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FREEDOM OF ESTABLISHMENT IN THE DIRECT TAX JURISPRUDENCE OF THE EUROPEAN COURT – A REVIEW

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1 Freedom of Establishment: Scope and Definition

Direct tax measures may hinder the exercise of the Treaty freedoms by imposing a burden, in particular where the right of establishment is concerned. The EU Treaty ('EC') aims at allowing free movement, and 'free movers' should not be 'penalized movers'. To achieve this, the taxpayer can rely on the freedom of establishment against a national tax provision, the European Court having confirmed that Article 43 EC, the Treaty provision enshrining the right to freedom of establishment, is directly effective.[2] The extent to which a taxpayer can rely on the right to freedom of establishment therefore depends on the scope of that provision.

The notion of establishment implies the fulfilment of three conditions, the first being the 'actual pursuit of an economic activity through a fixed establishment in another Member State'.[3] An economic activity 'is subject to Community law only in so far as it constitutes an economic activity within the meaning of Article 2 of the Treaty'.[4] This first condition reflects the commercial focus of the provision. In spite of this, the European Court has recognised that the right of establishment is available under

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2 *Reyners v Belgium* Case 2/74 [1974] ECR 631 at paragraph 30.

3 *Brasserie du Pêcheur SA v Federal Republic of Germany and The Queen v The Secretary of State for Transport ex parte Factortame Ltd and Others* (Joined Cases C-46/93 and C-48/93 [1996] ECR-I 1029 at paragraph 20.

4 *Walrave and Koch v Association Union Cycliste Internationale* Case 36/74 [1974] ECR 1405 at paragraphs 4 and 73.

certain conditions to non-profit organisations engaged in an economic activity.[5]

The second condition is that the economic activity must be a 'self-employed' activity. An Article 43 activity must also be distinguished from the provision of services under Article 60 EC. The distinction is made by looking at the permanent or temporary basis of an activity, determined 'in the light, not only of the duration ..., but also of ... regularity, periodicity or continuity'.[6] If the activity is of a stable and continuous nature the right of establishment protections are applicable.

Thirdly, there must be a cross-border activity. The Treaty does not apply to purely internal situations: nationals exercising an activity in their State only cannot invoke Article 43 EC.

Article 43 EC refers to the right to 'take up and pursue activities' thereby distinguishing two types of protected establishment – primary and secondary. There is also a difference between natural and legal persons: natural persons benefit from the right of primary establishment whereas companies do not.[7] On the other hand, both natural and legal persons benefit from the right of secondary establishment, i.e. the right to maintain more than one place of work within the Community in the form of agencies, branches or subsidiaries.

For natural persons to benefit from the right of establishment only one condition has to be fulfilled - being a national of a Member State. The right is thus available to dual nationals and nationals residing in a third country. The right to set up a secondary place of establishment is limited, however, to nationals who are already established in a Member State.

Two conditions are imposed on legal persons for them to be able to take advantage of the right: formation in accordance with the law of a Member State and possession of a registered office, central administration or principal place of business within the EU. The criterion is, in essence, an effective and permanent link with the economy of one Member State.[8]

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5 *Steymann v Staatssecretaris van Justitie* Case 196/87 [1988] ECR 6159.

6 *Reinhard Gebhard v Consiglio dell' Ordine degli Avvocati e Procuratori di Milano* Case C-55/94 [1995] ECR I-4165.

7 See Wouters, J. 'Verliesverrekening van vaste inrichtingen en het Europes vestigingsrecht', T.R.V. 1997, p.306. See also *R. v HM Treasury and IRC, ex parte Daily Mail and General Trust plc* Case 81/87 [1988] ECR 5505.

8 General Programme for the abolition of restrictions on freedom of establishment, *O.J.*, English Special Edition, Second Series, IX, p.7. However, the European Court does not adhere in a consistent way to the criterion, see *Centros Ltd. v Erhvervs-og Selskabsstyrelsen*

Once Article 43 applies, the protection afforded by the Treaty is protection against discrimination, a right to equal treatment.

2 Evolution of the Non-Discrimination Principle in Direct Taxation Cases

Article 12 is the basic Treaty provision relating to the principle of non-discrimination and prohibits 'discrimination on grounds of nationality'. However, the principle does not apply in internal situations. In the latter case, individuals have to rely on their national law for protection. Moreover, the European Court has held that Article 12 is a *lex generalis,* finding specific expression in the Articles on the fundamental freedoms, and being applied only if the situations at issue were not covered by *leges specialis*.[9]

Freedom of establishment had traditionally been understood as prohibiting direct discrimination but the European Court soon held that the prohibition also covered indirect discrimination. Since the *Italian Refrigerators* case, the Court has used the formula that discrimination consists in 'treating either similar situations differently or different situations identically,[10] but qualified it by stating that 'the different treatment of non-comparable situations does not lead automatically to the conclusion that there is discrimination'.[11] Discrimination is prohibited unless objectively justified.[12]

The main question facing the Court in proceedings against direct tax measures based on non-discrimination is the question whether non-residents and residents are in a comparable situation. In the early case law on the free movement of persons, the principle underlying the Court's reasoning was that non-residents **were** in a similar position to residents.[13]

Case C-212/97 [1999] ECR I-1459.

9 *Reyners v Belgium* Case 2/74 [1974] ECR 631 at paragraph 16.

10 *Italy v Commission* Case 13/63 [1963] ECR 165 at paragraphs 177-178.

11 On the notion of discrimination,, see van Raad, K., 'The impact of the EC Treaty's fundamental freedoms provisions on EU Member States' taxation in border-crossing situations - Current state of affairs', *EC Tax Review* 1995/4, p.190.

12 *Albert Ruckdeschel & Co. v Hauptzollamt Hamburg-St. Annen* Cases 117/76 and 16/77 [1977] ECR 1753 at paragraph 7.

13 See *Klaus Biehl v Administration des Contributions du Grand-duché de Luxembourg* Case C-175/88 [1990] ECR I-4695, *Hanns-Martin Bachmann v Belgium* Case C-204/90 [1992] ECR I-24, *R. v IRC, ex parte Commerzbank AG* Case C-330/91 [1993] ECR I-4017 and *Halliburton Services BV v Staatssecretaris van Financiën* Case C-1/93 [1994] ECR I - 1137.

The Court's ruling in *Schumacker* stands out in contrast to the earlier jurisprudence:

> 'In relation to direct taxes, the situations of residents and of non-residents are not, as a rule, comparable.'[14]

The *Schumacker* judgment is not easy to apply to legal persons. Indeed, the Court's reference to 'personal and family circumstances'[15] concerns individual taxpayers. It is less clear whether the distinction applies to companies.

In relation to business income from a permanent establishment, the Court decided in *Avoir Fiscal*[16] that where companies having their registered office in the host Member State and branches and agencies of foreign companies are both taxed on their income originating in the national/host Member State, they are in a similar situation.[17] In contrast, where resident companies are taxed on their worldwide income in the State of residence, permanent establishments of foreign companies would be in a different situation because they would only be taxed on income originating in the host State.[18] The question is then whether the *Schumacker* judgment can be applied to tax credits or exemption for investment income as analogous to 'personal or family circumstances'. In view of the Court's ruling in *AMID*,[19] this seems to be the case.

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14 *Finanzamt Köln-Altstadt v Roland Schumacker* Case C-279/93 [1995] ECR I-225 at paragraph 31.

15 For example, at paragraphs 37 and 38 of the judgment.

16 *Commission v France* Case 270/83 [1986] ECR 273.

17 *See Vanistendael, F., 'The consequences of Schumacker* and *Wielockx:* two steps forward in the tax procession of Echternach', 1996 (33 CMLRev., p.255).

18 See van Raad, K., 'The impact of the EC Treaty's fundamental freedoms provisions on EU Member States' taxation in border-crossing situations - Current state of affairs', *EC Tax Review* 1995/4, p.190 at p.195. This is confirmed in *Royal Bank of Scotland v Greek State* Case C-311/97 [1999] ECR I 2651 where Greek companies were taxed on their worldwide income and permanent establishment of foreign companies only on income arising in Greece. The Court looked if the different treatment amounted to discrimination of categories of legal persons in a dissimilar position.

See also Wouters, J., 'Verliesverrekening van vaste inrichtingen en het Europes vestigingsrecht', TRV 1997, p.306.

19 *Alegemene Maatschappij voor Investering en Dienstverlening NV (AMID v Belgium* Case C-141/99 [2000] ECR I -.

Direct discrimination.

Direct discrimination is discrimination on grounds of nationality. The European Court has consistently interpreted Article 48 EC in such a way as to assimilate corporate 'seat' to nationality in the case of companies. Therefore, national legislation differentiating on the basis of such a criterion will *prima facie* infringe Article 43 EC.

Indirect discrimination.

The concept of indirect discrimination was first referred to in *Sotgiu*,[20] a case concerning the free movement of workers:

> 'the rules regarding equality of treatment (...) forbid not only overt discrimination (...) but also covert forms of discrimination which by the application of other criteria of differentiation, lead to the same result'.

The first case concerning indirect discrimination in this area was *Thieffry*,[21] A rule which has the practical effect of putting a certain category of persons at a disadvantage is likely to be discriminatory.

