DOUBLE TAX CONVENTIONS AND COMPLIANCE WITH EU LAW*

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> "although direct taxation falls within their competence, the Member States must none the less exercise that competence consistently with Community law". (*ACT IV GLO*)[2]

Introduction

The establishment of the European Union[3] has generated numerous problems for the direct tax systems of the Member States resulting in an increasing number of European Court of Justice ("ECJ" or "the Court") cases. The objective of this analysis is to develop an appreciation of the main compliance obligations imposed on the EU Member States by the EC Treaty relating to their double tax convention

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2 ECJ, 12 Dec. 2006, Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v Commissioners of Inland Revenue*, ("*ACT IV GLO*"), [2006] ECR I-11673, paragraph 36.

3 The terms European Community (EC) and European Union (EU) are used interchangeably throughout the text. Since this manuscript was finished, the European Community has become the European Union with the adoption of the Lisbon Treaty in December 2009.

network. This article provides a summary of the main results of this investigation.[4] In the absence of harmonised rules at the EU level to deal with the problems of juridical and economic double taxation, the double tax conventions of the Member States form a necessary part of the regulatory framework for tax in the EU.[5] The overarching rule of this paradigm being that EU law is supreme and all double tax conventions concluded by the Member States must comply with EU (subject to the exception contained in Article 307 EC).[6] Since the Member States have assumed certain EU law obligations and transferred certain competences to the EU which affect their direct taxation powers, conflicts between the EU legal norms and their double tax conventions will often occur. This places certain limits on the provisions which may be included in such tax conventions because all provisions must comply with EU law.[7]

This article is divided into three parts. Part I introduces the "New Legal Order"[8] in the EU and the concept of supremacy of EU law. Part II examines the main provisions of the EC Treaty which interact with the double tax conventions of the Member States.[9] Part III draws some conclusions.

Part I: The EU's "New Legal Order"

With the coming into effect of the EC Treaty[10] and the establishment of the European Community in 1958, a "new legal order" came into being whereby the Member States limited their competences within the framework of the structure and

4 Competence issues, relating to whether competence is exclusively that of the Member States or that of the Community's institutions, and issues where competence is shared by the Member States and the Community, are beyond the scope of this article and are discussed elsewhere. See Tom O'Shea, *"Double Tax Conventions and the European Community: Competence Issues"* . See also, Tom O'Shea, *EU Tax Law and Double Tax Conventions* (Avoir Fiscal Ltd, London, 2008), Chapter 2.

5 See Tom O'Shea, *"EU Tax Regulatory Framework",* The Tax Journal, 955, 21-24, (3 November 2008).

6 See the discussion of "Pre-Community Agreements" below.

7 ECJ, 15 Jan. 2002, Case C-55/00, *Elide Gottardo v Istituto nazionale della previdenza sociale (INPS),* ("*Gottardo*"), [2002] ECR I-0413, paragraph 33.

8 See Frans Vanistendael, *"The limits to the new Community tax order",* C.M.L.Rev.1994, 31(2), 293-314.

9 Note, that for reasons of space, discussion of the Community's "state aid" rules are beyond the scope of this analysis.

10 The Treaty of Rome has been amended on a number of occasions. All references relate to the current consolidated version of the EC Treaty, see: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:321E:0001:0331:EN:pdf (last visited 1st Sep 2009).

objectives of the European Community.[11] From the outset, the rules of the EC Treaty had a significant interaction with the direct tax systems of the Member States because a new set of legal norms came into existence, provoking hierarchical questions about which legal rule applied when there was a conflict between the various norms.

This analysis of the jurisprudence of the ECJ has revealed that, contrary to the generally held view[12] that interaction between the EC Treaty and the direct tax systems of the Member States only commenced in 1986 with *Commission v France* ("*Avoir Fiscal")*[13], the actual interplay between the direct tax systems of the Member States and the EU legal system occurred much earlier with the Court's *Humblet* decision in 1960.[14]

Three early ECJ cases help illustrate that this "new legal order" had an immediate impact on the domestic legal systems of the Member States: *Humblet*, *Van Gend en Loos*,[15] and *Costa v ENEL.*[16]

Transfer of direct tax competence to the Community

Within two years of the creation of the Community,[17] the decision of the ECJ, in *Humblet,* showed that the direct tax systems of the Member States could come into conflict with Community law.

In *Humblet,* the right of the Member States to tax Community officials came under scrutiny as competence in relation to the taxation of salaries of Community officials

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11 ECJ, 17 Dec. 1970, Case 11/70, *Internationale Handelsgesellschaft mbH v Einfuhr- und Vorratsstelle für Getreide und Futtermittel,* ("*Internationale Handelsgesellschaft"), [1970] ECR 1125,* paragraph 4.

12 For a recent example of this view, see: Mark Quaghebeur, "*ECJ condemns Minimum Tax Base for Non-residents",* 2007 WTD 76-3: "It took the ECJ 30 years to venture into the area of direct taxation -- first with a solitary decision in the French *avoir fiscal* case in 1986". See Tom O'Shea, (Editor), "*From Avoir Fiscal to Marks and Spencer",* (2006) Tax Notes International, (May 15, 2006), 587-612 at 592.

13 ECJ, 28 Jan. 1986, Case 270/83, *Commission v France ("Avoir Fiscal"),* [1986] ECR 0273.

14 ECJ, 12 Dec. 1960, Case 6/60, *Jean-E. Humblet v Belgian State*, ("*Humblet*"), [1960] ECR 0559, (English Special Edition).

15 ECJ, 5 Feb. 1963, Case 26/62, *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration*, ("Van Gend & Loos), [1963] ECR 0001.

16 ECJ, 15 Jul. 1964, Case 6/64, *Flaminio Costa v E.N.E.L.,* [1964] ECR 0585.

17 In January 1958.

had been transferred to the Community.[18] The case raised the question whether Belgium could indirectly tax such salaries by using an exemption with progression method under its domestic rules, by taking the salary of the Community official into account when determining the progressive tax rate to be applied to the income of the spouse of that Community official. The ECJ noted[19] that even though a number of double tax conventions had been entered into by the Member States containing a clause providing for "exemption with progression", no such reservation had been included in the Community's Treaties.[20] Consequently, the Court held that remuneration paid to Community officials was withdrawn from "the Member States' sovereignty in tax matters"[21] and transferred to the Community's institutions. The Court went on to indicate that there was a clear distinction between income subject to the control of the national tax authorities of the Member States and the salaries of Community officials as the latter were subject to Community law alone as regards "liability to tax while the other income of officials remains subject to taxation by the Member States." The Court determined that

> "This division of reciprocal fiscal jurisdiction must exclude any taxation, direct or indirect, of income which is not within the jurisdiction of the Member States".[22]

The outcome was that the salary of the Community official could not be taken into account when determining the progressive tax rate on other income earned by his spouse. In other words, the Belgian domestic tax rules at issue were found to be incompatible with Community law and had to be amended.

Direct Effect of Community Rules

In its landmark decision in *Van Gend & Loos*, the Court determined that Community law did not simply apply at the Member State level; it also granted rights to nationals of the Member States that could be invoked before national courts and

18 See Article 11 (B) of the Protocol on the Privileges and Immunities of the European Coal and Steel Community ("ECSC"). The Founding Treaties are available at http://eur-lex.europa.eu/en/treaties/index.htm#founding (last visited 1st September 2009).

19 *Humblet* page 575.

20 This refers to the three "Communities" – the European Economic Community Treaty, the European Coal and Steel Community Treaty and the European Atomic Energy Community Treaty. See footnote 17 above.

21 *Humblet* page 577.

