Market".

154 Note that *Opinion 2/92* was delivered after *Opinion 1/94*.

155 The *Third Decision* concerned the conditions for the participation of certain foreign-controlled undertakings in the European Internal Market, and the conditions for their participation in trade between the Member States and Third countries.

within the Union's exclusive competence,[156] the Court found that the Union was competent to participate in the "Third Decision", but because the Union's competence did not cover all matters relating to Third Country establishments and to which that Decision related, the Member States were jointly competent.

The Court also rejected the notion that Article 308 EC[157] could automatically vest an exclusive external competence in the Union, saying-

> *"Save where internal powers can only be effectively exercised at the same time as external powers, internal competence can give rise to exclusive external competence only if it is exercised".*[158]

Thus, the Court echoes its *ERTA* judgment and indicates that the Union's exclusive external competence does not automatically flow from its power to lay down rules at internal level; the Member States only lose their right to enter into an agreement with a Third Country where "there are common rules which could be affected by such obligations".[159] Thus, although the "sweep-all" clause contained in Article 308 EC (Article 352 TFEU) gives the Union a potentially very wide law-making power, such a clause in itself does not trigger Union competence until the powers have been exercised and "common rules" have been adopted under that provision.

"Common rules" and transitional periods

Finally, it should be noted that transitional periods prior to the introduction of "common rules" also generate competence problems for the Member States. For instance, in *Kramer*,[160] the Court confirmed that the Member States could continue to enter into international commitments with Third Countries until the Union adopted "common rules" or, alternatively, until the end of the transitional period, whichever occurred first. Once the transitional period came to an end, the Member States were obliged to proceed by common action within the Union's institutions and Union framework.

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156 Under the Common Commercial Policy, Article 113 of the Treaty at the time of the case; Article 133 EC now. See *Opinion 2/92* paragraph 11.

157 This was Article 235 of the Treaty at the time of the case.

158 *Opinion 2/92* Part V paragraph 8.

159 *Opinion 2/92* Part V paragraph 3.

160 *Kramer*, paragraph *20.* The six-year transitional period was specified by the Act of Accession. The Court explained that Article 116 of the Treaty at the time of the case imposed the obligation on the Member States to act within a Community framework "in respect of all matters of particular interest to the Common Market".

"Common rules" and "Common Policies"

Must the "common rules" form part of a "Common Policy"? In the *ERTA* decision, the Court made it clear that "whenever a matter forms the subject matter of a common policy, the Member States are bound in every case to act jointly in defence of the common interests of the Community".[161]

An example of a common policy impacting upon an international agreement may be seen in *Opinion 1/75* when an international agreement involving the OECD and its "Understanding on a Low Cost Standard" interacted with the Common Commercial Policy, where the Court expressed its Opinion on the Union's powers to conclude the "Understanding". The Court recognised that as the subject-matter of the standard laid down in the "Understanding" concerned export credit operations; a matter which came within the ambit of the Common Commercial Policy; the Union was empowered to adopt internal rules and conclude international agreements with Third Countries as-

> *"A commercial policy is in fact made up by the combination and interaction of internal and external measures, without priority being taken by one over the others"*.

The Court went on to examine the exclusive nature of the Union's powers in the area of the Common Commercial Policy and noted that the subject-matter of the "Understanding" fell within Article 113 of the Treaty (Article 207 TFEU): common commercial policy. As such, Member States no longer retained the competence to act concurrently with the Union in this field because this would compromise the "effective defence of the common interests of the Community". Moreover, any unilateral action on the part of the Member States would "lead to disparities in the conditions for the grant of export credits".[162] Thus, allowing the Member States to conclude the international agreement involving the "Understanding" would allow the Member States to adopt "positions different from those which the Community intends to adopt".

Interestingly, and of relevance to double tax conventions, the Court rejected the argument that the Member States should be involved in the agreement because they would have to bear the obligations and financial burdens arising from the agreement. The Court, holding that the Union's competence was exclusive, said that

> *"The 'Internal' and 'External' measures adopted by the Community within the framework of the Common Commercial Policy do not necessarily involve, in order to ensure their compatibility with the Treaty, a transfer to*

161 *ERTA* paragraph 77.

162 Part 2 of *Opinion 1/75*.

> *the institutions of the Community of the obligations and financial burdens which they may involve: such measures are solely concerned to substitute for the unilateral action of the Member States, in the field under consideration, a common action based upon uniform principles on behalf of the whole Community"*.