In the case of legal persons the European Court has ruled that a distinction based on the seat of a company leads to direct discrimination. However, in *Avoir Fiscal*,[22] the Court assimilated the location of a company's seat to the place of residence of a natural person.[23] The *Commerzbank* case took this further: the European Court considered a distinction based on fiscal residence to constitute indirect discrimination.[24] Moreover, in *ICI* the Court assimilated residence to seat in the case of a subsidiary and this led to a finding of indirect discrimination.[25]

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20 *Giovanni Maria Sotgiu v Deutsche Bundespost* Case 152/63 [1974] ECR 153 at paragraph 11.

21 *Thieffry v Conseil de l'Ordre des avocats à la Cour de Paris* Case 71/76 [1977] ECR 765.

22 *Commission v France* Case 270/83 [1986] ECR 273.

23 *Commission v France* Case 270/83 [1986] ECR 273 at paragraph 18, last sentence and paragraph 19.

24 *R. v IRC, ex p. Commerzbank AG* Case C-330/91 [1993] ECR I- 4017 at paragraph 15.

25 *Imperial Chemical Industries plc v Colmer* Case C-264/96 [1998] ECR I- 4695 at paragraphs 22-23 . The Court was, in the author's view, referring to the legal differences between a subsidiary and a permanent establishment. A subsidiary has a seat in the host State, whereas a branch does not. Therefore, different treatment as between a subsidiary and a branch is directly discriminatory since it uses the company's seat as criterion. In the case of fiscal

Non-discriminatory restrictions.

Non-discriminatory restrictions are measures liable to hinder or render less attractive the exercise of one of the freedoms by imposing an additional burden or cost even if they apply without distinction.

If one looks at the text of Article 43, the first paragraph explicitly points towards a restriction-based reading whereas the second only points towards the national treatment requirement.[26] Evolution started with some indications that the European Court saw more than just a prohibition of discrimination in the *Klopp*[27] and *Commission v France*[28] judgments. Later the Court explicitly referred to non-restriction measures being caught by Article 43 EC in the *Kraus* ruling,[29] the reasoning in which is very similar to the reasoning in *Cassis de Dijon*[30] in that it referred to the conditions necessary for such measures to comply with the freedoms.[31]

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residence, subsidiaries are resident for tax purposes in the host State but branches are not. Due to the fact that fiscal residence usually falls together with the place of effective management, the criterion constitutes indirect discrimination 'only'. The effect of applying the second criterion is the same, but indirectly. The Court thus did not blur the issue but took into account the legal differences between the two forms of establishment.

26 Article 43 reads as follows:

> 'Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the Territory of any Member State .
>
> Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 48, under the conditions laid down for its own nationals by the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.'

27 Case 107/83 [1984] ECR 2971.

28 Case 96/85 [1986] ECR 1475.

29 *Kraus v Land Baden-Württemberg* Case C-19/92 [1993] ECR I 1663 at paragraph 32.

30 *Cassis de Dijon* (*Rewe-Zentrale v Bundesmonopolverwaltung für Brantwein*) Case 120/78 [1979] ECR 649.

31 See Wouters, J., 'Fiscal barriers to companies' cross-border establishment in the case law of the EC Court of Justice', (1994)14 YEL, p.73.

Recent examples in the area of direct taxation can be found. The Court analysed restrictions by the host State as non-discriminatory measures in the *Futura Participations*[32] and *Centros*[33] cases.

The Court in *Futura* expressly mentioned the prohibition on restrictions in Article 43 EC but went on to say that 'the imposition of such a condition, which specifically affects companies or firms having their seat in another Member State[34]' seems to blur the distinction between non-discriminatory restrictions and indirectly discriminatory measures for which the same criteria are used,[35] Wouters sees in this judgment an indication that the European Court is willing to introduce a different approach depending on whether the measure relates to the activity of a legal person or to market access (demanding compliance with an administrative, material condition). In the first instance, a discrimination reasoning is followed whereas in the second a non-discriminatory reasoning is followed.[36]

In *Centros*, the Court expressly referred to four conditions to be fulfilled by non-discriminatory measures. The *Daily Mail* ruling[37] is considered to be an example of the development of Article 43 EC to prohibit restrictions imposed by the host state.

2.1 Are there limits to the European Court's jurisdiction under Article 43 EC?

The extension of the interpretation of Article 43 to prohibit indistinctly applicable measures has been criticised and labelled as 'hidden harmonisation'.[38] It is thought to lead to the disintegration of national tax systems. Caamaño and Carrero, for

32 *Futura Participations SA v Administrations des Contributions* Case C-250/95 [1997] ECR I-2471.

33 *Centros Ltd v Erhvervs-Og Selskabsstyrelsen* Case C-212/97 [1999] ECR I-1459.

34 *Futura Participations SA v Administrations des Contributions* Case C-250/95 [1997] ECR I-2471 at paragraph 26.

35 See *R. v IRC, ex parte Commerzbank AG* Case C-330/91 [1993] ECR I-4017 at paragraph 15 .

36 Wouters, J., 'Verliesverrekening van vaste inrichtingen en het Europes vestigingsrecht', T.R.V. 1997, p.306 at p.310.

37 *R. v HM Treasury and IRC, ex parte Daily Mail and General Trust plc* Case 81/87 [1988] ECR 5505 at paragraph 16.

38 See Lehner, M. 'Limitation of the national power of taxation by the fundamental freedoms and non-discrimination clauses of the EC Treaty', EC Tax Review 2000/1 Vol. 9, p. 5.

instance, criticize the *Futura Participations* decision[39] by stating that the judgment could lead to the prohibition of any tax measures that entail a foreigner established in a Member State having to duplicate formal or material obligations.[40] Their interpretation is consistent with the principle of 'mutual recognition' in the case law of the Court.[41]

However, in view of the coherent interpretation of the fundamental freedoms one may ask if that fear is really justified. In the field of the free movement of goods, the European Court has restricted its jurisdiction by excluding some national measures from the ambit of Article 28 EC altogether.[42] The same trend appears in the field of the freedom to provide services[43] and the free movement of workers.[44] In the field of the freedom of establishment such a restriction of the Court's jurisdiction is illustrated by *Peralta*,[45] where the Court held that the difficulties flowing from the national law at issue did not 'as to their nature, differ from those which flow from disparities between national legislative rules, for example in the area of wages, social charges or tax'.[46] Therefore, the mere differences between domestic tax systems, tax bases or tax rates are not such as to constitute a restriction

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39 *Futura Participations SA v Administrations des Contributions* Case C-250/95 [1997] ECR I-2471.

40 Caamaño, M.A. and Calderón Carrero, J.M., 'Accounting, the permanent establishment and EC law: the *Futura Participations* Case', EC Tax Review 1999/1, p.24.

41 See *Cassis de Dijon* (*Rewe-Zentrale v Bundesmonopolverwaltung für Brantwein*) Case 120/78 [1979] ECR 649.

42 *Keck and Mithouard (Criminal Proceedings against)* (Joined Cases C-267/91 and C-268/91 [1993] ECR I-6097 at paragraph 16.

43 See *Alpine Investments BV v Minister van Financiën* Case C-384/93 [1995] ECR I-1141, where the European Court stated (in paragraph 38) that the prohibition at issue 'directly affects access to the market in services in the other Member States' and therefore does not fall outside the scope of application of Article 49 EC.

44 See *Bosman v Commission* C-117/91R [1991] ECR I-3353 at paragraph 103.

45 Case 349/92 [1994] I-3453.

46 *Peralta*,Case 349/92 [1994] I-3453 at paragraph 34.

of cross-border economic activities.[47] [48] The first limit on the European Court's jurisdiction in direct tax cases is that the fundamental freedoms cannot serve as a basis for the legal enforcement of an extensive approximation of national tax systems.

Negative integration needs to be balanced by positive legislative approximation. The *Peralta* ruling could be thought not easily reconcilable with the recurrent statement by the Court that the absence of harmonisation does not justify the difference in treatment. However, that statement is usually qualified by the *dictum* that 'Article 43 EC prohibits the Member States from laying down in their laws *conditions for the pursuit of activities* by persons exercising their right of establishment which differ from those laid down for its own nationals'. The phrase 'conditions for the pursuit of activities' clearly does not refer to the tax system or tax bases.

A second limitation of the Court's jurisdiction in the area of the interpretation of the freedom of establishment as prohibiting non-discriminatory measures is that up until now, the European Court applied such an interpretation only in relation to measures of an administrative or procedural character in proceedings against the host State.

2.2 Justifications[49]

In principle, discriminatory measures can only be justified on Treaty grounds. Non-discriminatory measures also benefits from the 'rule of reason' justifications. However, for the purpose of justification, indirectly discriminatory measures are treated as indistinctly applicable measures in the case law of the Court in direct taxation. Even in the case of direct discrimination the European Court has not applied the rule in a consistent way. Only recently has there been a return to

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47 In this sense, see Schön, W., 'Tax competition in Europe – The legal perspective', A.F.T. 2000/12, p. 492 and Wouters, J., 'Verliesverrekening van vaste inrichtingen en het Europes vestigingsrecht', T.R.V. 1997, p.306.