22 *Humblet* page 578.

tribunals.[23] More importantly the ECJ stated that

> "the Community constitutes a new legal order of international law for the benefit of which the States have limited their sovereign rights, albeit within limited fields, and the subjects of which comprise not only Member States but also their nationals".[24]

Consequently, certain Community law rules had immediate effects in the domestic legal systems of the Member States – including their direct taxation systems.

Supremacy of EU law [25]

Perhaps, the most significant issue decided by the ECJ in the early years of this "new legal order" occurred in *Costa v ENEL*, where the ECJ determined that EU law was supreme over the national laws of the Member States. The Court derived this entitlement from a variety of factors: from the spirit of the EU's Treaties; from the fact that a new legal system had been established which had created new rights for individuals in Member States' legal systems; from the creation of the EU's framework and institutions; and from the limitations imposed on the sovereignty of the Member States together with the transfer of powers to the EU. The Court also noted that Community Regulations were binding and directly applicable in all Member States[26] and that EU law had to apply uniformly in the Member States. The ECJ went on to comment that

> "the obligations undertaken under the Treaty (…) would not be unconditional, but merely contingent, if they could be called into question by subsequent legislative acts of the signatories (…) The transfer by the States from their domestic legal system to the Community legal system of the rights and obligations arising under the Treaty carries with it a permanent limitation of their sovereign rights, against which a subsequent

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23 For instance, the concept of direct effect. The Court has held that each of the fundamental freedoms has direct effect, see footnote 142 below. For an example of direct effect at play, see ECJ, 19 Jan. 1982, Case 8/81, *Ursula Becker v Finanzamt Münster-Innenstadt ("Becker"),* [1982] ECR 0053.

24 *Van Gend & Loos*, Part II (B) of the judgment.

25 For example, R.M. Petriccione, "*Supremacy of Community Law over National Law",* E.L. Rev. 1986, 11(4), 320-327; A. Kellerman, "*Supremacy of Community Law in the Netherlands*", E.L. Rev. 1989, 14(3), 175-185; T. Schilling, "*The Court of Justice's Revolution: Its Effects and the Conditions for its Consummation, what Europe can learn from Fiji",* E.L. Rev. 2002, 27(4), 445-463; and M. Ross, "*Effectiveness in the European Legal Order(s): Beyond Supremacy to Constitutional Proportionality",* E.L. Rev. 2006, 31(4), 476-498; S. Drake, "*Twenty years after Von Colson: The impact of 'Indirect Effect' on the protection of the individual's Community rights",* E.L. Rev. 2005, 30(3), 329-348.

26 See Article 249 EC.

unilateral act incompatible with the concept of the Community cannot prevail".[27]

Legal norms for direct tax in an EU context

This "new legal order" generated uncertainty for the national direct tax systems of the Member States. Superior EU legal rules were added to a regulatory framework which already included domestic tax rules and double tax conventions. EU law was interpreted by the ECJ and, from the outset, was accepted by the Member States as being supreme. Some EU rules had direct applicability[28] in the Member States' legal systems, other EU rules gave directly effective rights[29] to individuals and companies; and EU law obligations, assumed by the Member States, placed further limitations on many of their retained competences, including those in the direct taxation and double tax convention spheres.[30]

This research demonstrates that there was an overlap of these EU legal-norms with the established national, and international, legal rules and concepts resulting in areas of interaction and conflict. In the direct tax arena, this meant that as EU law was supreme,[31] national tax laws and provisions in double tax conventions could be incompatible with EU law. Therefore, whilst competence in relation to direct tax matters and double tax conventions remained with the Member States, such competence had to be exercised in a way which complied with EU law.[32]

The Regulatory Framework for tax in the EU

The EU has a unique regulatory framework for direct taxation, which can be

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27 ECJ, 15 Jul. 1964, Case 6/64, *Flaminio Costa v E.N.E.L.,* [1964] ECR 0585.

28 For a recent analysis see Richard Kral, "*National normative implementation of EC regulations. An exceptional or rather common matter?"* E.L.Rev. 2008, 33(2), 243-256.

29 For a recent analysis, see Paul Craig, *"The legal effect of Directives: policy, rules and exceptions*", E.L.Rev. 2009, 34(3), 349-377. See also Trevor Hartley, *"The constitutional foundations of the European Union",* L.Q.R. 2001, 117(Apr), 225-246.

30 For early examples see *Avoir Fiscal* and *Gilly*. ECJ, 28 Jan. 1986, Case 270/83, *Commission v France ("Avoir Fiscal"),* [1986] ECR 0273 and ECJ, 12 May 1998, Case C-336/96, *Mr and Mrs Robert Gilly v Directeur des Services Fiscaux du Bas-Rhin, ("Gilly")* [1998] ECR I-2793.

31 For example, see T. Lyons, "*Case Comment: ICI v Colmer affirms Community Supremacy",* B.T.R. 1999, 1, 65-69. ECJ, 16 Jul. 1998, Case C-264/96, *Imperial Chemical Industries plc (ICI) v Kenneth Hall Colmer (Her Majesty's Inspector of Taxes), ("ICI"),* [1998] ECR I-4695.

32 In relation to international agreements (and therefore, double tax conventions) see ECJ, 15 Jan. 2002, Case C-55/00, *Elide Gottardo v Istituto nazionale della previdenza sociale (INPS),* ("*Gottardo*"), [2002] ECR I-0413, paragraph 33.

summarised under four general headings: (a) the national tax laws of the respective Member States; (b) international agreements, including double tax conventions, concluded by the Member States with each other and with non-member countries dealing with international taxation issues; (c) international agreements concluded by the EU with non-member countries (such as the European Economic Area Agreement);[33] and (d) EU rules (such as directives, regulations and decisions). These differing legal norms exist side by side and operate to regulate direct taxation in the EU under the overarching rule that EU law is supreme.

It is important to understand that direct taxation matters in the EU, as it currently stands, are regulated not simply by harmonised EU rules, but also by rules put in place by the Member States at the national and double tax convention/international law levels. Thus, each Member State retains the right to design its own direct taxation regime and to conclude its own network of double tax conventions subject to their compliance with EU law, which includes both primary[34] and secondary EU legislation.[35]

Understanding the main compliance obligations incurred by the Member States therefore, is the main objective of this article. These are examined in Part II where the main provisions of the EC Treaty which interact with the double tax convention network of the Member States and their direct tax systems are analysed.

Part II Double tax conventions and interactions with the EC Treaty

Part II contains the results of an investigation of the main EC Treaty rules which interact with the direct tax systems of the Member States, laying particular emphasis on their relationship with the Member States' double tax convention network. The results demonstrate that each Member State has significant compliance obligations under EU law which must be respected. These compliance obligations impose boundaries on the exercise of Member State competence in the direct tax sphere and, more specifically, in the double tax convention area. This is made clear by the ECJ in its jurisprudence through the use of the following mantra:

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33 The European Economic Area Agreement is available at the following link: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:21994A0103(01):EN:HTML (last visited 1 September 2009).

34 An example of "primary" Community legislation is the EC Treaty.

35 An example of secondary Community legislation related to the double tax convention field is the Parent-Subsidiary Directive. Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 7/41 (13 Jan 2004), available at the following link: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:007:0041:0044:EN:PDF (last visited 1 Sep 2009).

> "Although, as Community law stands at present, direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law".[36]

A Member State exercises a direct taxation competence when it enters into a double tax convention with another Member State or with a non-member country. All such agreements, unless they fall within the Article 307 EC exception, must comply with EU law.[37]

Articles 2 EC and 3 EC: Establishment of a Common Market

Establishment of a "common market" was arguably the primary objective or ultimate goal of the EU when it was established.[38] The "common market" concept goes beyond the notion of internal market because it encompasses the implementation of "common policies", an Economic and Monetary Union, and a variety of other concepts set out in Article 2 EC. The internal market is defined in Article 14(2) EC as

> "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty".

