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ROYAL BANK OF SCOTLAND: IMPLICATIONS FOR *BACHMANN*?

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At first sight, the recent case of *Royal Bank of Scotland plc* v *Elliniko Dimosio (Greek State)*[2] is just another plain case on tax discrimination in the EC. On reflection, however, some of the comments made by the judges and the Advocate General provide interesting pointers to the state of the jurisprudence in this area and may prove to be material in future cases before the Court of Justice. This is, perhaps, particularly true in relation to the debate over fiscal cohesion as a justification for discriminatory tax provisions. Before exploring this further it is necessary to outline the facts of *Royal Bank of Scotland*.

The Piraeus branch of the Royal Bank of Scotland, which had its seat in the UK, objected to paying tax on its profits at a rate of 40% when Greek banks paid tax at 35%. Not surprisingly, it alleged that this was an infringement of its fundamental right of freedom of establishment contained in Article 52, now Article 43, of the EC Treaty. Much of the law to be applied in deciding the case had been articulated by the Court of Justice in 1986 in *Commission* v *France*[3] (and it is interesting to note that France was, apparently, the only Member State to intervene in the case). That law, in short, is that the abolition of restrictions on freedom of establishment applies to companies setting up agencies, branches or subsidiaries in a host Member State and that to permit different treatment by the host Member State would deprive the right to freedom of establishment of all meaning.[4] The Court also had to re-affirm that the general prohibition of discrimination, now in Article 12 of the EC Treaty,

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2 Case C-311/97. Judgment was given on 29th April 1999. The Opinion of Advocate General M Siegbert Alber was delivered on 19th November 1998.

3 Case 270/83 [1986] ECR 273.

4 See paragraphs 22 and 23 of the judgment in *Royal Bank of Scotland* and paragraphs 13 and 18 of *Commission* v *France*.

that the general prohibition of discrimination, now in Article 12 of the EC Treaty, had no role to play where the freedom of establishment was in point. So far, the case has highlighted nothing which any reader of this journal would regard as noteworthy. There are two aspects of the case which are, however, of interest. First, the approach of the Court to the question of whether or not discrimination existed. Secondly, the attitude of the Court to the justification of the discrimination which was found to exist.

Establishing Discrimination

In considering whether or not discrimination existed, the Court emphasised the importance of making a comparison between entities in comparable situations because discrimination consists in the application of different rules to comparable situations or in the application of the same rule to different situations.[5] The actual comparison to be made in this case was said to be between a Greek branch of a company with its seat in the EC outside Greece and a company with its seat in Greece. (In fact, the comparison which the Court made was between banks in these situations rather than companies in general, but it is nevertheless true that the Court proceeded by comparison).

The Court said that its case-law on the necessity to proceed by comparison was well-settled. This is, of course, true. It is also true that the Court does not always regard itself as bound to proceed by way of comparison in determining the existence of discrimination, even in direct tax matters. This is particularly the case in the context of the freedom to provide services. As Mr Paul Farmer points out in his article *EC Law and Double Taxation Agreements,* in this issue, in *Safir,*[6] the Court concerned itself simply with determining whether or not the Swedish tax legislation, applicable to persons who had taken out insurance policies with insurers established outside Sweden, created obstacles to the freedom to provide services. Furthermore, this broad approach has been applied in tax cases concerned with the freedom of establishment where the activities of the home state of the disadvantaged entity are

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5 See paragraph 26 of the judgment.

6 Case C-118/96 *Jessica Safir* v *Skattemyndigheten i Dalarnas Lan, formerly Skattemyndigheten i Kapparbergs Lan* [1998] ECR I-1897. See also the cases discussed by Advocate General Fennelly in his opinion of 20th May 1999 in Case C-67/98 *Questore di Verina v Diego Zenatti* at paragraph 19 onwards.

in question. The *Daily Mail*[7] case and the recent case of *ICI* v *Colmer*[8] are two cases in point. In such cases there is no comparison to be made between the host or home state's treatment of entities having their seat in its jurisdiction and those having their seat elsewhere. Indeed, if a comparison of some kind were required, the freedom of establishment would, as the Court has said, be "rendered meaningless".[9]