48 However, the rulings of the European Court in *P H Asscher v Staatssecretaris van Financiën* Case C-107/94 [1996] ECR I-3089 and *AMID* (*Alegemene Maatschappij voor Investering en Dienstverlening NV v Belgium* Case C-141/99 [2000] ECR I -) seem to represent an inroad of the European Court into the sovereignty of the Member States in relation to the fixing of the tax rate and the determination of the tax basis.

49 See Edwards, V 'Secondary establishment of companies – The case law of the Court of Justice' YEL (1998) 18 p. 22 and Lyons, T., 'Discrimination against individuals and enterprises on grounds of nationality: direct taxation and the European Court of Justice', B.T.R., 1994, p.554.

formalism and legal certainty.[50]

2.3 Treaty based derogations: Article 46(1) EC

Member States are permitted by Article 46(1) EC to deny or restrict the exercise of the right of establishment on the grounds of public policy, public security or public health. Being exceptions to a fundamental right those derogations have to be interpreted restrictively - the measures must be suitable and necessary for the attainment of the objective.

In *ICI*, the European Court stated that a diminution of tax revenue is not a justification provided for by Article 46.[51] In *Centros*, the Court decided in the same way in relation to the protection of creditors.

2.4 The rule of reason exceptions

Non-discriminatory measures and indirectly discriminatory measures can be justified by case law exceptions. There is no exhaustive list of justifications: it is up to the Member States to convince the Court that a given goal justifies a derogation from Article 43 EC.

The Court has rejected as justifications: the lack of harmonisation,[52] the fact that the discrimination could have been avoided had the company seeking to establish itself chosen another form of secondary establishment,[53] the fact that advantages counterbalanced disadvantages,[54] the risk of tax avoidance and the administrative difficulties in obtaining information on non-resident taxpayers.

So far the European Court has only recognised two grounds of justification under the rule of reason: the effectiveness of fiscal supervision and the cohesion of tax system.

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[50] See *Centros Ltd v Erhvervs-Og Selskabsstyrelsen* Case C-212/97 [1999] ECR I-1459 and the parallel with the *Cassis de Dijon* ruling (*Rewe-Zentrale v Bundesmonopolverwaltung für Brantwein*) Case 120/78 [1979] ECR 649.

[51] *Imperial Chemical Industries plc v Colmer* Case C-264/96 [1998] ECR I-4695 at paragraph 28.

[52] See *Commission v France* Case 270/83 [1986] ECR 273.

[53] That justification was rejected in *Commission v France* Case 270/83 [1986] ECR 273, *R. v IRC, ex parte Commerzbank AG* Case C-330/91 [1993] ECR I-4017 and *Futura Participations SA v Administrations des Contributions* Case C-250/95 [1997] ECR I-2471.

[54] See *Commission v France* Case 270/83 [1986] ECR 273, *R. v IRC, ex parte Commerzbank AG* Case C-330/91 [1993] ECR I-4017.

The justification on ground of the cohesion of the tax system developed in *Bachmann*[55] has been limited by subsequent rulings.

In *Wielockx*, the European Court replaced individual/micro cohesion by bilateral/macro cohesion: in judging cohesion, bilateral treaties were also to be taken into account to see if cohesion at national level was preserved at bilateral level.[56] If it was not, the State could no longer rely on that justification any more. In 1995 the European Court restricted the possibility of justification at the level of the individual: there must be a direct link between deductibility and taxation,[57] in other words, the fiscal advantage and disadvantage must accrue to the same taxpayer and in relation to the same tax.

2.5 Conclusion.

In the context of the free movement and the internal market, the principle of non-discrimination can be seen as a minimum guarantee of market openness between Member States. It also safeguards unobstructed competition and the regulatory autonomy of the Member States. However, in its application in direct tax matters, the case law of the Court is confused and confusing. The European Court has had to reconcile non-discrimination with international tax law principles based on a differentiation of the situations of residents and non-residents. The Court also had to balance the sovereignty of the States with the interests of the taxpayers.

The principle of non-discrimination has evolved over time to cover non-discriminatory restrictions. This extension is problematic and raises the question of the limits of the European Court's jurisdiction. Arguably, the latest case law of the Court has tried to draw the line. Moreover, the freedom of establishment is not an absolute right and the development of the rule of reason allows more grounds of justifications for national tax measures. Only two grounds of justifications were recognised by the European Court however this indicates the willingness of the European Court to take national concerns into account in a balancing test.

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55 *Hanns-Martin Bachmann v Belgium* Case C-204/90 [1992] ECR I-24, at paragraphs 21-28.

56 *Wielockx* v Inspecteur der Directe Belastingen Case C-80/94 [1995] ECR I-2493 at paragraph 25.

57 *Svensson and Gustavsson v Ministre du Logement et de l'Urbanisme* Case C-484/93 [1995] ECR I-3955.

3 Right of Establishment of Natural Persons

3.1 Introduction

Belgian tax law uses the distinction accepted under international tax law: residents and non-residents are in a different situation therefore resident taxpayers are taxed on their world-wide income while non-resident taxpayers only have to pay tax on the income derived from Belgium.[58]

The analysis which follows will focus on the problems connected with personal allowances as a major obstacle to the free movement of self-employed persons. In section 4.1.4 Belgian law will be analysed in the light of the Court's jurisprudence.

3.2 The problem of personal allowances: which State has to take them into account?

Under international tax law, personal allowances, reliefs and reductions are a matter of concern for the home State. The host State is not obliged to grant those benefits to non-residents.[59] However, problems arise in the context of the free movement of persons: where, for example, a Belgian resident decides to establish himself in the Netherlands and derives all of his income from the latter state, he will not be able to deduct personal allowances against his taxable income either in Belgium or in the Netherlands. Such a case would act as a deterrent to the exercise of the right of establishment.

3.3 *Wielockx v Inspecteur der Directe Belastingen*[60]

In *Schumacker*[61] the European Court held that residents and non-residents not being in a comparable situation, a Member State could reserve some tax benefits for resident taxpayers. This does not hold good, however, where a non-resident 'receives the major part of his income and almost all his family income in a Member State other than that of his residence'.[62] Because of the factual impossibility of claiming personal allowances in the home State, the host State was required to grant

58 Articles 5 and 228 BITC.

59 Article 24.3. OECD Model Treaty.

60 Case C-80/94 [1995] ECR I-2493.

61 *Finanzamt Köln-Altstadt v Roland Schumacker* Case C-279/93 [1995] ECR I-225.

62 *Finanzamt Köln-Altstadt v Roland Schumacker* Case C-279/93 [1995] ECR I-225 at paragraph 38.

allowances. Some six months after the landmark decision, the Court had the opportunity to apply it to self-employed persons in *Wielockx*.

Mr. Wielockx was a Belgian resident who worked as a self-employed person in the Netherlands. As a non-resident he was not allowed to deduct contributions to an old age reserve, whereas self-employed residents of the Netherlands were allowed to do so. When *Wielockx* was referred to the European Court, the Court reiterated what it had said in *Schumacker* namely, that, although in principle not in the same situation as a resident, a non-resident, '*whether employed or self-employed*,[63] who receives all or almost all of his income in the State where he works is objectively in the same situation in so far as concerns income tax as a resident of that State who does the same work there'.[64] Therefore, the refusal to allow Mr. Wielockx to deduct the contributions from his taxable income was discriminatory because it resulted in a heavier tax burden in the host State.

The *Schumacker* and *Wielockx* cases represent an adaptation of the international tax rule, resulting in a new rule applying in relations between Member States[65]. That new rule is unclear and begs a lot of questions. Some of the uncertainties were answered by the Court in subsequent cases.

3.4 Subsequent case law: *Asscher*,[66] *Gilly*[67] and *Gschwind*[68]

The first point to have been clarified is the scope of the *Schumacker* test, i.e. does it also apply to source-related tax deductions and benefits. Arguably, *Asscher* answered this question.

Mr. Asscher was a Dutch national residing in Belgium. He worked in both States. His salary was taxed in the Netherlands at a higher tax rate than the salary of persons with the same occupation who were resident in the Netherlands. Not earning 90 per

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63 Italics supplied.

64 Paragraph 20 in *Wielockx v Inspecteur der Directe Belastingen* Case C-80/94 [1995] ECR I-2493.

65 Vanistendael, F., 'The consequences of *Schumacker* and *Wielockx*: two steps forward in the tax procession of Echternach' 1996 (33) CMLRev. p. 255.

66 *P H Asscher v Staatssecretaris van Financiën* Case C-107/94 [1996] ECR I-3089.

67 *Mr. and Mrs. Robert Gilly v Directeur des Services Fiscaux du Bas-Rhin* Case C-336/96 [1998] ECR I- 2793.

68 *Gschwind v Finanzamt Aachen-Aussenstadt* Case C-391/97 [1999] ECR I-5451.

cent of his income in the Netherlands and therefore not assimilated to a resident for tax purposes, Mr. Asscher had to pay 25 per cent tax whereas residents were taxed at a 13 per cent rate.

The Court found that Mr. Asscher was in a situation comparable to that of a resident taxpayer, not because he earned all or almost all of his income in the Netherlands but because he could not escape the application of the rule of progressivity.[69] The income earned in the Netherlands was exempted from tax in Belgium but taken into account for the purpose of determining the amount of tax in the Netherlands. Mr. Asscher was compulsorily insured in Belgium under the social security scheme for self-employed persons. He paid a higher tax rate in the Netherlands without deriving any social security rights there. Therefore the difference of treatment constituted by the different tax rate was (indirectly) discriminatory.