This follows on from its description in Article 3(1)(c) EC where the activities of the Community include

> "an internal market characterised by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital".

This definition of the internal market is of significance for the direct tax systems of the Member States because it represents the "integration" aspiration of the EC Treaty and places the fundamental freedoms in their context. This notion of internal

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36 ECJ, 14 Feb. 1995, Case C-279/93, *Finanzamt Köln-Altstadt v Roland Schumacker Finanzamt Köln-Altstadt v Roland Schumacker ("Schumacker"),* [1995] ECR I-0225, paragraph 21.

37 *Gottardo* paragraph 33.

38 See Article 2 EC. The Community was originally an "economic" Community represented by fundamental freedoms comprising of the free movement of goods, persons, services and capital, covering all aspects of the economy. The original name for the Community was the "European Economic Community" (EEC). The EEC has evolved into much more than an economic Community through the addition of European citizenship rights. These rights allow nationals of European Union Member States to move to, and reside in, another Member State without the need to carry on an economic activity there. See Article 18 EC and the discussion below.

market "integration" is composed of both a positive and a negative component.
The "positive" aspect of the internal market includes the EC Treaty and the secondary rules[39] adopted at the EU level to give better effect to the EU's fundamental freedoms and to resolve some of the problems of cross-border trade and investment generated by the different direct tax systems of the Member States.[40]
This investigation highlights the fact that the EC Treaty does not set out all the rules governing direct taxation in the EU, which remain mainly at the Member State level. Instead, the EC Treaty provides either for the adoption of "positive" or harmonised rules at the EU level, replacing or supplementing the rules of the Member States, or for a set of "negative integration" rules which the Member States have agreed to comply with when they joined the EU. Furthermore, the EC Treaty goes beyond the concept of simply providing a legislative solution and envisages coordination and approximation of Member States' rules.[41] In other words, a solution may be found at the level of the Member States by coordinating Member States' direct tax rules, or at the EU level through the adoption of minimum harmonisation directives which still allow the Member States to take certain actions.

Given this regulatory framework, the fundamental freedoms are a primary focus of this investigation because they establish a structure of "negative" rules concerning the factors of production affecting cross-border trade and investment, and cover all aspects of the economy, including direct taxation, and double tax convention matters.[42] Therefore, the jurisprudence of the ECJ in relation to direct tax matters

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39 Such as Regulation 1612/68 which expanded the free movement of workers' rights to include the "same tax and social advantages" in the host State. For an example of a situation where Regulation 1612/68 comes into play and extends the right of free movement of workers, see ECJ, 14 Feb. 1995, Case C-279/93, *Finanzamt Köln-Altstadt v Roland Schumacker, ("Schumacker")*, [1995] ECR I-0225, The EC Treaty also contains a "positive" element in the first two requirements of Article 10 EC.

40 For example, see the Parent-Subsidiary Directive, the Mergers Directive and the Interest and Royalties Directive. Council Directive 2003/123/EC which amended Council Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States; Council Directive 2005/19/EC which amended Council Directive 90/434/EEC on a common system of taxation applicable to mergers, divisions, transfer of assets and exchanges of shares concerning companies of different Member States; and Council Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

41 For example, Article 94 EC. See Denis Weber, "*Tax coordination: a joint responsibility of the Member States. Still a fantasy?"* (2007) 16 *EC Tax Review* pp. 162-163

42 ECJ, 1st Jul. 1993, Case C-20/92, *Anthony Hubbard (Testamentvollstrecker) v Peter Hamburger ("Hubbard"),* paragraph 19. The Court pointed out that "the effectiveness of Community law cannot vary according to the various branches of national law which it may affect". A further example is seen in the State aid provisions of the EC Treaty which limit the powers of the Member States to take certain actions which might affect fair competition within the Community. These rules equally have an impact on the direct tax systems and double tax conventions of the Member States. See, for example, the *Belgian Coordination*

may be seen as comprising not tax cases as such, but cases involving one or more of the fundamental freedoms, or secondary EU legislation adopted to make the internal market and its fundamental freedoms operate more effectively or smoothly.

By endeavouring to "abolish obstacles" to cross-border movements and through the creation of an "area without internal frontiers",[43] the EC Treaty places certain limits on the powers of the Member States to take action in areas where the EC Treaty is engaged. This impacts upon the design and operation of national direct tax systems and double tax conventions because such tax systems often focus on providing tax advantages related to the territory of a particular Member State and fail to take the fundamental freedoms into account.[44] Consequently, the direct tax rules of the Member States and their double tax conventions may come into conflict with EU free movement rules which see the internal market as "an area without internal frontiers" and require the Member States to respect EU legislation and their EU law obligations.

The "negative" component of the internal market may be seen in the rules of the EC Treaty which require the abolition of discrimination on grounds of nationality;[45] the rights of EU citizenship contained in Article 18 EC; and the rights contained in the fundamental freedoms, whereby the Member States have agreed not to maintain legislative, administrative or procedural obstacles to the exercise of the fundamental freedoms. This component requires the Member States to abstain from having rules which are incompatible with the rules contained in the EC Treaty. The jurisprudence of the ECJ in relation to direct taxation and double tax convention matters primarily concerns this "negative" aspect because the role of the ECJ is merely to interpret EU law and the obligation of the Member State is to refrain from breaching an EU law rule. In other words, in applying the fundamental freedoms, the function of the ECJ in the integration process is a "negative" role. The Court's judgments, generally, explain EU law to the Member States. The ECJ has no jurisdiction to force a Member State to introduce new legislation to remedy its breach of a fundamental freedom. The ECJ merely sets out in its judgments whether a tax rule such as the one at issue is either compatible or incompatible with a fundamental freedom. It is then a matter for the Member State to change its tax regime to ensure that the particular freedom is not breached. This can be achieved through the abolition of the

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Centres' case and the *New Lander* case involving Belgian and German tax rules respectively. ECJ, 22 Jun. 2006, Joined Cases C-182/03 and C-217/03, *Belgium v Commission, ("Belgian Coordination Centres"),* [2006) ECR I-5479 and ECJ, 19 Sep. 2000, Case C-156/98, *Germany v Commission ("New Lander"),* [2000] ECR I-6857.

43 Article 14(2) EC.

44 See the Introduction to Commission Communication, "*Co-ordinating Member States' direct tax systems in the Internal Market",* COM (2006) 825 final.

45 See the general rule in Article 12 EC and the more specific rules contained in each of the fundamental freedoms.

rule in question or by the extension of a similar tax advantage to the person exercising the fundamental freedom to that which is granted domestically. The ECJ, therefore, does not "strike down" the tax rules of the Member States, even though sometimes this may be the effective outcome.

A good example of the parameters placed on the ECJ in the area of double tax conventions is seen in *Jacques Damseaux v Belgium ("Damseaux")*,[46] which concerned the taxation of dividends received by Belgian individual from a French company. Under the France-Belgium double taxation convention, both Belgium and France were entitled to tax the dividends. The problem in the case occurred when Belgium decided not to grant a tax credit for the French withholding taxes even though such a credit was provided for in the tax convention. Damseaux argued that this treaty override resulted in a dividend paid to him by a French company being taxed at a higher rate than a similar dividend from a Belgian company, and that this was contrary to his free movement of capital rights. The ECJ stated that

> "the Court does not have jurisdiction, under Article 234 EC, to rule on a possible infringement, by a contracting Member State, of provisions of bilateral conventions entered into by the Member States designed to eliminate or to mitigate the negative effects of the coexistence of national tax regimes (…) Nor may the Court examine the relationship between a national measure and the provisions of a double taxation convention, such as the bilateral tax convention at issue in the main proceedings, since that question does not fall within the scope of the interpretation of Community law".[47]

The ECJ went on to conclude that Article 56 EC did not preclude a double tax convention like the one at issue which allowed juridical double taxation to remain unrelieved because there were no EU rules dealing with the elimination of such double taxation within the EU.