Common rules and exclusive Union competence

In *Opinion 1/94*, the Court clarified its thinking on what constituted exclusive external competence. It confirmed that exclusive external competence rested with the Union in three situations: whenever the Union has (i) included in its internal legislative acts provisions related to the treatment of nationals of Third Countries; (ii) expressly conferred on its institutions powers to negotiate with Third Countries; (iii) has achieved complete harmonisation of the rules governing access to a self-employed activity. In relation to (i) and (ii), the Union acquired an exclusive external competence in the areas covered by those acts; in relation to (iii) the Union acquired an exclusive external competence even in the absence of an express provision authorising it to negotiate with Third Countries, because the common rules adopted may be affected if the Member States conclude international agreements with Third Countries.[163]

From a double tax convention perspective, *Opinion 1/94* indicates that exclusive external competence does not rest with the Union in all matters involving double tax conventions between Member States and Third Countries. This is clear for a number of reasons. First, the direct tax directives are minimum harmonisation directives which focus entirely on intra-EU relationships and establish the European Internal Market in certain limited sectors. Second, as competence in direct tax matters remains with the Member States, and as the Union has not been granted a negotiating mandate to conclude double tax conventions with Third Countries, the Member States retain this power and can enter into double tax conventions subject to their Union law compliance obligations.[164] Third, the Union has not achieved complete harmonisation of the direct tax field by its adoption of the direct tax directives. There are many matters relating to the elimination of double taxation and the sharing of overlapping tax jurisdiction that only the Member States remain competent to achieve, such as the elimination of double taxation. This is usually achieved on a bilateral basis through the use of double tax conventions. Clearly, if the Member States conclude double tax conventions with Third Countries, the current set of "common rules" will generally not be "affected" by such agreements.

However, as the Union has adopted a number of common rules in the direct tax area, like the Parent-Subsidiary Directive, this issue is investigated in more detail in the next section.

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163 *Opinion 1/94* paragraphs 95-96.

164 *Gottardo* paragraph 33.

"Affecting" the common rules

In the *ERTA* case, the Court indicated that once the Union had adopted "common rules" the Member States no longer had the power to enter into international agreements with Third Countries "which affect those rules".[165] It expanded this explanation in a subsequent paragraph to include "obligations which might affect those rules or alter their scope".[166] Thus, if the Union has been granted an exclusive competence to take action by the "common rules", then the Member States are precluded "whether acting individually or collectively" from entering into obligations which impose conditions on the Union's prerogatives.[167] However, not all "common rules" grant an exclusive competence to the Union. As was seen in *Opinion 2/91*, the Court is satisfied that if the rules represent "minimum harmonisation" rules or are adopted under Article 94 EC (Article 115 TFEU), the Member States are not entirely restrained from taking action and entering the field: they can take more stringent action without affecting the "common rules" because the "common rules" are not exclusive in nature.[168]

Of equal significance is the point that even though a power has been granted to the Union to take certain action, it is only when that power has actually been exercised through a legislative measure at the Union level that competence actually shifts to the Union level.[169] In *Opinion 1/94*, for example, the Court makes the point that exclusive external competence rests with the Union (…) whenever the Union has included in its "internal legislative acts" provisions related to the treatment of Third Country nationals.

"Open Skies"

The concept of "affecting" the "common rules" may be seen clearly in *Commission v Germany ("Open Skies")* where the Commission argued that the bilateral air transport agreement entered into by Germany contained provisions which would affect the scope of the Union's legislative measures contrary to the *ERTA*

165 *ERTA* paragraph 17. For a recent example, in relation to a proposal submitted by Greece to the International Maritime Organisation in contravention of the Union's external competence, see ECJ, 12 Feb 2009, *Commission v Greece*, [2009] ECR I-0000 (not yet reported).

166 *ERTA* paragraph 22.

167 ECJ, 4 Oct 1979, *Opinion 1/78* paragraph 32.

168 *Opinion 2/91* paragraph 21. Note the Court referred to Article 100 of the Treaty which is now Article 94 ECT. See also the Opinion of Advocate General Mazák in *ELISA* paragraph 53.