In *Asscher* the Court looked at the overall situation, looking at the effect of both the Belgian and Dutch tax system on the tax burden. The Court rejected the defence of justification on grounds of cohesion of the tax system.

The first conclusion to be drawn from *Asscher* is that the European Court distinguishes two types of allowances, personal reliefs and source-related reliefs. Personal reliefs are allowances attached to the person of the taxpayer and closely related to his personal circumstances. Those personal reliefs are the responsibility of the state of residence, except where the taxpayer is in the same situation as Mr. Schumacker. On the other hand, source-related reliefs are benefits attached to the taxpayer's business income. They must be granted by the source state on the same footing as for residents.

The second conclusion is that *Wielockx* would probably be decided on other grounds today.[70] The contributions at issue in *Wielockx* were business-related: they were inextricably attached to the taxpayer's business income and were based on objective factors. Therefore, the Court should have granted Mr. Wielockx the deduction irrespective of the relative amount of income he derived from the source state. This

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69 *P H Asscher v Staatssecretaris van Financiën* Case C-107/94 [1996] ECR I-3089 at paragraphs 46-48.

70 In this sense, Wattel, P.J. 'Taxing non-resident employees: Coping with *Schumacker*' European Taxation 1995/11-12, p.347; van Raad, K., 'The impact of the EC Treaty's fundamental freedoms provisions on EU Member States' taxation in border-crossing situations - Current state of affairs', *EC Tax Review* 1995/4, p.190 and Farmer, P. 'EC law and national rules on direct taxation: a phoney war?', EC Tax Review 1998/1, p. 13.

approach follows *Schumacker*.[71]

In *Gilly*, a French couple both lived in France. Mr. Gilly worked there as a teacher and Mrs. Gilly was also a teacher but in Germany, earning 55 per cent of the household total income. As a result of the Double Taxation Convention between Germany and France, Mrs. Gilly was taxed in Germany but that State did not take into account her personal and family circumstances. France did take those into consideration when determining the total household income.

The Gillys found the situation discriminatory because a certain degree of double taxation remained: the tax credit accorded in the home State on foreign income was lower than the tax actually paid in the source State. However, the European Court did not accept the argument, treating the difference in treatment as a result of disparities in the tax law of the Member States.[72]

In *Gschwind*,[73] Mr. Gschwind, a Dutch national, lived with his family in the Netherlands where his wife worked. He was employed in Germany, earning 58 per cent of the family income. As a result of a Double Taxation Convention between Germany and the Netherlands, he was taxed in Germany and assessed as a person subject to unlimited taxation – thus as a resident – but treated as single. He therefore lost all his personal allowances and the benefit of the splitting tariff. Nevertheless the Court did not find the refusal of the German authorities to take into account his personal and family circumstances discriminatory.

One remark about the *Gschwind* case: if Mr. Gschwind was assessed as a person subjected to unlimited taxation, the difference between residents and non-residents is removed. Therefore, the conditions imposed on him to benefit from the splitting regime where residents are not subject to those conditions, are clearly discriminatory. The Court should have followed its *Avoir Fiscal*[74] ruling to the effect that where residents and non-residents are 'on the same footing for the purpose of taxing their profits, those rules cannot, without giving rise to discrimination, treat them differently in regard to the grant of an advantage related to taxation'.[75]

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71 Paragraphs 48-58 in *Finanzamt Köln-Altstadt v Roland Schumacker* Case C-279/93 [1995] ECR I-225 at paragraphs 45-58.

72 *Mr and Mrs Robert Gilly v Directeur des Services Fiscaux du Bas-Rhin* Case C-336/96 [1998] ECR I- 2793 at paragraph 47.

73 *Gschwind v Finanzamt Aachen-Aussenstadt* Case C-391/97 [1999] ECR I-5451.

74 *Commission v France* Case 270/83 [1986] ECR 273.

75 *Commission v France* Case 270/83 [1986] ECR 273 at paragraph 20.

From *Gilly* and *Gschwind* it appears that for the European Court once the taxpayer earns home state income equal to or more than the home state allowances, he is able to benefit from the home state allowances and there is no need for the host state to intervene. The Court did not refer to a particular percentage for an income to constitute 'all or almost all' of the earned income in the source State. This is understandable as this is more a matter for positive integration than for the Court. The Commission, on the other hand, recommends to the host state that a non-resident taxpayer deriving 75 per cent of his total income there, should not be taxed more heavily than a resident.[76] Nevertheless, the Commission Recommendation has been implemented differently in the Member States.

Avery Jones, in an article written in 1996,[77] raised the issue of the difficulty of applying *Schumacker* in tax credit countries. He stated that taxpayers resident in a tax credit state could never be in the same circumstances as a resident of the source state due to the fact that the tax credit method takes away the benefits granted by the source state. The foreign tax credit is limited to the amount the credit state would have levied itself on the income and therefore no neutrality is achieved in a case where the host state tax is higher than the home country tax. This is exactly the problem referred to by the taxpayer in *Gilly,* however, the European Court refused to deal with the problem of different treatment in such a case, it being an issue that can only be solved through cooperation between the Member States.

3.5 *Zurstrassen*[78]

Zurstrassen concerned a Belgian national who lived and was employed in Luxembourg. His unemployed wife and his children resided in Belgium. Mr. Zurstrassen earned 98 per cent of the household income in Luxembourg, the remaining 2 per cent representing his income as a professor at a Belgian university. He relied upon Article 39 against his home State, Luxembourg.

Under Luxembourg law, spouses residing separately in Luxembourg and non-residents who were married (and not *de facto* separated) where at least 50 per cent.

[76] Commission Recommendation 94/79/EC of 21st December 1993 on the taxation of certain items of income received by non-residents in a Member State other than that in which they are resident, O.J. L39, p.22.

[77] Avery Jones, J.F. 'Carry on discrimination' *European Taxation* 1996 p. 46; see also the reactions of Farmer, P. 'EC law and national rules on direct taxation: a phoney war?', *EC Tax Review* 1998/1, p. 13 and Wattel, P.J. 'Home neutrality in an internal market' *European Taxation* 1996, p. 150.

[78] *Patrick Zurstrassen v Administration des Contributions Directes* Case C-87/99 [2000] ECR I-3337.

of the household income was earned in Luxembourg and they both worked in Luxembourg, are assessed to tax jointly. The question was whether the condition that both spouses must have their residences in the same state was precluded by Article 39.

The European Court found that the residence condition imposed for both spouses constituted indirect discrimination.[79] The Court referred to *Schumacker* but observed that Mr. Zurstrassen was 'a resident taxpayer in the state where he is paid almost his entire earned income'. Luxembourg being the state of residence, it had to take into account the taxpayer's personal and family circumstances, therefore the Luxembourg authorities had to treat Mr. Zurstrassen as a married person with dependents. The benefit of the joint assessment to tax of spouses could not be made conditional on their both being residents.

The *Zurstrassen* ruling confirms the previous case law of the Court that personal and family circumstances have to be taken into account by the home State. However, the statement to the effect that Luxembourg 'is the only State which can take account of Mr. Zurstrassen's personal and family circumstances since he is not only resident in that State but, *additionally, is paid almost the entire earned income of the household there*',[80] is confusing.

Is the Court introducing a new criterion for the granting of joint tax assessment for married couples? The Court cannot be saying that, in proceedings against the home state, the taxpayer must earn almost all of the household income there to be able to benefit from joint assessment. This would run contrary to the international tax rule and to *Schumacker*. Moreover, such a requirement would amount to indirect discrimination.

Is it the Court imposing an additional condition where the spouses live in different Member States? The Commission's view expressed in the context of the right of residence of a worker's family may be relevant here:

> 'it is not permissible to make the right to free movement subject to the manner in which the spouses wish to conduct their married life, by requiring them to live under the same roof'.[81]

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79 *Patrick Zurstrassen v Administration des Contributions Directes* Case C-87/99 [2000] ECR I-3337 at paragraphs 19-20.

80 *Patrick Zurstrassen v Administration des Contributions Directes* Case C-87/99 [2000] ECR I-3337 at paragraph 23 - Italics supplied.

81 *Diatta v Land Berlin* Case 267/83 [1985] ECR 567 at paragraph 13.

The reasoning of the Court in *Zurstrassen* is consistent with *Diatta*:[82] to require *both* spouses to reside in the same Member State would be contrary to the right of free movement and, by analogy, to the right of establishment of self-employed persons.

The statement of the European Court referred to above could be seen as a criterion for determination of the Member State required to take the personal and family circumstances into account where the spouses live in different States and both earn part of the family income. For example, if Mrs. Zurstrassen also worked and earned an income in Belgium where she resided, and her husband lived in Luxembourg and earned an income both in Belgium and Luxembourg, they would both be entitled to personal and family deductions on their earned income and would benefit from joint assessment. This could lead to discrimination against a married couple living in the same state, in that they were only allowed personal and family deductions of their home state once. Therefore, such a couple would have to pay more tax in some cases. Even if that problem is a result of the disparities between the laws, the criterion provided by the Court would imply that the home state where the substantial part of the household income is earned is responsible for taking the personal and family circumstances into account, to the exclusion of the other state. Consequently, personal and family allowances would be allowed against taxable income only once.