The "negative" aspect of the fundamental freedom rules (free movement of goods, persons, services and capital) plays a crucial role in relation to the direct tax systems of the Member States because even though competence in relation to direct tax matters remains with the Member States, they must exercise those taxing powers (including the conclusion of double tax conventions) in compliance with EU law. As such, the primary focus of this analysis is on the "negative rules" of the EC Treaty. These "negative integration" rules govern the internal market and represent, for the Member States, boundaries to the exercise of their direct taxing competence which have to be considered when cross-border activities within the scope of the EC Treaty

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46 ECJ, 16 Jul. 2009, Case C-128/08, *Jacques Damseaux v Belgian State, ("Damseaux"),* [2009] ECR I-0000 (not yet reported).

47 *Damseaux* paragraph 22.

take place.[48] The Member States are allowed to restrict the fundamental freedoms neither with their direct tax rules nor with their double tax conventions.

Furthermore, when the Court interprets provisions of EU law, the concept of the internal market must be taken into account and, in particular, the fundamental freedoms. This is clear from the Court's decision in *Srl CILFIT and others and Lanificio di Gavardo SpA v Ministero della sanità* ("*CILFIT")*,[49] where it was determined that

> "every provision of Community law must be placed in its context and interpreted in the light of the provisions of Community law as a whole, regard being had to the objectives thereof and to its state of evolution at the date on which the provision in question is to be applied".

The internal market, therefore, provides the background framework for the operation of the other provisions of the EC Treaty.

Article 10 EC: The Principle of Loyal Co-operation

Under Article 10 EC, Member States are obliged to "take all appropriate measures" to fulfil their EU law obligations;[50] to "facilitate the achievement of the Community's tasks";[51] and to "abstain from any measure which could jeopardise the attainment of the objectives of this Treaty".[52] Thus, Article 10 EC imposes both "positive" and "negative" obligations on the Member States, and more particularly, a duty of sincere[53] and genuine cooperation on the part of the Commission and the Member States.[54]

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48 A discussion of the "positive" rules of the internal market, such as the Parent-Subsidiary Directive, the Mergers Directive, the Interest and Royalties Directive, etc. are beyond the scope of this article. It is clear that such rules also impose considerable obligations on the Member States.

49 ECJ, 29 Feb. 1984, Case 77/83, *Srl CILFIT and others and Lanificio di Gavardo SpA v Ministero della sanità,* [1984] ECR I-1257, paragraph 20.

50 Article 10 EC, first sentence.

51 Article 10 EC, second sentence.

52 Article 10 EC, last sentence.

53 Thus, in *Commission v Italy* the Commission brought infringement proceedings because the Italian authorities had failed to reply to enquiries of the Commission pursuant to Article 226 EC Treaty. The Court ruled: "By its persistent silence, the Italian Government had frustrated efforts to uncover the facts vital to the detailed examination of the complaint". ECJ, 13 Jul. 2004, Case C-82/03, *Commission v Italy*, [2003] ECR I-6635, paragraph 9.

54 For example, in *Commission v Spain* the Court indicated that Member States are "obliged, by virtue of Article 10 EC, to facilitate the achievement of the Commission's tasks, which

Arguably, this provision of the Treaty has immense relevance for the double tax conventions and direct tax systems of the Member States. Member States which enter into double tax conventions in breach of EU law rules are not abstaining from "any measures", which could jeopardise EU objectives.[55] Furthermore, it is arguable that a double tax convention entered into by an "origin" Member State which restricts, in an unjustified manner, the exercise of a fundamental freedom by one of its own nationals is equally a breach of Article 10 EC when read in conjunction with the appropriate fundamental freedom.[56]

The significance of Article 10 EC for the double tax conventions of the Member States can be seen from *Matteucci*,[57] where the Court analysed a free movement of worker's situation in the context of a bilateral cultural agreement entered into by Belgium and Germany which granted educational scholarships to their respective nationals. An Italian national, resident in Belgium, with free movement of worker rights, sought a scholarship under the international agreement, arguing that she was

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consist in particular of ensuring that the provisions adopted by the institutions pursuant to the Treaty are applied." ECJ, 26 Jun. 2003, Case C-404/00, *Commission v Spain,* [2003] ECR I-6695, paragraph 27.

55 For an analogy from the Court's competition jurisprudence, see *Mauri*, paragraph 29, where the ECJ said that, although Articles 81 and 82 of the EC Treaty are concerned with the conduct of undertakings and not with the laws etc. of the Member States, "those Articles, read in conjunction with Article 10 EC, which lays down a duty to cooperate, none the less require Member States not to introduce or maintain in force measures, even of a legislative or regulatory nature, which may render ineffective the competition rules applicable to undertakings". The Court went on to say that Articles 10 EC and 81 EC were infringed where a Member State "requires or encourages the adoption of agreements, decisions or practices contrary to Article 81 EC…" (paragraph 30). ECJ, 17 Feb. 2005, Case C-250/03, *Giorgio Emanuele Mauri v Ministero della Giustizia and Commissione per gli esami di avvocato presso la Corte d'appello di Milano, ("Mauri"),* [2005] ECR I-1267.

56 For instance, *van Lent*, concerned a vehicle registration tax imposed by Belgium on a vehicle belonging to a leasing company established in another Member State which was leased by an employer and used by a Belgian resident employee in both Member States. The Court noted that although Member States could prescribe the conditions for the registration of motor vehicles travelling on their territory, Community law still had to be complied with – "the measures adopted cannot be exempt from the application of Articles 10 EC and 39 EC," (paragraph 13). The Belgian tax rule, thus, had the effect of making it impossible for a person to benefit from the provision of a vehicle belonging to an employer in another Member State. This had two effects – one from the perspective of an employer – such a tax rule could discourage employers from engaging employees who resided in other Member States because of the higher costs and administrative difficulties involved (paragraph 20); and from the perspective of the employee because - "Such a measure, which has the effect of preventing a worker from benefiting from certain advantages, in particular, the provision of a vehicle, *may deter him from leaving his country of origin* in order to exercise his right of free movement" (paragraph 21 – emphasis is added). ECJ, 2 Oct. 2003, Case C-232/01, *Criminal proceedings against Hans van Lent, ("Van Lent"),* [2003] ECR I-11525.