169 *Opinion 1/94:* the "rules must come into being"; *Kramer* – the powers granted to the Community must "be exercised"; and *Opinion 2/92*: The Member States only lose their right to enter into agreements with Third countries where "there are common rules which could be affected by such obligations".

judgment.[170] It instigated infringement proceedings against a number of Member States claiming that the bilateral agreements were liable to have an affect on the Union's internal legislation and, that such agreements "could be carried out effectively and in a legally valid manner, only at Community level".[171] The Commission argued that, as a comprehensive system of rules designed to establish an internal market in the air transport sector had been put in place at Union level, the bilateral agreements with the United States affected the scope of the common rules contrary to the *ERTA* judgment. Accordingly, the Union's external competence was infringed.

The Commission complained, in particular, that the bilateral agreements entered into by the Member States contained "nationality clauses" which were incompatible with both primary and secondary Union law, and contained other provisions which allowed American airline companies to operate in the European Internal Market without being subject to all the obligations of the system established by the common rules.[172] The Commission also argued that an exclusive external competence had been established because Article 84(2) EC[173] gave the Union the power to conclude air transport agreements with Third Countries, and that this power had been exercised in relation to Norway, Sweden and Switzerland. In the alternative, the Commission argued for a shared competence in a situation where the Court found that the common rules were not complete. Germany argued that Member States retained the competence to conclude bilateral air transport agreements as long as the Council of Ministers had not created a Union competence to negotiate air transport agreements with Third Countries.

The Court found that the Union had put in place common rules under Article 84(2) EC, and if the Member States were allowed to enter into bilateral agreements these might jeopardise the attainment of the objective pursued by those rules[174] where such rules could be affected by the bilateral agreements, on the lines of its *ERTA* judgment.

The Court then examined whether the common rules were affected by the bilateral transport agreement concluded by Germany with the United States. Applying its *ERTA* and *Opinion 1/94* reasoning, the Court found that the Union acquired an exclusive external competence in three situations:

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170 For instance, see *Commission v Germany ("Open Skies")*, paragraph 26 in fn 149 above.

171 See *Commission v Germany ("Open Skies")*, paragraph 26.

172 See *Commission v Germany ("Open Skies")* paragraph 74.

173 Article 80(2) EC (Article 100 TFEU).

174 See *Commission v Germany ("Open Skies")* paragraph 105.

(i) where international commitments fell within the scope of the common rules[175] or within an area which was largely covered by such rules;[176] in such a case, the Member States cannot enter into international agreements outside the Union's institutions, "even if there is no contradiction between the common rules and the bilateral agreement";[177]

(ii) whenever the Union has adopted internal legislative acts concerning Third Countries or expressly granted Union institutions the power to negotiate with Third Countries;[178] and

(iii) even in the absence of any express grant of power to negotiate with Third Countries, where the Union has achieved complete harmonisation of a particular field and the common rules could be affected by a bilateral agreement entered into by the Member States.[179]

The Court then proceeded to examine the bilateral agreement between Germany and the United States to ascertain whether it affected the common rules and noted that the Union Regulations provided that only Union carriers were entitled to introduce new products or fares lower than existing ones. Such common rules prevented Third Country carriers which operated within the European Internal Market from setting fares and rates when they operated on intra-Union routes.

> *"Accordingly, to the extent indicated in Article 1(3) of Regulation 2409/92, the Community has acquired exclusive competence to enter into commitments with non-member countries relating to that limitation on the freedom of non-Community carriers to set fares and rates".*[180]

The outcome was that the Member States were no longer competent to enter into international agreements concerning air transport fares and rates to be charged by Third Country carriers on intra-Union air routes; by concluding the Protocol with the United States the Member State infringed the Union's exclusive external competence in this area. Even though the Germany-United States bilateral

175 *ERTA* paragraph 30

176 *Opinion 2/91* paragraph 25.

177 See *Commission v Germany ("Open Skies")* paragraph 108, citing *Opinion 2/91* paragraphs 25 and 26.

178 See *Commission v Germany ("Open Skies")* paragraph 109, citing *Opinion 1/94* paragraph 95 and *Opinion 2/92* paragraph 33.

179 See *Commission v Germany ("Open Skies")* paragraph 110, citing *Opinion 1/94* paragraph 96 and *Opinion 2/92* paragraph 33.