The European Court has not dealt with the problem of the difference between the laws of the home and host states as to the availability of personal and family allowances. The Court limits itself to determining whether there is the theoretical possibility of those circumstances being taken into account by the home State or, alternatively, by the host State. The question whether the home State, for example, would have granted more or less or different personal and family allowances is not relevant. There is also no requirement to 'top up' the reliefs.[83] Again, the Court seems to consider that issue outside its jurisdiction under the provisions of the Treaty relating to the freedoms.

How is *Schumacker* and the subsequent case law to be applied where a taxpayer derives virtually all of his income from more than one other Member State? Could the *Zurstrassen* ruling be of any help in this context?

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82 *Diatta v Land Berlin* Case 267/83 [1985] ECR 567.

83 Farmer, P. 'EC law and national rules on direct taxation: a phoney war?', EC Tax Review 1998/1, p. 13.

If the statement of the Court in *Zurstrassen*[84] is interpreted as explained above, that would be helpful in determining the Court's position and would reflect the view that where income is earned in different states, one of them has the primary responsibility to allow for personal deductions to the exclusion of the other(s). Nevertheless, were the European Court to follow that interpretation, uncertainties still remain in cases where an almost identical percentage of income is earned in different host countries.

Wattel argues that the rule that the host state must grant its personal allowances to certain non-residents should be extended to all non-residents, on a pro rata basis.[85] Wattel highlights different problems. The first is that the *Schumacker* solution is flawed: if the taxpayer derives 60 per cent of his income from the home country, he will only get part of the home state personal allowances and no personal allowances from the host state. On the other hand, if he earns 10 per cent of his income in his state of residence, the host state will have to intervene. Therefore, the non-resident in the latter case is better off.

The second problem is that the European Court seems to assume that home states allocate personal allowances to the domestic part of the income. This is incorrect. The home country will first determine the worldwide income, then it will allocate the personal deductions to that worldwide income. The foreign income is then not taxed and therefore, a part of the deduction is lost.

Wattel's solution is that both the state of residence and the state of source should take into account personal circumstances and both should tax non-residents as residents. The personal deductions would then be allocated on a pro rata basis. This would resolve all problems in the situation where a taxpayer earns income in several states and the problem of the loss of some allowances. The determination of the percentage of income necessary to satisfy the *Schumacker* test will also be solved as that test will no longer be applicable.

The main problem with Wattel's proposed solution is that it removes the difference between residents and non-residents. This goes outside the jurisdiction of the Court

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84 To the effect that Luxembourg 'is the only State which can take account of Mr. Zurstrassen's personal and family circumstances since he is not only resident in that State but, *additionally, is paid almost the entire earned income of the household there*'.

Patrick Zurstrassen v Administration des Contributions Directes Case C-87/99 [2000] ECR I-3337 at paragraph 23 - Italics supplied.

85 Wattel, P.J. 'Progressive taxation of non-residents and intra-EC allocation of personal tax allowances: Why *Schumacker, Asscher, Gilly* and *Gschwind* do not suffice', European Taxation 2000/6, p.210.

in relation to tax matters and clashes with international tax law.

3.6 Impact on Belgian tax law

The Belgian Tax Reform of 1962 introduced a distinction between residents and non-residents. The former are taxed on their worldwide income whereas the second are only taxed on income earned in Belgium. In 1989 a further distinction was introduced[86] and non-resident taxpayers were divided into two categories:

(1) non-residents who had an abode in Belgium during the entire fiscal year and who were taxed in substantially the same way as residents; and

(2) non-residents who did not have a home in Belgium during the entire fiscal year and who were denied certain personal allowances and their marital situation was not taken into account.

The Constitutional Court held the distinction between privileged and ordinary non-residents to be discriminatory.[87] The Belgian Court held that the distinction was arbitrary since non-residents who received Belgian-source pension income and who did not have a home in Belgium during the entire taxable period were excluded from the benefits of personal allowances in both the state of employment and the state of residence. Implicit in the judgment is that non-justified discrimination arose for non-residents and that therefore Belgium, as their home state, had to take personal circumstances into account.[88]

As a result a new regime was introduced in 1992 and that was also brought before the Belgian Constitutional Court. The new regime specified new criteria for privileged non-residents. Non-residents were privileged if they

(1) had an abode in Belgium during the entire taxable period, or

(2) did not have an abode in Belgium but they were employed in Belgium or received pension income for at least nine full months during the tax period which represented at least 75 per cent of the world-wide earned income.

86 Law of 22nd December 1989, Moniteur Belge, 29th December 1989.

87 Cours d'Arbitrage, 21st November 1991, Moniteur Belge, 14th December 1991.

88 Hinnekens, P. 'Impact of non-discrimination under EC Treaty on Belgian income tax law', EC Tax Review 1996/2 p.56.

The Belgian Court set-aside the second criterion as discriminating against self-employed persons but held the 75 per cent rule reasonable in view of the principle of proportionality.[89] The 75 per cent rule was clearly inspired by the work of the Commission on the draft of what would become the Recommendation of 1993.

The Belgian Tax Reform of 1996 modified the distinction between the ordinary and privileged non-resident taxpayers and this modified system is the system currently applicable in Belgium. Ordinary non-residents are still not entitled to personal allowances and certain personal deductions.[90] Privileged non-residents are those:

(1) who have an abode in Belgium during the entire taxable period, and

(2) those who do not, but receive income in Belgium constituting at least 75 per cent of their worldwide income.

Article 244 Belgian Income Tax Code ('BITC') entitles those privileged non-residents to personal allowances and deductions. Belgian tax law does not distinguish between residents and non-residents regarding the tax rate applicable to earned income. Nevertheless, even if a non-resident falls into the privileged categories, some differences remain. For example, under Article 104(1) BITC, 80 per cent of alimony payments are deductible from the taxable income of the resident or non-resident taxpayer; however, non-residents are only allowed to deduct such payments if the recipient of the payment is a resident taxpayer.

The justification for the additional condition imposed by Article 244(1) and 242(2) BITC is probably the same as that advocated by Belgium in *Bachmann*. The alimony payments are deductible by the taxpayer who pays them but they constitute taxable income, as to 80 per cent, in the hands of the recipient, even if the recipient is a non-resident who receives the income from a Belgian resident. There is thus a correlation between deductibility and taxation.

Such a defence would probably not be accepted by the European Court. A resident paying alimony to a non-resident would be able to deduct the payment from his taxable income. On the other hand, the non-resident recipient would usually not pay tax in Belgium on the alimony payments received, as a result of bilateral tax treaties. Therefore, coherence is shifted at the bilateral level and Belgium could not invoke it to justify the discrimination.

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89 Cours d'Arbitrage, 26th April 1994, Fiscale Jurisprudentie-Jurisprudence Fiscale, 94/153, p.350.

90 Article 243 BITC *juncto* Article 227, 1° Belgian Income Tax Code.

More generally, the question could be asked whether the distinction between ordinary and privileged non-residents is itself justified. The question is whether the criteria of distinction may lead to indirect discrimination between two categories of non-residents.

In the author's view, the discriminating criteria are justified and proportionate to the aim of the Belgian legislation as they allow for the difference between non-residents who have a close link with the State and those who do not, except for their economic activities, such as frontier workers. The criteria also comply with the rule that it is the home state which has to take personal circumstances into account, except in some circumstances.

Article 244(2) BITC has to be examined in the light of the decision in *Zurstrassen*. That article states that, for privileged non-resident taxpayers who are married, their tax assessment is determined as if they were single if only one of the spouses derives an income to be taxed in Belgium and the other spouse earns an exempted income of more than 270,000 Belgian francs. Therefore, the spouse who is taxable in Belgium does not benefit from any allowances related to the family circumstances. In *Zurstrassen*, the European Court deemed national legislation which required both spouses to be resident in the national territory to be able to benefit from joint assessment to tax contrary to Article 39. In Belgium, however, Article 244(2) BITC does not impose a dual residence condition. The condition imposed by the law refers to the nature and the percentage of the income earned by the other spouse. Moreover, a similar provision applies to married resident taxpayers.[91]

3.7 Conclusion

The European Court has adapted the international tax law rule on the allocation of jurisdiction between States in relation to personal and family allowances – it is still the primary responsibility of the home state but the host state may have to intervene in certain circumstances. The question is whether those allowances are taken into account, albeit only in theory, somewhere. From the case law, it appears that Member States must grant all non-resident taxpayers the right to deduct source-related allowances but will only have to grant personal and family allowances to some non-resident self-employed persons, i.e. where the home state cannot take those allowances into account.

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91 Article 88 BITC.

4 Right of Establishment of Companies

The question in relation to the freedom of establishment of legal persons is whether the tax law of a Member State discriminates by treating permanent establishments of non-resident companies differently from resident companies. The analysis will first deal with the European Court judgments in proceedings against the host State and, secondly, with proceedings against the home State. In each case, the impact of the Court's jurisprudence on Belgian domestic law will be examined.