It may, one day, be necessary to determine whether a comparison-based approach is really necessary in relation to tax cases concerning freedom of establishment where the rules of the host state are in issue. In *Royal Bank of Scotland* the comparison-based approach was sufficient to give rise to discrimination and so the Court could safely re-affirm its case-law based on the making of comparisons. It appears, however, that the Commission thought that a broader approach may be necessary. The Advocate General, in *Royal Bank of Scotland*, records that the Commission dropped its contentions based on the distinction between direct and indirect discrimination during the course of the oral procedure and contended simply that the freedom of establishment should not be subjected to any limitation[10]. There may be good reasons why this course was taken, but as the judgment of the Court shows, there is likely to be no reason to depart from the comparison-based approach to discrimination where the complaint of discrimination is itself based on a comparison of tax liabilities, as was the case in *Royal Bank of Scotland*. Nevertheless, as the Court adopts a broad approach to the existence of discrimination in the context of freedom of establishment where the activities of the home state are concerned, it should, if it is necessary to prevent the freedom of establishment from being rendered meaningless, adopt a similar approach where the activities of the host state are concerned.

Justifying Discrimination

The *Royal Bank of Scotland* does more than highlight the debate as to the nature of discrimination. It is concerned too with what is necessary to establish a justification for discrimination. The Court states simply:

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7 Case 81/87 *The Queen* v *HM Treasury and Commissioners of Inland Revenue,* ex parte *Daily Mail and General Trust plc* [1988] ECR 5483 at p 5510, paragraph 16 of the judgment.

8 Case C-264/96 *Imperial Chemical Industries plc (ICI) v Kenneth Hall Colmer (HM Inspector of Taxes)* [1998] ECR I - 4695 at p 4721, paragraph 21 of the judgment.

9 See the judgment in *Daily Mail* at paragraph16 referred to by the Court in *ICI v Colmer* at paragraph 21 of its judgment.

10 See paragraph 30 of his Opinion.

> "According to settled case-law, only an express derogating provision, such as Article [46] of the EC Treaty, could render...discrimination compatible with Community law..."[11]

On past form one might have expected there to be at least some reference to *Bachmann* v *Belgium*[12] and the well-known, if elusive, concept of "fiscal cohesion". Instead, one has a simple reminder that discrimination may be justified only by reference to the EC Treaty supported by a reference to *Bond van Adverteerders and Others* v *The Netherlands State*[13]and *Stichting Collectieve Antennevoorziening Gouda and Others* v *Commissariat voor de Media.*[14] Had the Court not purported to specify what may justify discrimination, the absence of any mention of *Bachmann* might have passed unnoticed as Greece did not, it seems, rely upon the case. As the Court apparently intended to set out the justifications for discrimination, the absence of a reference to the case deserves some comment, especially as the judges in *Royal Bank of Scotland* who affirmed the importance of finding a "Treaty justification" for discrimination all formed part of the larger court which heard *ICI* v *Colmer* in which *Bachmann* was acknowledged.

In *ICI*, the judges emphasised that, whilst fiscal cohesion had been treated as justifying discrimination, loss of tax receipts could not be a justification for discrimination because it was not one of the grounds listed in Article 56, as it then was, of the Treaty[15]. Of course, this was no new emphasis on the principle of permitting discrimination only on the basis of express Treaty-based justifications as the cases referred to in *Royal Bank of Scotland*, and referred to above, show. But if prevention of loss of tax is not permitted as a justification of discrimination, why should the cohesion of a tax system be permitted as an exception? After all, this concept does not appear in Article 46, as it now is, of the Treaty and the Court has, on a number of occasions made clear that the "general interest grounds" in the Treaty do not include economic aims.[16] Furthermore, it is only a specific form of the defence of the prevention of loss of tax receipts which was rejected in *ICI*. This

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11 Paragraph 32 of the judgment.