180 See *Commission v Germany ("Open Skies")* paragraph 124.

agreement specified that the Union's Regulation had to be complied with, the Court underlined that the failure of the Member State to fulfil its Union obligations arose from-

> *"the fact that it was not authorised to enter into such a commitment on its own, even if the substance of that commitment does not conflict with Community law".*[181]

The Court was satisfied that in the area of fares and rates, and in the area of CRS's, the Union had an exclusive external competence and that-

> *"the Community's tasks and objectives of the Treaty would be compromised if Member States were able to enter into international commitments containing rules capable of affecting rules adopted by the Community or of altering their scope".*[182]

However, by way of contrast, it is interesting to note that in *Commission v Germany ("Inland Waterway"),*[183] the Commission argued that Germany had failed to fulfil its Union law obligations by entering into bilateral agreements with the Ukraine, Poland and Romania relating to the conditions under which Third Country carriers could transport goods or passengers within the European Internal Market, even though Union Regulations governing such transport had been adopted. The Commission argued that the Union had an exclusive external competence in this field and that the bilateral agreements were in conflict with the common rules, and should not have been concluded by Germany. Moreover, because the Council of Ministers had conferred a negotiating mandate on the Commission to conclude a multilateral agreement on behalf of the Union, the Member States were precluded from entering into bilateral agreements which might affect those negotiations.

Given the significance of this case to understanding the *ERTA* doctrine, it is worth briefly understanding its background. The Commission had received a mandate to negotiate an international agreement (relating to inland waterway transport) from the Council in 1992. In 1993, the Commission requested several Member States (including Germany) to abstain from any initiative likely to compromise its negotiations. This was followed in 1996 by the initialling of a multilateral agreement was initialled but not brought into effect – it remained as a proposal from the

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181 See *Commission v Germany ("Open Skies")* paragraph 127. The Court goes on to describe a further instance of exclusive external competence in the area of CRS's, or computerised reservation systems, used in the European Internal Market. The common rules relating to CRS's also applied to Third countries. See paragraphs 130 and 131.

182 See *Commission v Germany ("Open Skies")* paragraph 136.

183 ECJ, 14 July 2005, Case C-433/03, *Commission of the European Communities v Federal Republic of Germany, ("Inland Waterway"),* [2005] ECR I-6985.

Commission to the Council. Meanwhile, Germany had concluded agreements in 1991 (with Romania and Poland) and in 1992 (with Ukraine), and had further agreements in place with Czechoslovakia and Hungary since 1988. Germany denied infringement of the Union's competence and of infringing Union law.

The Commission made three basic complaints:

(i) infringement of the Union's exclusive external competence within the meaning of the *ERTA* decision;

(ii) that the bilateral agreements entered into by Germany were incompatible with Union Regulation No. 1356/96 concerning inland waterway transport; and

(iii) infringement of Article 10 EC (Article 4 TEU) – a failure of the duty to abstain from action which might jeopardise a Union initiative.

On the infringement of the Union's exclusive competence issue, the Commission argued that the bilateral agreements affected the common rules adopted by the Union in Regulation No. 3921/91; by permitting "cabotage" in Germany by Third Country transport companies, the agreements infringed the harmonised rules concerning "cabotage" in the European Internal Market contained in Regulation No. 3921/91. The Commission argued that this Regulation covered Third Country carriers because the rights of Swiss carriers under the Mannheim Convention were recognised.[184]

Significantly, for double tax conventions, the Court disagreed with these arguments. It held that Regulation No. 3921/91 only concerned "Union" carriers, established within the Union and the reference in the Regulation to the rights of Switzerland under the Mannheim Convention was merely a formal acceptance of that situation. As the agreements did not fall within an area covered by the Regulation, they could not affect the common rules. The Court said:

> *"Those provisions cover only carriers of goods or passengers by inland waterway established in a Member State, which use vessels whose owner or owners are natural persons domiciled in a Member State and are Member State nationals, or legal persons which have their registered place of business in a Member State and the majority holding in which or majority of which belongs to Member State nationals".*[185]

184 See *"Inland Waterway"*, paragraphs 36-37.

185 See *"Inland Waterway"*, paragraph 48, citing ECJ, 2 June 2005, Case C-266/03, *Commission v Luxembourg ("Inland Waterway")*, [2005] ECR I-04805, paragraph 46.