4.1 Restrictions imposed by the host State.

4.1.1 Case law up to *Saint-Gobain*.

The facts in *Avoir Fiscal*[92] were that France used a system of tax reimbursements to avoid double taxation of company profits – a credit was granted to resident companies and to subsidiaries of foreign companies, while foreign companies established in the form of a branch or agency did not benefit from the 'avoir fiscal' even if they were also taxed on the dividends received. The European Court adopted an *effet utile* approach to Article 43 when it stated that generally, and on the particular facts of the case, the forms of secondary establishment mentioned in that article are equal for tax matters:[93] both were taxed under French law and their profits are determined in the same way. Article 43 did not differentiate between the forms of secondary establishment and a national tax provision discouraging the use of one of these forms was therefore contrary to the freedom of establishment. In this its first ruling, the Court specified basic principles which were applied and qualified later.

In *Commerzbank*,[94] the UK legislation allowed the payment of interest (repayment supplement on overpaid tax only to companies resident for tax purposes in the UK, so the UK branch of a German bank did not receive it. The criterion used for differentiation was fiscal residence, which led to indirect discrimination.[95] The European Court did not accept an argument that non-resident and resident companies were not in the same situation because the former were exempted from the tax which gave rise to the refund. The Court did not carry out an overall comparison of the tax position, but only a comparison between the situation of a resident company

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92 *Commission v France* Case 270/83 [1986] ECR 273.

93 *Commission v France* Case 270/83 [1986] ECR 273 at paragraph 20.

94 *R. v IRC, ex p. Commerzbank* Case C-330/91 [1993] ECR I-4017.

95 *R. v IRC, ex p. Commerzbank* Case C-330/91 [1993] ECR I-4017 at paragraph 15.

which paid tax which was not legally due and a non-resident company in the same situation.

In *Halliburton Services*,[96] the facts were that a Dutch company, had to pay transfer tax when it bought property from the Dutch branch of a German company belonging to the same group. The European Court found that this constituted unjustified direct discrimination since, had the German company established a subsidiary in the Netherlands, Halliburton would have been exempted from the transfer tax.[97]

The *Futura Participations* case[98] is important from two points of view: firstly, the Court seemed to adapt its previous case law in line with the *Schumacker* case when it recognised the principle of territoriality; and, secondly, it was the first case where the European Court applied Article 43 to a non-discriminatory measure.

The Court in *Futura* did not find discriminatory a provision that non-resident taxpayers were allowed to deduct from their taxable income losses carried forward from previous years only if those losses were economically related to income received in Luxembourg, because the income to be taxed there was determined by only taking into account the profits and losses of the permanent establishment, whereas resident companies were taxed on their worldwide income. Thus, resident and non-resident companies were not on the same footing for the purpose of taxation, their situation was different.

As regards a requirement that non-resident companies must have kept accounts in Luxembourg complying with the national rules, the European Court considered it as a restriction burdening more specifically foreign companies. The Court found that such a condition could be consistent with the principle of the effectiveness of fiscal supervision but that in this case it went beyond what was necessary: indeed, foreign companies were not, as a rule, obliged to keep accounts in Luxembourg relating to

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96 *Halliburton Services BV v Staatssecretaris van Financiën* Case C-1/93 [1994] ECR I - 1137.

97 *Halliburton Services BV v Staatssecretaris van Financiën* Case C-1/93 [1994] ECR I–1137 at paragraphs 19-20. See Wouters, J 'Fiscal barriers to companies' cross-border establishment in the case-law of the EC Court of Justice', (1994) 14 YEL, p.73 in which he takes the view that *Halliburton Services BV v Staatssecretaris van Financiën* Case C-1/93 [1994] ECR I-1137 is the application of *R. v HM Treasury and IRC, ex parte Daily Mail and General Trust plc* Case 81/87 [1988] ECR 5505 to the host State.

98 *Futura Participations SA v Administrations des Contributions* Case C-250/95 [1997] ECR I - 2471.

their Luxembourg activities.[99]

In *Centros*,[100] a UK company wanted to operate in Denmark and to avoid Danish minimum capital requirements it applied to register a branch in Denmark rather than incorporating there. Registration was refused on the grounds that Centros had never carried on business in the UK and effectively wanted to establish its principal (and sole) establishment in Denmark. The European Court found that to refuse to register branches of companies formed in accordance with the law of another State constituted a non-justified restriction on the freedom of establishment.[101]

In *Royal Bank of Scotland*,[102] the Greek provision resulting in a different rate of corporate tax for national and foreign banks on Greek profits was found to be directly discriminatory. The Court referred to *Schumacker* and found that domestic and foreign banks were in a similar position for tax purposes. The discrimination was not justified.

Finally, the *Baxter* case[103] concerned a French tax on the turnover of medical factories in the assessment of which deductions were allowed in relation to the expenses of research carried out in France. French law subjected undertakings exploiting one or more proprietary medicinal products in France to three special levies. In particular, there was a special levy whose basis of assessment consisted of the pre-tax turnover achieved in France in a particular period in reimbursable proprietary medicinal products and medicinal products approved for use by public authorities, after deduction of the costs accounted for during the same period corresponding to expenditure on scientific and technical research carried out in France.

Baxter and the other applicants, which were subsidiaries of parent companies established in other Member States, argued that the mechanism for deducting

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99 *Futura Participations SA v Administrations des Contributions* Case C-250/95 [1997] ECR I-2471 at paragraphs 37 and 38.

100 *Centros Ltd v Erhvervs-Og Selskabsstyrelsen* Case C-212/97 [1999] ECR I-1459.

101 *Centros Ltd v Erhvervs-Og Selskabsstyrelsen* Case C-212/97 [1999] ECR I-1459 at paragraphs 21 and 34-38.

102 *Royal Bank of Scotland plc v Greek State* Case C-311/97 [1999] ECR I-2651.

103 *Société Baxter, B. Braun Médical SA, Société Fresenius France, Laboratoires Bristol-Myers-Squibb SA v Premier Ministre, Ministère du Travail et des Affaires Sociales, Ministère de l'Économie et des Finances, Ministère de l'Agriculture, de la Pêche et de l'Alimentation* Case C-259/97.

expenditure on scientific and technical research from the amount of special levy payable caused discrimination between French laboratories carrying out research mainly in France and foreign laboratories which had their principal research units outside France.

The European Court accepted the applicants' argument and rejected the attempted justification that the measure was necessary for effective fiscal supervision in establishing the genuineness of research expenditure as the measure expressly excluded the taxpayer from providing the evidence enabling the tax authorities to ascertain the nature and genuineness of the research expenditure incurred in other Member States.

4.1.2 *Compagnie de Saint-Gobain, Zweigniederlassung v Finanzamt Aachen-Innenstadt*[104]

Saint-Gobain was a French company with a branch in Germany, Saint-Gobain ZN, which held shares in a US company and indirectly, via two German subsidiaries, in a Swiss, an Austrian and an Italian company. Saint-Gobain ZN was taxed in Germany on the dividends it received. A dispute arose as it was not granted the following in Germany:

1. Corporation tax relief for international groups provided for by a double taxation convention concluded with a third state by Germany;

2. he crediting, against German corporation tax, of corporation tax levied in another state on the profits of a subsidiary established there; and

3. capital tax relief for international groups.

The criterion used by German law to determine whether the treatment was available was that of the company's seat and could therefore lead to direct discrimination. Moreover, the freedom to make a 'neutral choice' as to the form of secondary establishment was restricted by the fact that the concessions were not granted to permanent establishments, but were granted to subsidiaries.[105]

The next point developed by the Court was the question of comparability: were non-resident companies with a permanent establishment in a comparable situation to that of resident companies? The Court's approach was in line with its previous

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[104] Case C-307/97 [1999] ECR I-6161.

[105] *Compagnie de Saint-Gobain, Zweigniederlassung v Finanzamt Aachen-Innenstadt* Case C-307/97 [1999] ECR I-6161 at paragraphs 37-38 and 42-43.

jurisprudence, starting with *Avoir Fiscal*,[106] where it stated that the comparability of resident and non-resident companies has to be considered in relation to a particular tax provision relating to a specific income.[107]

Therefore, the liability to tax being identical for both, the condition for granting tax concessions could not be based on the difference in the way resident and non-resident companies were taxed. The European Court then refuted the attempted justifications of a reduction in tax revenues and the compensating advantage which permanent establishments enjoyed.

The potentially revolutionary part of the judgment in *Saint-Gobain* lies in the rejection by the European Court of the German argument that double taxation conventions between a Member State and a third country do not come within the sphere of Community competence. In line with the *Avoir Fiscal*, *Wielockx* and *Gilly* cases, the European Court stated that the Member States are at liberty to determine the connecting factors for the purposes of allocating powers of taxation, nevertheless, this does not affect the application of the EC Treaty. The Member States must consequently respect Community rules. The Court then goes on:

> 'In the case of a double taxation treaty concluded between a Member State and a non-member country, the national treatment principle requires the Member State (...) to grant to permanent establishments of non-resident companies the advantages provided for by that treaty on the same conditions as those which apply to resident companies.
>
> (...) The balance and the reciprocity of the treaties (...) would not be called into question by a unilateral extension, (...) since such an extension would not in any way affect the rights of the non-member countries which are parties to the treaties and would not impose any new obligation on them.'[108]

The question arose whether the above statement could be taken to imply that the Court would recognise a 'most favoured nation' obligation for the state of the permanent establishment. The issue was raised in *Metallgesellschaft* and *Hoechst* where the European Court did not answer the question, although one can argue that, after the judgment of the Court in those cases, the applicants were put on a par with

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106 *Commission v France* Case 270/83 [1986] ECR 273.