12 Case C-204/90 *Hanns-Martin Bachmann* v *Belgian State* [1992] ECR I-249.

13 Case 352/85 [1988] ECR 2085.

14 Case C-288/89 [1991] ECR I-4007.

15 Paragraph 28 of the judgement

16 See e.g. Case C-484/193 *Svensson and Gustavsson v Ministre du Logement et de l'Urbanisme*[1995] ECR I-3955 at 3977 (paragraph 15 of the judgment). See also, the recent Opinion of Advocate General M Antonis Saggioin Case C-200/98 *X AB and Y AB v Riksskatteverket* delivered on 3rd June 1999 at paragraph 22.

is apparent when one looks at why the Court of Justice considered that the cohesion of the tax system was in point in *Bachmann*. It was because:

> "...the loss of revenue resulting from the deduction of life assurance contributions from total taxable income...is offset by the taxation of pensions, annuities or capital sums payable by the insurers."[17]

If the discriminatory denial of deductions had not been justified there would have been a simple tax loss which could not have been offset.

Given that in *Bachmann* and *ICI* the loss of tax receipts was pleaded by both Member States one then asks why the plea succeeded in one case and not the other. The reason is that in the earlier case there was a direct link between the tax deductibility of insurance premiums and the taxability of payments by insurers i.e. between the discriminatory provisions and tax receipts. In the later case there was no such link.[18]

Cohesion - A Description of Discrimination

Now, I do not wish to cast doubt on the decision in *ICI* . I do wish to focus on the requirement of a direct link between the limitation of tax relief and the diminution of tax receipts which it is, apparently, necessary to establish in order to elevate loss of tax into a justification for discrimination. It appears that the requirement of a direct link[19] means that the more the discriminatory provision affects tax receipts, the greater the chance there is of establishing that the provision is justified. If a Member State gives tax reliefs only to those taxpayers having a corporate seat in its jurisdiction, it is likely to do so on the rather general assumption that tax receipts will, probably, ultimately be obtained from the benefiting entity. Such an approach would not contain the necessary direct link to maintain the justification of tax cohesion. Member States which value their tax receipts more than their popularity could be forgiven for thinking that the appropriate response to this state of affairs is to create a tax system which does contain a direct link and which is, therefore, more dependent upon discrimination, not less so.

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17 Case 204/90 [1992] ECR I - 249 at 282, paragraph 22.

18 See paragraph 29 of the judgment in *ICI*.

19 The requirement of a "direct link" has of course been mentioned in other cases: see Case 484/93 *Svennsson and Gustavsson* v *Ministre du Logement et de l'Urbanisme supra* at p 3977 paragraph 18.

In the author's view, the concept of the cohesion of a tax system is not a justification of discrimination but a description of it. For this reason, we should be grateful that the Court in *Royal Bank of Scotland* has focused attention again on the need for justifications of discrimination to be Treaty-based. It has done so before, for example, in *Svensson* and *ICI*, and then commented with apparent distaste on the existence of the *Bachmann* decision. In *Svensson*, the Court, before indicating the need for a "direct link", added rather grudgingly, it might be thought:

> "Admittedly, the Court held...in...*Bachmann*...that rules...could be justified by the need to maintain the integrity of the fiscal regime."[20]

In *ICI*, the Court noted that:

> "It is true that *in the past* the Court has accepted that the need to maintain the cohesion of tax systems could, in certain circumstances, provide sufficient justification for maintaining rules restricting fundamental freedoms..."[21] (emphasis added).

In *Royal Bank of Scotland* the requirement for a Treaty-based justification for discrimination was acknowledged without reference to *Bachmann* at all. Perhaps the concept of fiscal cohesion belongs as firmly in the past as the case in which it was developed. If so, in the interests of legal certainty in this fundamental area of law and in the interests of Member States and taxpayers alike, the concept should not simply die of neglect but should be formally buried. Failure to address directly the role of cohesion in tax cases is bound to result in the justification of cohesion being applied in other areas of law, such as social security.[22] That, surely, is something to be avoided.

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20 See paragraph 16 of the judgment, p 3977 *supra*.

21 See paragraph 28 of the judgment, p 4723 *supra*.

22 See e.g the comments of Advocate General Jacobs in his Opinion in Case C-202/97 *Fitzwilliam Executive Search v Laudelijk Institunt Sociale Verzekenngen* delivered on 28th January 1999, at paragraph 45, where on the facts in question, *Bachmann* was regarded as inapplicable.