Similarly, the Court rejected the Commission's argument that the bilateral agreements conflicted with Regulation No. 1356/96 which was adopted in 1996 after the agreements were concluded by Germany. The agreements provided[186] that Third Country carriers could provide transport services by inland waterway between Germany and other Member States subject to a special authorisation from the relevant authority. The Court noted that the main aim of Regulation No 1395/96 was to establish the internal market in the area of transport of goods and passengers by inland waterway,

> *"by eliminating all restrictions and discrimination as regards the provider of services on the grounds of his nationality or the place of his establishment".*[187]

Consequently, since this Regulation only applied to carriers established in a Member State, using the vessels specified in Regulation No. 3921/91, Regulation No. 1356/96 did not prevent Third Country carriers from carrying out services within the European Internal Market, and the provisions of the agreements did not modify the nature or scope of that Regulation. The contested bilateral agreements entered into by Germany did not change the rules contained in the Regulations as they merely allowed third country carriers on a reciprocal basis to operate services between Germany and other Member States if authorised by the competent authority specified in the relevant bilateral agreement.[188]

The important point was that the rules did not extend the internal market to the non-member countries. The significance of this ruling for double tax conventions of the EU Member States is discussed in Part V below.

Part IV: Competence and the Lisbon Treaty

The Treaty on European Union and Union Competences

The Treaty of Lisbon amends the EC Treaty and the Treaty on European Union (TEU) and outlines more clearly the exclusive and shared competences of the EU.[189] Under the amended TEU, which is discussed in this Part, the European Union replaces and succeeds the European Community. Article 3(3) TEU specifies that the Union shall establish an internal market and that competence in relation to the

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186 See *"Inland Waterway"*, paragraph 75.

187 See *"Inland Waterway"*, paragraph 79.

188 See *"Inland Waterway"*, paragraph 82.

189 For an interesting editorial on EU citizenship and the changes to be introduced by the Lisbon Treaty, see *"Two-speed European Citizenship? Can the Lisbon Treaty help close the gap?"* CMLR 45: 1-11, 2008.

internal market is a shared one.[190]

Article 4 TEU emphasises that any competences not conferred on the Union remain with the Member States. Article 3(6) TEU provides that the Union "shall pursue its objectives by appropriate means commensurate with the competences which are conferred upon it in the Treaties". Article 5(1) TEU goes on to highlight that the principle of conferral[191] governs the limits of Union competences and the principles of subsidiarity[192] and proportionality[193] provide further parameters on the use of EU competences.

The TEU[194] makes in clear that EU competences are not extended by the fact that the EU has recognised the rights, freedoms and principles set out in the Charter of Fundamental Rights of the EU of 7 December 2000 ("the Charter").[195] Article 51 of the Charter sets out its field of application; Article 51(2) highlights that the Charter "does not extend the field of application of Union law beyond the powers of the Union or establish any new power or task for the Union, or modify powers and tasks as defined in the Treaties".

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190 See Article 4(2) TFEU discussed below.

191 Under the principle of conferral, the EU can act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out in the TEU and the TFEU. See Article 5(2) TEU.

192 Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the EU can take action only "if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States…but can rather, by reason of the scale or effects of the proposed action, be better achieved at the Union level". See Article 5(3) TEU.

193 Under the principle of proportionality, the content and form of EU action cannot exceed "what is necessary to achieve the objectives of the TEU and TFEU. See Article 5(4) TEU.

194 See Article 6 TEU.

195 See Official Journal 2007/C 303/01. A detailed discussion of the Charter goes beyond the scope of this article. However, there are a number of provisions of the Charter which will impact on the direct tax area. These include Article 15 which concerns the freedom to choose an occupation and the right to engage in work. Article 15(3) provides that "nationals of third countries who are authorised to work in territories of the Member States are entitled to working conditions equivalent to those of citizens of the Union". Clearly, this may have implications for the direct tax systems of the Member States who must now ensure equal treatment for such third country nationals. This notion of equal treatment is also emphasised in Article 20 dealing with equality before the law and Article 23 which specifies "equality between men and women" in all areas, including employment, work and pay. Article 45(1) provides that every EU citizen has "the right to move and reside freely within the territory of the Member States". This right has already generated jurisprudence from the ECJ in cases like *Pusa* and *Turpeinen* where the taxation of pensions of EU citizens was scrutinised. See ECJ, 29 Apr 2004, Case C-224/02, *Heikki Antero Pusa v Osuuspankkien Keskinäinen Vakuutusyhtiö, ("Pusa")*, [2004] ECR I-5763; ECJ, 9 Nov 2006, Case C-520/04, *Pirkko Marjatta Turpeinen, ("Turpeinen")*, [2006] ECR I-10685.