57 ECJ, 27 Sep. 1998, Case 235/87, *Annunziata Matteucci v Communauté française of Belgium and Commissariat général aux relations internationales of the Communauté française of Belgium, ("Matteucci"),* [1998] ECR 5589.

entitled to the same "tax and social" advantages as a worker resident in Belgium, and that the educational scholarship was a "social" advantage available to Belgian nationals. Matteucci sought the same advantage because even though the scholarship was provided by another Member State, it still benefited Belgian nationals. The Belgian argument that the scholarships in question were granted by Germany, and according to the wording of the bilateral agreement the scholarships were limited to Belgian and German nationals, was rejected. The ECJ said:

> "In providing that a worker who is a national of a member-State shall, in the territory of other member-States, enjoy the same social advantages as national workers, Article 7(2) of Regulation 1612/68 lays down a general rule which, in the social field, imposes responsibility on every member-State with regard to every worker who is a national of another member-State but is established in its territory, in respect of equal treatment with national workers. Consequently if a member-State offers its national workers the opportunity to take a course of training in another member-State, that opportunity must be extended to Community workers established in its territory".[58]

The Court went on to accept the argument of the Italian Government that:

> "the authorities of the country of training cannot refuse to abide by the choice of the authorities of the host country if the choice made under Article 7 of Regulation 1612/68 is in favour of a non-national Community worker. Although this provision requires the host member-State to give the same social advantages to Community workers as to its own nationals, another member-State cannot prevent the host State from fulfilling its obligations under Community law".[59]

The Court explained that under Article 10 EC[60] the Member States had to fulfil their EU law obligations:

> "Consequently, if the application of a Community-law provision risks being impeded by a measure taken in the framework of implementing a bilateral agreement, even one concluded outside the ambit of the Treaty, every member-State must facilitate application of that provision and, for this purpose, must assist every other member-State which has an obligation under Community law".[61]

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58 *Matteucci,* paragraph 16.

59 *Matteucci,* paragraph 18.

60 Article 5 of the Treaty at that time.

61 *Matteucci,* paragraph 19.

The consequences of the Court's holding in *Matteucci* are potentially considerable for the double tax conventions of Member States. First, if a Member State concludes a double tax convention with another Member State, or with a non-member country which is incompatible with EU law, that Member State must still grant "national treatment"[62] to a national of another Member State exercising a fundamental freedom in its territory who is in a comparable situation to one of its residents and for whom the double tax convention benefits are available.[63]

Second, if a Member State concludes a double tax convention with a non-member country which is incompatible with EU law rule, this may have consequences for all the other Member States. The Member State that concluded the double tax convention has to make it compatible with EU law and comply with its obligations, by either amending or terminating the agreement.[64] All other Member States must "assist every other member-State which has an obligation under Community law" to ensure that the EU law rule is applied.[65]

Third, for Member States with double tax conventions concluded prior to joining the EU, so-called "pre-EU agreements", the fact that such conventions were concluded prior to accession is not a valid excuse if they are incompatible with EU law: they must still be amended or terminated.[66]

Lastly, the *Matteucci* decision foreshadowed the Court's judgment in the *D case*[67] in relation to the MFN issue. The Court made it clear that the MFN issue does not exist

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62 The national treatment principle is discussed in more detail below. The principle basically states that nationals of EU Member States must receive equal treatment when they exercise the freedoms in situations where they are in a comparable situation to the nationals of either the host or origin Member State whose rule is at issue. The principle was expressed by the Court in *De Groot*. ECJ, 12 Dec. 2002, Case C-385/00, *F.W.L. de Groot v Staatssecrataris van Financiën*, ("*De Groot*"), [2002] ECR I-11819, paragraph 94.

63 *Matteucci, p*aragraph 23: "A bilateral agreement which reserves the scholarships in question to nationals of the two member-States, the parties to the agreement, cannot prevent the application of the principle of equality of treatment between national and Community workers established in the territory of one of those two member-States". In relation to freedom of establishment, see *Saint-Gobain*. ECJ, 21 Sep. 1999, Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt, ("Saint-Gobain"),* [1999] ECR I-6161.

64 See the discussion below concerning "Pre-Community Agreements" and Article 307 EC.

65 ECJ, 27 Sep. 1998, Case 235/87, *Annunziata Matteucci v Communauté française of Belgium and Commissariat général aux relations internationales of the Communauté française of Belgium, ("Matteucci"),* [1998] ECR 5589, paragraph 19.

66 *Matteucci*, paragraph 19. See also the discussion below concerning Article 307 EC and *Gottardo.*

67 ECJ, 5 Jul. 2005, Case C-376/03, *D. v Inspecteur van de Belastingdienst/Particulieren/ Ondernemingen buitenland te Heerlen ("D Case"),* [2005] ECR I-5821.

in EU law because Matteucci had to be in the same situation as a Belgian resident in order to obtain the equivalent benefits of the double tax convention: thus, Italian nationals were entitled to access the benefits of the Belgo-German Cultural Agreement only if they were exercising a fundamental freedom (as a "worker") and were established in one of the contracting States (Belgium). Other Italian nationals, residing, say, in Italy, were not entitled to the benefit of the cultural agreement. In *Matteucci*, therefore, the Court implicitly rejects the MFN principle in relation to the free movement of workers.[68] Germany did not have to extend the benefits to nationals of all the other Member States *always* – it only had to extend the benefits to such nationals who had exercised one of the fundamental freedoms and who were in a comparable situation to residents of Belgium.

In relation to double tax conventions, the Court's judgment in the *D case* involved the free movement of capital, whereas *Matteucci* related to the free movement of workers. Thus, if Mr. D could not put himself in a comparable situation to a resident of the Netherlands or Belgium under the double tax convention, then he was not entitled to national treatment in the Netherlands or under the Belgo-Dutch double tax convention. Had Mr. D been a resident of the Netherlands or Belgium, he would have been entitled to equal treatment. *Matteucci* shows that a Member State can treat residents and non-residents differently under a bilateral agreement: an Italian entitled to free movement of worker rights in Belgium qualified for equal treatment whereas an Italian resident in another Member State other than Belgium did not. Therefore, it is clear from the *Matteucci* decision that the Court accepts that nationals of Member States can be treated differently under bilateral agreements, and consequently, that the MFN principle is not part of EU law.

Article 12 EC: prohibition of discrimination on grounds of nationality

This research highlights that the prohibition of discrimination on grounds of nationality contained in Article 12 EC is not an absolute obligation imposed on the Member States. It is subject to two significant conditions: first, the prohibition applies only "within the scope of application" of the EC Treaty and, second, Article 12 EC is "without prejudice to any special provisions" contained in the EC Treaty: these include, the free movement of goods,[69] persons,[70] services [71] and capital.[72]

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68 For a full discussion of the MFN principle in Community law and, in particular, the *D case,* see Tom O'Shea, "*The ECJ, the `D' case, double tax conventions and most-favoured nations: comparability and reciprocity"* (2005) *EC Tax Review, 14,* 190-201.

69 Free movement of goods – Article 23 EC et seq.

70 Persons may be sub-divided into workers (Article 39 EC); persons who have established themselves as self-employed (Article 43 EC); and companies and firms (Article 48 EC).

71 Article 49 EC et seq.

72 Article 56 EC et seq.

As each of the fundamental freedom provisions is also limited in terms of its scope, the consequence is that *all* discrimination on grounds of nationality is not prohibited by Article 12 EC. Some limits on the absolute prohibition of discrimination on grounds of nationality, therefore, are acceptable. Furthermore, the rules contained in the fundamental freedom provisions take precedence within their scope of application and make Article 12 EC relatively redundant.

Article 12 EC comes into play when there is discrimination on grounds of nationality and the fundamental freedoms do not apply.[73] This is clear from the Court's jurisprudence where it applies the more specific fundamental freedom rules if they are applicable, and does not apply Article 12 EC.[74] An example is seen in *Gilly*, where the Court confirms that Article 12 EC[75] lays down "the general principle of prohibition of discrimination on grounds of nationality" which

> "applies independently only to situations governed by Community law in respect of which the Treaty lays down no specific prohibition of discrimination (…) In the field of freedom of movement for workers, the prohibition of discrimination has been specifically implemented and embodied in Article 48 of the Treaty and by acts of secondary legislation".[76]

Consequently, the Court is obliged to check to see if one of the fundamental freedoms is applicable before applying Article 12 EC.