107 *Commission v France* Case 270/83 [1986] ECR 273 at paragraphs 19-20 and *Royal Bank of Scotland plc v Greek State* Case C-311/97 [1999] ECR I-2651, paragraphs 28-29.

108 *Compagnie de Saint-Gobain, Zweigniederlassung v Finanzamt Aachen-Innenstadt* Case C-307/97 [1999] ECR I-6161 at paragraphs 58-59.

companies resident in a Member State which had concluded a double taxation convention with the UK.

4.1.3 *Metallgesellschaft* and *Hoechst* cases[109]

Both Metallgesellschaft and Hoechst were companies resident in the UK and were subsidiaries of German companies. They paid dividends to their parent and were therefore required under UK law to pay advance corporation tax ('ACT'). The subsidiaries were subsequently able to set off the ACT against the mainstream corporation tax ('MCT') for which they were liable in the UK. Under UK law, a group income election was permitted only where both the subsidiary and the parent were resident in the UK. The subsidiaries contended that the requirement for payment of the ACT on the dividends distributed amounted to direct discrimination.

Hoechst also raised the issue of a 'most favoured nation' obligation: it argued that for a Member State to deny any tax credit to a company resident in another Member State, when it grants such credit to resident companies and to companies resident in certain other Member States by virtue of its double taxation conventions, was contrary to Article 43 since it constituted discrimination between parent companies resident in different Member States.[110]

The European Court stated that the UK legislation created a difference in treatment between subsidiaries resident in that State depending on the place of the parent's seat. The advantage of the group income election was denied to resident subsidiaries of foreign companies. There was thus a cash flow disadvantage.

The Court refuted the submissions of the UK government that resident subsidiaries of foreign companies were not in the same position as resident subsidiaries of national companies. The Court did not deal with the issue of the tax credit, as it was felt not to be necessary in view of its answer to the first question put to it. The Court dealt with the first issue when it stated that it was not logical to make non-resident companies which were not allowed a tax credit under a double taxation convention and therefore which were not liable to corporation tax and ACT in the UK, liable 'to make advance payment of a tax to which it will never be liable'.[111]

109 *Metallgesellschaft Ltd and Others v IRC; Hoechst AG v IRC* Cases C-397/98 and C-410/98.

110 *Metallgesellschaft Ltd and Others v IRC; Hoechst AG v IRC* Cases C-397/98 and C-410/98 at paragraphs 32-33.

111 *Metallgesellschaft Ltd and Others v IRC; Hoechst AG v IRC* Cases C-397/98 and C-410/98 at paragraphs 55-56.

4.1.4 Impact of European Court jurisprudence on Belgian tax law.

Since 1996, resident and non-resident companies have both been subjected to corporate income tax at a rate of 39 per cent.[112] There is thus no discrimination on the grounds of a company's seat in relation to the tax rate nevertheless, some of the Belgian provisions need closer examination in the light of the European Court jurisprudence.

The principle stated in *Commerzbank*[113] found expression in judgments by the Belgian Cours de Cassation. At stake were Articles 262,2° and 283 BITC which imposed a specific condition for permanent establishments of non-resident companies before they could benefit from the 'dividend received deduction'.[114] The Belgian Court found those provisions to be discriminatory for permanent establishments of companies established in a state which had concluded a double taxation convention with Belgium containing a non-discrimination provision.[115] Those provisions were repealed in 1996 on the grounds that they were also contrary to Article 43 EC. Accordingly, permanent establishments are now able to obtain withholding tax credits in Belgium for dividends they receive, irrespective of any tax treaty.

The *Futura Participations* case[116] may have an impact on Article 342 BITC.[117] Under Article 342 BITC the Belgian tax authorities can determine taxable income on a lump-sum basis by comparison with the taxable profit of at least three similar taxpayers in the event that the taxpayer did not maintain a reliable set of accounts. For permanent establishments, however, the taxable income to be determined in that

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112 Article 246 BITC *juncto*; Article 215 BITC.

113 *R. v IRC, ex p. Commerzbank AG* Case C-330/91 [1993] ECR I- 4017.

114 Article 262, 2° BITC provided that if no withholding tax had been levied on the dividends in Belgium, the foreign company had to pay it and could not recover the tax. Article 283 stated that non-resident companies could not credit any withholding tax against the non-resident corporate income tax with regard to dividends qualifying for the dividend received deduction.

115 Cass., 26th January 1995, Fiscale Jurisprudentie-Jurisprudence Fiscale 95/53 and Cass., 23rd March 1995, Fiscale Jurisprudentie-Jurisprudence Fiscale 95/128.

116 *Futura Participations SA v Administrations des Contributions* Case C-250/95 [1997] ECR I - 2471.

117 See Wouters, J. 'Verliesverrekening van vaste inrichtingen en het Europes vestigingsrecht', *T.R.V.* 1997, p.306 and Hinnekens, P. 'Impact of non-discrimination under EC Treaty on Belgian Income tax law' EC Tax Review 1996/2 p. 56.

way cannot be less than 400,000 Belgian francs a year.[118] In the author's opinion, and contrary to the view of the Brussels Court of Appeals,[119] that provision is discriminatory as it applies only to the permanent establishments. Moreover, it does not permit non-resident companies to show that their taxable income in Belgium is less than the minimum imposed by the Belgian provision.

The judgment of the Brussels Court of Appeals in *Trans World Commodities Ltd*[120] is also at odds with the European Court's ruling in *Centros*.[121] In the Belgian case, a company formed in accordance with English law relied on Article 43 EC before the Belgian court. It considered Article 342(2) BITC to be discriminatory.

The Belgian court, however, considered the UK company to be a mere sham for its parent company was established in Panama. Therefore, the foreign company could not rely on the freedom of secondary establishment. This judgment is incompatible with the view expressed by the European Court in *Centros* that once a company is formed in accordance with the law of a Member State, it benefits from the freedom of establishment. The fact that the permanent establishment does not carry out activities on its own is irrelevant.

4.2 Restrictions imposed by the home State.

4.2.1 *Daily Mail*[122] and *Imperial Chemical Industries plc v Colmer*[123]

In *Daily Mail*, a UK company wanted to emigrate to the Netherlands. The UK Treasury refused authorisation unless the company sold part of its assets before transferring its residence. The European Court held that Article 43 EC would be without meaning if a home state could prohibit companies from leaving its territory to become resident in another country. Nevertheless, the Court could not resolve the conflict of corporate law on the basis of Article 43. This was a problem to be harmonised by future legislation. The Member States remain competent to

118 Article 342 §2 BITC and Article 182 of the Royal Decree implementing the BITC.

119 Brussels, 9th June 1992, Fiscale Jurisprudentie-Jurisprudence Fiscale 93/2 and Brussels, 30th June 1994, AFT 1995, p.102.

120 Brussels, 9th June 1992, Fiscale Jurisprudentie-Jurisprudence Fiscale 93/2.

121 *Centros Ltd v Erhvervs-Og Selskabsstyrelsen* Case C-212/97 [1999] ECR I-1459.

122 *R. v HM Treasury and IRC, ex parte Daily Mail and General Trust plc* Case 81/87 [1988] ECR 550.

123 Case C-264/96 [1998] ECR I- 4695.

determine the nationality of a company and the circumstances leading to its loss.

The *ICI* case concerned a British company which wanted to set off its losses against its profits by using a tax relief for groups under UK law. The UK authorities did not allow this, since the majority of ICI's subsidiaries were not resident in the UK. The European Court recalled its ruling in *Daily Mail*[124] that the prohibition of discrimination in Article 43 EC also applies to the home state tax law. The UK legislation was found to be directly discriminatory.

4.2.2 *Alegemene Maatschappij voor Investering en Dienstverlening NV (AMID) v Belgium*[125]

AMID was a Belgian company with a permanent establishment in Luxembourg. Its Belgian establishment made a loss, whereas in the same year its Luxembourg subsidiary made a profit. In the following year, AMID wanted to deduct its Belgian loss from the previous year from its Belgian profits but that deduction was refused.

Under Belgian law, the income of a Belgian company is split into three categories: Belgian profits, non-treaty country profits and treaty country profits. The rules to set off the negative result of one category against the positive result of another are that the Belgian losses are first to be set off against Belgian profits, then against non-treaty country profits and finally, if these are insufficient, against the treaty country profits. Moreover, Belgian law also provided that previous losses may only be offset if they have not hitherto been capable of being offset or have not previously been covered by profits exempted by treaty. The double taxation convention between Belgium and Luxembourg provided that income realised in Luxembourg and attributable to the permanent establishment of a foreign company was to be taxed in Luxembourg and exempted in Belgium. Luxembourg law, on the other hand, did not allow the Belgian losses to be set off against the Luxembourg profits.[126]

AMID contested the refusal to allow it to deduct losses incurred by its Belgian establishment from the profits made by it in the subsequent year. It argued that Belgian companies with permanent establishments in another Member State were discriminated against compared with companies having branches only in Belgium.

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124 *R. v HM Treasury and IRC, ex parte Daily Mail and General Trust plc* Case 81/87 [1988] ECR 5505.