Article 6(3) TEU goes on to indicate that although the fundamental rights granted under the European Convention for the Protection of Human Rights and Fundamental Freedoms constitute general principles of EU law, they do not extend "in any way the competences of the Union".[196]

In relation the institutions of the Union (such as the European Parliament, the European Council, the Council, the European Commission, the Court of Justice), Article 13(2) TEU provides that each institution "shall act within the limits of the powers conferred upon it in the Treaties, and in conformity with the procedures, conditions and objectives set out in them".

Finally, in relation to the enhanced cooperation procedure discussed in the next section, Article 20(1) TEU provides that the Member States which wish to establish enhanced cooperation may make use of the Union's institutions and its non-exclusive competences, subject to the limits and in accordance with the arrangements laid down in Article 20 TEU and Articles 326-334 TFEU (examined in the next section in more detail).

Competences of the EU in the Treaty on the Functioning of the EU

The new Treaty on the Functioning of the European Union (TFEU) organises the functioning of the EU and determines "the areas of, delimitation of, and arrangements for exercising its competences".[197] The "Categories and Areas of Union Competence" are highlighted in Articles 2-6 TFEU.

Article 2(1) TFEU specifies that only the EU may legislate in areas where the EU has been granted an exclusive competence, with the Member States being relegated to a back-seat role whereby they may legislate "only if empowered by the Union or for the implementation of Union acts".

Article 2(2) TFEU deals with shared competences between the EU and the Member States whereby both the EU and the Member States can legislate and adopt legally binding acts. The provision states that "The Member States shall exercise their competence to the extent that the Union has not exercised its competence" and makes it clear that competence returns to the Member States in a situation where "the Union has decided to cease exercising its competence". Article 2(5) TFEU points out that the EU has the competence to "support, coordinate or supplement the actions of the Member States, without thereby superseding their competence in these areas" which are specified in Article 6 TFEU. These areas relate to health, industry,

196 For an example of the scope of the jurisdiction of the Court in the area of fundamental rights see ECJ, 3 Sep 2008, Joined Cases C-402/05 P and C-415/05 P, *Yassin Abdullah Kadi, Al Barakaat International Foundation v The Council of the European Union and Commission*, [2008] ECR I-0000 (not yet reported).

197 Article 1 TFEU.

culture and tourism, education, training and sport, civil protection and administrative cooperation. Only the latter category appears to have an immediate relevance for direct taxation and the double tax conventions of the Member States in the area of mutual administrative assistance. Article 2(5) TFEU goes on to clarify that any legislative acts of the EU in these areas "shall not entail harmonisation of the Member States' laws or regulations".

Article 3(1) TFEU outlines the areas where the EU has exclusive competence. These areas include (inter alia) the customs union; the common commercial policy; and establishing the competition rules necessary for the functioning of the internal market. Again, in relation to direct taxation and the double tax conventions of the Member States, only the latter category may have an immediate relevance in the direct tax area, particularly in the area of the State aid rules.

Article 4(1) TFEU indicates that the Union shall share competence with the Member States "where the Treaties confer on it a competence which does not relate to areas referred to in Articles 3 and 6" TFEU. Article 4(2) TFEU provides the "principal areas" that the EU and the Member States are to share competence, including in particular, the internal market.

Article 5(1) TFEU highlights the obligation of the Member States to "coordinate their economic policies within the Union". This proviso relates to all EU Member States and provides that specific provisions apply to the Member States whose currency is the euro. Finally, Article 288 TFEU specifies that to exercise the competences of the EU the institutions of the EU "shall adopt regulations, directives, decisions, recommendations and opinions".

Enhanced cooperation

The enhanced cooperation procedure is outlined in Articles 326-334 of the TFEU. This procedure allows a group of EU Member States to establish enhanced cooperation between themselves in one of the areas covered by the TFEU, excluding areas where the EU has exclusive competence. Any enhanced cooperation must comply with the Treaties[198] and "respect the competence, rights and obligations of those Member States which do not participate in it".[199] The enhanced cooperation is not allowed to undermine the "internal market or economic, social and territorial cohesion"[200] and cannot constitute a barrier to trade or discrimination in trade between the Member States, nor is it allowed to distort competition between them.[201]

198 Article 326 TFEU.

199 Article 327 TFEU.

200 Article 326 TFEU.

201 Article 326 TFEU.

When the enhanced cooperation is being established, it is open to all the Member States. It is also open to non-participating Member States at a later date provided that they comply "with the acts already adopted within that framework" and with "any conditions of participation".[202] Significantly, the Member States that are not involved in the enhanced cooperation are under an obligation not to impede its implementation.[203]