An example of Article 12 EC being applied by the Court in the area of direct taxes is seen in *Schempp*[77] which involved a German taxpayer and tax rules concerning the deduction of maintenance payments to his former spouse who no longer resided in Germany, but had moved to Austria. Had the former spouse remained in Germany, a tax deduction would have been granted, but because the former spouse had moved to Austria (where the maintenance payment was not taxed) Germany refused to grant Mr. Schempp a deduction. The ECJ had to decide whether such a situation fell within the scope of the EC Treaty, and it determined that Article 12 EC had to be read "in conjunction with the provisions of the Treaty on citizenship".[78]

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73 For instance, see *Schempp,* discussed in the next section. ECJ, 12 Jul. 2005, Case C-403/03, *Egon Schempp v Finanzamt München V, ("Schempp"),* [2005] ECR I-6421.

74 This flows from the Latin maxim "lex specialis derogat legi generali".

75 It was Article 6 of the Treaty at the time of the case.

76 *Gilly,* paragraphs 37-38. The outcome was that the Court found it unnecessary to rule on the interpretation of Article 12 EC Treaty (Article 6 of the Treaty at the time of the case). ECJ, 12 May 1998, Case C-336/96, *Mr and Mrs Robert Gilly v Directeur des services fiscaux du Bas-Rhin ("Gilly"),* [1998] ECR I-2793.

77 ECJ, 12 Jul. 2005, Case C-403/03, *Egon Schempp v Finanzamt München V, ("Schempp"),* [2005] ECR I-6421.

78 *Schempp,* paragraph 15.

Consequently, as the former spouse had exercised her free movement rights as an EU citizen and as this action had an impact on Mr. Schempp's right to deduct, the EC Treaty was applicable. Moreover, Article 12 EC could be relied upon by all EU citizens

> "in all situations falling within the material scope of Community law[79] (…) Those situations include those involving the exercise of the fundamental freedoms guaranteed by the Treaty and those involving the exercise of the right to move and reside within the territory of the Member States".[80]

Thus, even though Mr. Schempp did not move to another Member State, the fact that his former spouse did, thus exercising her right of free movement, meant that the EC Treaty was engaged. The Court then went on to note that the payment of maintenance to a person resident in Germany could not be equated to a payment of maintenance to a person resident in Austria because

> "The recipient is subject in each of those two cases, as regards taxation of the maintenance payments, to a different tax system".[81]

Consequently, there was no discrimination under Article 12 EC because the two situations were not comparable. The fact that Mr. Schempp's former spouse was a non-resident of Germany enabled Germany to treat Mr. Schempp differently because it could objectively justify its different tax treatment.

Articles 17 EC and 18 EC: EU Citizenship

Articles 17 EC and 18 EC provide for "Citizenship of the Union".[82] EU Citizens are to enjoy the rights conferred by the EC Treaty subject to any duties imposed thereby.[83] Every citizen of the EU has "the right to move and reside freely within the territory of the Member States, subject to the limitations contained in the EC Treaty and by the measures adopted to give it effect".[84]

This investigation of the Court's jurisprudence revealed that the right to move and reside in the territory of other Member States, given to EU citizens, is a new and

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79 *Schempp,* paragraph 17.

80 *Schempp,* paragraph 18.

81 *Schempp,* paragraph 35.

82 Article 17(1) EC: "Every person holding the nationality of a Member State shall be a citizen of the Union".

83 Article 17(2) EC.

84 Article 18(1) EC.

additional fundamental freedom. The Court makes this clear in *Turpeinen* where it confirmed that

> "Situations falling within the scope of Community law include those involving the exercise of the fundamental freedoms guaranteed by the Treaty, in particular those involving the freedom to move and reside within the territory of the Member States, as conferred by Article 18 EC".[85]

The Court has determined that this right of free movement is a directly effective right similar to the fundamental freedoms[86] and has observed that "Union citizenship is destined to be the fundamental status of nationals of the Member States".[87] In *Chen*, the ECJ describes citizenship of the Union as a "fundamental principle".[88] From a host Member State perspective, this citizenship right entitles a EU national[89] in the same situation as a host State national "to enjoy within the *ratione materiae* of the EC Treaty the same treatment in law irrespective of their nationality, subject to

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85 *Turpeinen,* paragraph 19. The "in particular" reference refers to situations involving the exercise of the fundamental freedoms. ECJ, 9 Nov. 2006, Case C-520/04, *Pirkko Marjatta Turpeinen ("Turpeinen"),* [2006] ECR I-10685. For a discussion of another possible "fundamental freedom", see Tom O'Shea, "*Festersen*: *Another New Fundamental Freedom?"* (2007) Tax Notes International, July 2, 51-54.

86 See *Baumbast* paragraphs 84-86, where the Court said that "the right to reside within the territory of another Member State … is conferred directly on every citizen of the Union by a clear and precise provision of the EC Treaty…Any limitations and conditions imposed on that right do not prevent the provisions of Article 18(1) EC from conferring on individuals rights which are enforceable by them and which national courts must protect". ECJ, 17 Sep. 2002, Case C-413/99, *Baumbast and R v Secretary of State for the Home Department*, ("Baumbast"), [2002] ECR I-7091. Also, Advocate General Kokott in the *N case* has said that "free movement of citizens of the Union is a fundamental freedom which is to be interpreted broadly". See the *N case* and *Turpeinen*. ECJ, 7 Sep. 2006, Case C-470/04, *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo ("N case"),* [2006] ECR I-7409 and ECJ, 9 Nov. 2006, Case C-520/04, *Pirkko Marjatta Turpeinen ("Turpeinen"),* [2006] ECR I-10685.

87 ECJ, 20 Sep. 2001, *Rudy Grzelczyk v Centre public d'aide sociale d'Ottignies-Louvain-la-Neuve ("Grzelczyk"),* paragraph 31. In *Baumbast,* paragraph 83, the Court noted that citizens of the Union do not have to pursue an economic activity in another Member State in order to enjoy the rights granted to citizens.

88 ECJ, 19 Oct. 2004, Case C-200/02, *Kunqian Catherine Zhu and Man Lavette Chen v Secretary of State for the Home Department* ("*Chen"),* paragraph 31.

89 A national of a Member State lawfully residing in the territory of another Member State comes within the scope ratione personae of the EU citizenship provisions. ECJ, 12 May 1998, Case C-85/96, *María Martínez Sala v Freistaat Bayern, ("Martinez-Sala"),* [1998] ECR I-2691, paragraph 61.

such exceptions as are expressly provided for".[90] From an origin Member State perspective, the different treatment of a resident exercising free movement rights is compared with the treatment of a national of that origin Member State not exercising such rights[91] to ensure that the origin Member State cannot penalise a resident for the fact that he has availed of those rights unless some justification can be shown.[92] This investigation has determined that EU citizenship is destined to become increasingly significant in the area of double tax conventions and direct taxation matters. The Court's jurisprudence in this area has already had an impact on double tax conventions. Thus, in *Pusa*,[93] the Court dealt with a situation involving the Finland-Spain double tax convention when a Finnish national left his origin Member State (Finland) and settled in Spain upon retirement. Under the tax convention, Pusa's income was subject to taxation in Spain. A problem arose because of an outstanding debt owed by Pusa in Finland. As a consequence, the Finnish authorities attached his gross pension prior to payment, but they failed to take into account the amount of tax payable in Spain. Consequently, Pusa was left with less than the minimum income to live on as required by the Finnish rules.

The ECJ repeated that the right of an EU citizen was to receive the same treatment in law in all Member States as that accorded to nationals of those Member States who find themselves in the same situation.[94] Consequently, origin Member States could not treat their nationals less favourably than those who had not availed "of the opportunities offered by the Treaty in relation to freedom of movement"[95] as to do

90 ECJ, 2 Oct. 2003, Case C-148/02, *Carlos Garcia Avello v Belgian State ("Garcia Avello"),* [2003] ECR I-11613, paragraph 23. The Court noted, however, in paragraph 26, that EU citizenship does not extend the scope rationae materiae of the EC Treaty also to internal situations which have no link with Community law.