125 Case C-141/99 [2000] ECR I.

126 See *Futura Participations SA v Administrations des Contributions* Case C-250/95 [1997] ECR I - 2471, where this was found to be justified.

The European Court stated that the Belgian legislation constituted a restriction on the freedom of establishment of companies. Indeed, the fact that domestic losses are to be offset against profits exempted by treaty introduces a difference in the tax treatment of companies having establishments only in Belgium and companies which have establishments in other Member States. The European Court did not accept the arguments of the Belgian government referring to the differences between those two categories.

The Belgian Supreme Court had considered the Belgian provisions referred to in the *AMID* case[127] to be compatible with the EC Treaty on the basis that the principle of the unity of a company's profits implied that there was no distinction made between the income of the company in relation to its source.[128] All were potentially taxable in Belgium.

A double taxation convention was merely concerned with exemptions and not with the determination of the taxable basis. Therefore, Belgium was free to determine the taxable basis of national companies by taking into account for that purpose income exempted from taxation in Belgium. This may be true but the fact remains that companies which exercise their right of secondary establishment are in some cases subject to double taxation.

Illustration

A Belgian company suffered a loss of 500 for the year x at its Belgian head office, and its Belgian branch makes a profit of 500. The following year (x +1), a profit of 1,000 is made at the seat and the branch breaks even. The taxable basis is thus 1,500 but the company will only be taxed on 1,000, the losses being set off.

In the case of a Belgian company with a branch in another State, based on the same facts, the taxable basis in Belgium is 1,500 because the profit of the branch is taken into account in determining the taxable basis. In Belgium, the company will be taxed on 1,000, as for companies operating only in Belgium. Nevertheless, the company will also be taxed on its profits in the host State. Belgian tax legislation does not allow losses to be offset if they were covered by profits exempted by double taxation convention.

127 *Alegemene Maatschappij voor Investering en Dienstverlening NV (AMID) v Belgium* Case C-141/99 [2000] ECR I -.

128 Cass., 28th May 1968, Arr. Cass. 1968, p.1187 and Cass., 29th June 1984, AFT 1984, p.203.

The judgment of the European Court in *AMID* is far-reaching in two respects. Firstly, it has an impact on the determination of the taxable basis under the exemption method.[129] Indeed, the restriction on the right of secondary establishment would be removed if Belgium did not take foreign income into consideration for the purpose of determining the tax base of companies. In the example given above, the Belgian company with a foreign branch would have a taxable base of 1,000, but would only be taxed on 500 after offsetting the losses. It would also be taxed on 500 in the host State. Therefore, its tax burden would be the same as a Belgian company having a branch in Belgium.

Secondly, the judgment is far-reaching in that it considers the position of the company by reference to its overall tax burden and does not refer to the fact that disparities between the law of different States may bring about double taxation. It disregards the national sovereignty of the Member States in the field of direct taxation. In a sense, the Court considered that there was only a single jurisdiction covering the whole of the EU.

4.2.3 Impact of European Court jurisprudence on Belgian tax law.

Under Article 210 BITC, Belgian companies are allowed to transfer their registered office, central administration or principal place of business to another State and Articles 208 and 209 BITC provide for taxation of the company's assets in such a case. The company is taxed on the profits made on the distribution of its assets which looks like an exit charge. In the author's view, an exit charge constitutes an obstacle to the right of establishment but can be justified in view of the objective which is to safeguard the fiscal claims of the State.

Article 211 BITC deals with mergers and divisions of Belgian companies. If the absorbing company or the company resulting from the transaction is a Belgian company, gains realised on the merger or the division are exempt from tax. This is clearly a disincentive to merger with a foreign company. The Belgian tax rule tries to discourage Belgian companies from leaving the country. It also discourages foreign companies merging with Belgian ones.

The *AMID* case[130] has had an impact on Belgian tax law. From now on, a Belgian company will be able to deduct losses incurred in previous years from the taxable

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129 *Alegemene Maatschappij voor Investering en Dienstverlening NV(AMID) v Belgium* Case C-141/99 [2000] ECR I - is similar to *P H Asscher v Staatssecretaris van Financiën* Case C-107/94 [1996] ECR I-3089, as both cases highlight the same problem.

130 *Alegemene Maatschappij voor Investering en Dienstverlening NV(AMID) v Belgium* Case C-141/99 [2000] ECR I -.

profit for the current year, even if those losses could be set off against the profits realised by a permanent establishment in another Member State. There are, however, limitations to the ruling of the Court in *AMID*.

Firstly, it seems that the ruling applies only if the losses could not have been effectively deducted from taxable income in the Member State concerned. The Court in this regard followed the *Schumacker* judgment: what is important is that the deductions have to be taken into account in at least one Member State. Therefore the ruling would not have applied if Luxembourg law had allowed Belgian losses to be deducted from Luxembourg profits. This does not nevertheless remove the restriction inherent in the Belgian provisions.

Secondly, the judgment of the Court in *Amid* only applies in an EC context. Therefore, the situation where Belgian losses are to be set off against profits realised by a permanent establishment in a non-Member State is not covered by the European Court's judgment. Belgian companies could in that situation rely on Article 10 and 11 of the Constitution before the Belgian Constitutional Court.

AMID also has a potential impact on other Belgian tax deductions, such as the deductions in relation to investments and the deductions allowed on profits which are only allowed on Belgian profits. Having regard to the fact that the deductions may only be deducted from the Belgian income of the same accounting year and not from that of following years, Belgian companies earning income through a permanent establishment in another Member State are in a less favourable position than Belgian companies operating only in Belgium. Indeed, if there is a loss incurred in the Belgian establishment, the deductions are not allowed to be made from the profits earned through the permanent establishment in another state.

4.3 Conclusion.

Companies benefit from protection in relation to the right of establishment under the European Court's jurisprudence; nevertheless, they do not benefit from the right of primary establishment, as natural persons do.

Both *Metallgesellschaft* and *Hoechst*[131] and *AMID*[132] could be thought to be landmark decisions. For the European Court to decide that there is a 'most favoured nation clause' under Article 43 would be too far reaching as it would deeply encroach on the Member States' sovereignty. It would also call for a re-negotiation of all the

131 *Metallgesellschaft Ltd and Others v IRC; Hoechst AG v IRC* Cases C-397/98 and C-410/98.

132 *Alegemene Maatschappij voor Investering en Dienstverlening NV(AMID) v Belgium* Case C-141/99 [2000] ECR I -.

Double Taxation Conventions. A solution could be a model Double Taxation Convention adopted under Article 293 EC however, this is not realistic having regard to the positions expressed at the Nice Summit.

AMID reflects a new trend in the European Court's jurisprudence which is definitively far reaching - it impacts on the exemption method and the rule of progressivity. There is, moreover, an imbalance as the European Court decided in *Gilly*[133] not to tackle the discrimination inherent in the credit method, considering it to be the result of disparities between national laws. The question is then whether *Gilly* would be decided otherwise today.

5 General Conclusions

The European Court has extended its jurisdiction by analysing the non-discrimination principle as also prohibiting indirect discrimination and non-discriminatory restrictions. Nevertheless, the European Court also recognised its limited jurisdiction. Firstly, the rule that residents and non-residents are not, generally, in a similar position constitutes a limitation on the application of the principle of equal treatment in tax matters. Secondly, the Court has consistently recognised that the Member States are free to determine the connecting factors to allocate the powers in taxation, in conformity with EC law. Thirdly, the Court has never obliged the States to chose between a credit or an exemption system for the avoidance of double taxation. If the application of one of those systems entailed discrimination, the European Court has accepted its lack of jurisdiction on grounds of the disparities between the laws.

Nevertheless, in *Zurstrassen*[134] and *Royal Bank of Scotland,*[135] the Court considered the existence of different tax rates to be discriminatory.

More important, however, is *AMID* since one possible interpretation of that judgment is that the Court considers the determination of the tax base by the exemption method to be contrary to Article 43 EC in some instances which means that the Member States would not be able to determine the tax base of their taxpayers independently.

133 *Mr and Mrs Robert Gilly v Directeur des Services Fiscaux du Bas-Rhin* Case C-336/96 [1998] ECR I- 2793.

134 *Patrick Zurstrassen v Administration des Contributions Directes* Case C-87/99 [2000] ECR I-33

135 *Royal Bank of Scotland plc v Greek State* Case C-311/97 [1999] ECR I-2651.

Moreover, the *AMID* judgment creates an imbalance as the Court did not decide in this way in *Asscher*[136] in relation to the credit method. The next step would be to recognise a 'most favoured nation' obligation. This would deeply encroach on the Member States' sovereignty. Indeed, were the States obliged to grant permanent establishments of foreign companies the most favoured treatment provided for under their double taxation conventions, this would remove the need for bilateral double taxation conventions.

Double taxation conventions are concluded having regard to the specific tax environment of the states' parties to it. If a 'most favoured nation' obligation is recognised, the specific national environment is disregarded. There would only be one relevant tax environment: the Internal Market. The only solution then would be the negotiation of a European multilateral convention in accordance with the OECD Model and adapted to the Court's jurisprudence.

136 *P H Asscher v Staatssecretaris van Financiën* Case C-107/94 [1996] ECR I-3089.