To initiate the enhanced cooperation procedure Member States must submit a proposal to the Commission specifying the scope and objectives of the enhanced cooperation and the Commission "may" submit a proposal to the Council to that effect. If the Commission fails to do so, it must inform the Member States concerned the reasons for its decision. Authorisation to proceed with the enhanced cooperation is granted by the Council on a proposal from the Commission after obtaining the consent of the European Parliament.[204] All members of the Council may participate in its deliberations, however, only the participating Member States may take part in the vote. A unanimous vote is required only in relation to those areas of the Treaties which require a unanimous vote.[205]

The enhanced cooperation procedure provides the framework for a number of Member States to cooperate more closely in areas like direct taxation where the unanimity requirement prevents the Council from legislating in relation to direct tax matters.[206]

The enhanced cooperation procedure might be used also in the area of double tax conventions in situations where a group of Member States may wish to have the rules currently contained in their bilateral/multilateral agreements, (which lead to a variety of disparities in cross-border situations), harmonised or approximated. The

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202 Article 328 TFEU.

203 Article 327 TFEU.

204 Article 329 TFEU.

205 Article 333(1) TFEU.

206 Already, there have been some indications that the Commission's CCCTB project (Common Consolidated Corporate Tax Base) may move forward in the absence of unanimity in the Council on the basis of the enhanced cooperation procedure. See http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/CCCTBWP057_annotated_en.pdf
and
http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm
(last visited 10 December 2009). For analysis, see Paul H.M. Simonis, *"CCCTB: Some Observations on Consolidation from a Dutch Perspective"*, INTERTAX, 37,1, pp 19-39; Michael Dougan, *"The Treaty of Lisbon 2007: Winning Minds, Not Hearts"*, CMLR 45: 617-703, 2008; Lucia Hrehorovska, *"Tax Harmonisation in the European Union", INTERTAX, 34, 3, pp 158-166;* Thomas Jaeger, *"Enhanced Cooperation in the Treaty of Nice and Flexibility in the Common Foreign and Security Policy", EFAR 7: 297-316, 2002.*

enhanced cooperation procedure gives this "twin-speed" and "twin-track" approach an opportunity to happen and allows other Member States the opportunity to follow suit at a later date.

Part V: Conclusions

The primary conclusion to be drawn from the above analysis relates to the question: "Is the ability of the Member States to conclude tax treaties chained up?" The Court has clearly answered this question in the negative. This is because the common rules put in place by the Union in the direct tax area are "minimum harmonisation" rules. Consequently, the Member States can enter into double tax conventions which grant equal or more favourable treatment than that provided for in the direct tax directives.[207] Moreover, the Member States may continue to enter into double tax conventions with Third Countries because such agreements do not extend the European Internal Market and the Union has not acquired an exclusive external competence in the area of double tax conventions under the *ERTA* jurisprudence. This is clear from the *Inland Waterway* jurisprudence discussed above.

Another key outcome relates to the 1960 *Humblet* decision of the ECJ where the Court pointed out that competence in direct tax matters was no longer the exclusive domain of the Member States because some competence in relation to direct taxation had been transferred to the Union. This had two important consequences for the Member States: (a) competence conflicts were now possible whenever a Member State's direct tax rule interacted with an area where exclusive competence was at the Union level; and (b) compliance problems could occur because of the hierarchy of legal norms operating in the Union; as Union law was supreme, the direct tax rules (and the rules contained in the double tax conventions) of the Member States could be in conflict with primary and secondary Union law.

From the analysis of the nature of Union competence it is clear that the Union has the necessary powers to implement secondary legislation in relation to the European Internal Market. For example, it can adopt regulations[208] (like the European Company Regulation)[209] and directives[210] (like the Parent Subsidiary Directive).

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207 See Kamiel Mortelmans, *"The Relationship between the Treaty Rules and Community Measures for the Establishment and Functioning of the Internal Market – Towards a Concordance Rule"*, (2002) CMLR, 39,1303-1346, at 1331, and Michael Dougan, *"Minimum harmonisation and the Internal Market"*, (2000) CMLR, 37, 853-885.