91 Or exercising those rights in another Member State but not disadvantaged by the tax rule at issue. See, for instance, *Cadbury Schweppes* where a United Kingdom parent company could be disadvantaged by the United Kingdom's CFC taxation regime if it set up a subsidiary in Ireland but not if the same United Kingdom parent company set up a subsidiary in (say) France because the United Kingdom CFC rules were not triggered in the French situation as France taxed companies at a tax rate similar to the United Kingdom whereas Ireland taxed the subsidiary at a much lower 10% rate than that imposed in the United Kingdom. The comparison was still between two nationals of the United Kingdom. ECJ, 12 Sep. 2006, Case C-196/04, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue ("Cadbury Schweppes"),* [2006] ECR I-7995.

92 ECJ, 11 Jul. 2002, Case C-224/98, *Marie-Nathalie D'Hoop v Office national de l'emploi ("D'Hoop"),* [2002] ECR I-6191, paragraph 31. In *D'Hoop*, Belgian rules treated residents differently for the purposes of a tide-over allowance depending on whether such a resident had obtained a diploma in another Member State and thus pursued their free movement rights to pursue education in another Member State.

93 ECJ, 29 Apr. 2004, Case C-224/02, *Heikki Antero Pusa v Osuuspankkien Keskinäinen Vakuutusyhtiö ("Pusa"),* [2004] ECR I-5763.

94 *Pusa,* paragraph 18.

95 *Pusa,* paragraph 18. This is an application of the "Migrant/Non-migrant Test" or "national

so would deter them from exercising their freedom rights and create an obstacle to residence in the host Member State.[96] The Court said:

> "To preclude all consideration of the tax payable in the Member State of residence when such tax has become payable and to that extent affects the actual means available to the debtor, in particular his ability to meet his basic needs, cannot be justified (…)" [97]

Accordingly, the tax paid by Pusa in Spain had to be taken into account by Finland when it calculated the deduction from the pension.

In a similar vein, in *Bidar,* a case involving a student's maintenance grant, the Court pointed out that Article 18 EC and Article 12 EC should be construed together to "assess the scope of the application of the Treaty within the meaning of Article 12 EC".[98] Thus, the scope of application of Article 12 EC was expanded by the introduction of citizenship rights in the EU. Whereas previously a Community national had to be economically active in order to benefit from the fundamental freedom rights granted in the EC Treaty, this "economically active" condition is no longer a requirement for a citizen of the EU to obtain the right to move and reside in another Member State. The Court used the phrase: "at the present stage of development of Community law", indicating the dynamic nature of EU law which was altered in this situation by the introduction of EU citizenship rights; by the addition of new and/or amended provisions in the EC Treaty; by the adoption of secondary EU legislation in the area; and the fact that EU law rules had to be read in the light of these new citizenship rules as they now formed part of the EC Treaty.
On a sideline matter, relating to the possible justification of a Member State's restrictive rules, the Court noted that Member States must, in their social security systems, accept a certain level of financial solidarity with nationals of other Member States,[99] although they were justified in having rules which ensured that the grant of the maintenance allowance did not "become an unreasonable burden which could have consequences for the overall level of assistance which may be granted by that

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treatment" test (discussed below) in the area of free movement of EU citizens.

96 *Pusa,* paragraph 20.

97 *Pusa,* paragraph 34.

98 ECJ, 15 Mar. 2005, Case C-209/03, The *Queen, on the application of Dany Bidar v London Borough of Ealing and Secretary of State for Education and Skills ("Bidar"),* paragraph 31.

99 See also, *Elsen* paragraph 33, where the Court dealt with a social security matter and reminded Member States that although they could organise their social security systems, they still had to comply with Community law when exercising those powers and, in particular, the "Treaty provisions on freedom of movement for workers (…) or again the freedom of every citizen of the Union to move and reside in the territory of the Member States". ECJ, 23 Nov. 2000, Case C-135/99, *Ursula Elsen v Bundesversicherungsanstalt für Angestellte ("Elsen"),* [2000] ECR I-10409.

State".[100] This forewarned the Court's reasoning in *Marks and Spencer,* and its development of a new justification in the area of direct taxes and double tax conventions: the need to safeguard the balance in the allocation of taxing rights between the Member States, which is discussed below.[101]

The Court's understanding of what constituted a Member State's entitlement "to prevent individuals from improperly taking advantage of EU law or from attempting, under cover of rights created by the Treaty, illegally to circumvent national legislation"[102] came under scrutiny in *Chen* which explored the interaction between the concept of abuse of EU law rights, and the rights of EU citizens to move from one Member State to another.

Chen, a Chinese national, arranged for her child to be born in Belfast, Northern Ireland. As a consequence, Chen was able to take advantage of Irish nationality laws that granted Irish citizenship to her child at birth because the child was born on the island of Ireland. It was common ground[103] that Mrs. Chen took up residence on the island of Ireland in order to acquire Irish nationality and to enable her to acquire the right to reside in the United Kingdom with her child.

The Court rejected the United Kingdom's arguments that these arrangements constituted an abuse of EU law rights. It observed that it was for each Member State to set the conditions for the acquisition and loss of nationality, subject to compliance with EU law.[104] Consequently, a Member State could not restrict the "effects of the grant of nationality of another Member State by imposing an additional condition for recognition of that nationality with a view to exercise of the fundamental freedoms provided for in the Treaty".[105] Thus, the United Kingdom could not refuse nationals of other Member States the benefit of an EU freedom merely because their nationality was "acquired solely in order to secure a right of residence under Community law for a national of a non-member country".[106] This understanding of "abuse" and "non-abuse" of the fundamental freedoms impacts on the notion of "tax avoidance" with repercussions for double tax conventions one of whose purposes is

100 *Bidar,* paragraph 56.

101 ECJ, 13 Dec. 2005, Case C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes), ("Marks and Spencer"),* [2005] ECR I-10837, paragraph 43, et seq. See Tom O'Shea, *"Marks and Spencer v Halsey (HM Inspector of Taxes): Restriction, Justification and Proportionality*", (2006), 15(2), EC Tax Review, 66-82,

102 *Chen,* paragraph 34

103 *Chen,* paragraph 11.

104 *Chen,* paragraph 37.

105 *Chen,* paragraph 39.

106 *Chen,* paragraph 40.

to counter tax avoidance.[107]

To conclude, the Court's jurisprudence concerning EU citizenship, as seen in cases like *Pusa*,[108] *Schempp,*[109] and especially *Turpeinen,* demonstrates that the concept of citizenship will continue to interact with the direct tax systems of the Member States and their double tax conventions. As the concept of European citizenship is continually evolving, and has achieved the status of another fundamental freedom right, its scope needs further definition by the Court. The fact that the right of EU citizens to move and reside in other Member States has been interpreted in a similar fashion to the other fundamental freedoms indicates that this trend is likely to continue. The Court's case law also indicates that consideration of the taxation situation in the two Member States is often necessary, echoing the Court's *Manninen* judgment[110] where a two-State approach was taken into account in relation to the "coherence of the tax system" justification offered by Finland. Finally, the *Pusa* case confirms[111] that the "national treatment" requirement[112] applies in relation to the free movement of citizens in the same way as it applies in relation to the other fundamental freedoms, further confirming a fundamental argument of this analysis that the national treatment principle applies to situations involving both the origin and host Member States.[113]

Articles 39 EC to Article 60 EC: The Fundamental Freedoms

The free movement of goods, persons, services and capital represent the

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107 See, for instance, Frans Vanistendael, "*Halifax and Cadbury Schweppes: one single European theory of abuse in tax law?"* (2006), *EC Tax Review*, 15, 192-195.