208 Using Article 308 EC as a legal basis.

209 Council Regulation (EC) No 2157/2001 of 8th October 2001 on the Statute for a European company (SE).

210 Using Article 94 EC as a legal basis which is restricted to "directives".

However, until it actually adopts such rules, generally speaking, there is no competence conflict and competence in the direct tax area remains with the Member States subject to their compliance obligations with Union law. However, the fact that the Union has the power to adopt directives concerning the European Internal Market means that it has a shared competence with the Member States in the area of double tax conventions and direct taxes.[211]

Exercising that competence has been difficult because of (a) the reluctance of the Member States to harmonise direct taxes and (b) the unanimity requirement in the Council voting procedure to adopt Union direct taxation rules ("tax veto") and, equally, because of (c) the existence in the TFEU[212] of the principle of subsidiarity, which restricts legislative intervention at the Union level considerably. But it is clear from the above analysis that the Union certainly has the capacity or the competence to adopt legislative measures in the area of direct taxes and double tax conventions. Moreover, once the Union has taken legislative action, the possibility for conflict between the Union's rules and those of the Member States increases from both a compliance, and a competence, perspective because the Member States can no longer have rules (at domestic or double tax convention level) which conflict with the higher Union norms.

This is apparent from the nature of the Union's Internal Market "horizontal" competences which do not need to mention the word "tax" or "fiscal" on their face but still may have an impact on the area of direct taxation and on double tax conventions.[213] Regulating the European Internal Market includes regulating the direct tax and double tax convention rules of the Member States (to a certain extent) because such rules may "affect" or represent an obstacle to a Union norm and, consequently, may need to be amended or repealed; and if the rule is contained in a double tax convention, the double tax convention may need to be amended or terminated.[214] Consequently, even though it may be argued that direct tax matters are generally regulated at the Member State level, Union rules may usurp that function, particularly in the area of the European Internal Market.

The regulatory framework for tax in the EU, however, needs double tax conventions and domestic tax regimes because competence in direct tax matters remains mainly with the EU Member States. Nearly all of the rules relating to the elimination of double taxation and dealing with direct tax matters are not located at the Union level; they are at the Member State level or at the international level in the case of

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211 See Article 4(2) TFEU.

212 Article 5 TEU.

213 See ECJ, 1 Jul. 1993, Case C-20/92, *Anthony Hubbard (Testamentvollstrecker) v Peter Hamburger*, [1993] ECR I-3777, para. 19.

214 For a recent example in relation to bilateral investment treaties see fn 76 above.

double tax conventions of the Member States which all have an international law element.[215] This sharing of competence in the direct taxation field leads to anomalies and disparities and many complications. However, the European Internal Market continues to function in the direct tax area and in the area of double tax conventions despite these anomalies and disparities.

To date, few cases involving direct taxation and competence issues have come before the ECJ. This is because the Member States have been very reluctant to allow direct taxation competence to move up to the Union level. The few tax directives that have been adopted have some significance in relation to cross-border dividend, interest and royalty payments and mergers but double tax conventions are still a necessary instrument to deal with juridical and economic double taxation problems that occur in the EU.

The enhanced cooperation procedure discussed above may lead to changes in the future in the direct taxation areas involving large business who would benefit from harmonised or coordinated rules because much of their business is conducted globally rather than domestically. But the antagonism of many smaller EU Member States to the Commission's CCCTB project seems to indicate that many Member States will be very reluctant to transfer competence in relation to direct taxation matters to the Union level in the near future.[216]

215 Some Member States implement double tax conventions by incorporating them into their domestic law ("Duallist"); others view double tax conventions as a higher legal norm and incorporate a double tax convention immediately as part of their domestic law ("Monist"). As all double tax conventions are international agreements, they all have an international law element. Double tax conventions between two or more Member States must fully comply with Union law. Double tax conventions entered into by a Member State with a Third Country must also fully comply with Union law unless the Article 307 EC (Article 351 TFEU) exception applies for "prior agreements", but obviously the Third Country is not bound by Union law. The Member State is bound by Union law and should the double tax convention contain a provision which is incompatible with Union law, the Member State must either amend the convention or terminate it.

216 For instance, see the letter from the Tax Executives Institute, Inc. to Thomas Neale, Head of the Task Force dealing with the CCCTB project, where they point out that if only a limited number of Member States adopt the CCCTB (e.g. through the enhanced cooperation procedures) the benefits of the proposal will be diminished and that the Commission should continue to work towards the issuance of a Directive supported by all Member States. The letter is available at:
http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/TEI_commentsCCCTB.pdf (last visited 10 December 2009).