108 Involving the taxation of pensions and double tax conventions.

109 Involving the taxation of maintenance payments where a tax deduction was denied because a spouse moved to another Member State by exercising her EU citizenship rights.

110 ECJ, 7 Sep. 2004, Case C-319/02, *Petri Manninen ("Manninen"),* [2004] ECR I-7477.

111 *Pusa,* paragraph 18.

112 Advocate General Kokott in her Opinion in the *N case* picks up on this point saying: "the measure must none the less impose a disadvantage on a citizen of the Union if he wishes to rely on Article 18 EC against his home State. The disadvantage may be economic but could consist in other things which impede emigration". ECJ, 7 Sep. 2006, Case C-470/04, *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo ("N case"),* [2006] ECR I-7409.

113 The Court alludes to this in its *De Groot* judgment, where it states that Member States must "respect the principle of national treatment of nationals of other Member States and of their own nationals who exercise the freedoms guaranteed by the Treaty". See ECJ, 12 Dec. 2002, Case C-385/00, *F.W.L. de Groot v Staatssecretaris van Financiën*, ("*De Groot*"), [2002] ECR I-11819, paragraph 94.

"framework" rules of the EU[114] covering all aspects[115] of the economy, including direct taxation matters and double tax conventions. The freedoms govern Member State actions falling within the scope of the EC Treaty, and more particularly, within the scope of the internal market which comprises "an area without internal frontiers"[116] in which the freedoms are ensured "in accordance with"[117] the EC Treaty and, which is "characterised by the abolition, as between the Member States, of obstacles to the free movement of goods, persons, services and capital".[118] This means that the Member States have already agreed to abolish obstacles to the fundamental freedoms unless such obstacles can be justified.

The rules contained in the fundamental freedoms have a number of consequences for the Member States and their double tax conventions. First, although direct taxation and double tax convention matters fall within the competence of the Member States, the fundamental freedoms place significant limits on that competence as the Member States have already agreed in the EC Treaty[119] to abolish direct tax and double tax convention rules which represent discrimination on grounds of nationality falling within the scope of the EC Treaty and any obstacles to the fundamental freedoms unless justified in the general interest.

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114 As noted briefly in the text above, the free movement of goods, persons, services and capital constitute the "negative integration" rules of the EC Treaty. In other words, they establish parameters for the exercise of Member State competence. These "negative integration" rules are supplemented by "positive" harmonised legislation adopted in order to supplement the fundamental freedom rights contained in the EC Treaty and to put in place harmonised rules at the Community level.

115 See *Hubbard* paragraph 19 where the Court observed that "the effectiveness of Community law cannot vary according to the various branches of national law which it may affect". For example, in the *SAIL* case, the Court confirmed that Community law could apply in relation to a Member State's criminal law rules when it held that a question referred from the national court in that field was admissible. ECJ, 21 Mar. 1972, Case 82/71, *Ministère public de la Italian Republic v Società agricola industria latte* (*"SAIL"),* [1972] ECR 0119, paragraph 5.

116 Article 14(2) EC. This "area without internal frontiers" must of course be understood in the light of the entire EC Treaty, in particular, Article 56 which extends the free movement of capital to non-member countries. See ECJ, 6 Oct. 1982, Case 283/81, *Srl CILFIT and Lanificio di Gavardo SpA v Ministry of Health,* (*"CILFIT")*, [1982] ECR 3415.

117 Article 14(2) EC.

118 Article 3(1)(c) EC.

119 For instance, Article 39(2) EC – "abolition of any discrimination on grounds of nationality between workers of the Member States"; Article 43 EC – "restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited" (…) "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"; Article 49 EC – "restrictions on the freedom to provide services within the Community shall be prohibited"; and Article 56 EC– "all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited".

Second, the EU's constitutional framework provides EU nationals with directly effective EU law rights[120] which they can enforce when national and double tax convention rules come into conflict with the fundamental freedoms. As the fundamental freedoms have all been held to be directly effective by the ECJ,[121] this means that the rights granted in the fundamental freedoms can be litigated before national courts and preliminary rulings may be sought from the ECJ on the interpretation of matters concerning EU law.

Third, certain harmonised rules have been put in place at the EU level via secondary legislation such as directives and regulations. One example in the double tax convention area is the Parent-Subsidiary Directive.[122]

Fourth, the EU's institutions play a significant enforcement role in ensuring that EU law is upheld: the Commission has the competence to bring infringement proceedings against Member States who fail to fulfil their EU obligations by maintaining in force rules which are incompatible with EU law;[123] and the Court interprets and applies EU law and ensures that national and double tax convention rules comply with EU rules in those cases which come before it.[124]

Lastly, in relation to double tax conventions, the Member States are under an obligation to only enter into double tax conventions which comply with the

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120 For example, in relation to freedom of establishment, the Court made it clear in *Reyners* that "After the expiry of the transitional period, the directives provided for by the Chapter on the right of establishment have become superfluous with regard to implementing the rule on nationality, since this is henceforth sanctioned by the Treaty itself with direct effect". ECJ, 21 Jun. 1974, Case 2/74, *Jean Reyners v Belgian State, ("Reyners"),* [1974] ECR 0631.

121 *Van Duyn* (Workers), *Bordessa* (Capital), *Reyners* (Establishment), *Van Binsbergen* (Services). ECJ, 4 Dec. 1974, Case 41/74, *Yvonne van Duyn v Home Office*, *("Van Duyn"),* [1974] ECR 1337; ECJ, 23 Feb. 1995, Joined Cases C-358/93 and C-416/93, *Criminal proceedings against Aldo Bordessa, Vicente Marí Mellado and Concepción Barbero Maestre, ("Bordessa"),* [1995] ECR I-0361; ECJ, 21 Jun. 1974, Case 2/74, *Jean Reyners v Belgian State, ("Reyners"),* [1974] ECR 0631; and ECJ, 3 Dec. 1974, Case 33/74, *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid, ("Van Binsbergen"),* [1974] ECR 1299.

122 Council Directive 2003/123/EC which amended Council Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

123 For instance, "*Avoir Fiscal*" and *Commission v Belgium (Belgian Coordination Centres).* ECJ, 28 Jan. 1986, Case 270/83, *Commission v France ("Avoir Fiscal"),* [1986] ECR 0273 and ECJ, 22 Jun. 2006, Joined Cases C-182/03 and C-217/03, *Belgium v Commission, ("Belgian Coordination Centres"),* [2006) ECR I-5479.

124 For example, see *Saint-Gobain* and *Bouanich.* ECJ, 21 Sep. 1999, Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt, ("Saint-Gobain"),* [1999] ECR I-6161 and ECJ, 19 Jan. 2006, Case C-265/04, *Margaretha Bouanich v Skatteverket, ("Bouanich"),* [2006] ERC I-0923.

fundamental freedoms and EU law in general, whether those double tax conventions are with other Member States or with non-member countries.[125]

The fundamental freedoms, in terms of abolishing "obstacles" to intra-EU trade and investment,[126] are closely linked to the general "non-discrimination on grounds of nationality" rule contained in Article 12 EC and the granting of the right to move and reside to EU citizens contained in Article 18 EC. Indeed, the fundamental freedoms are a more specific implementation of those general rules.[127]

This investigation has revealed that the concepts of "non-discrimination on grounds of nationality" and "non-restriction of the fundamental freedoms in the absence of justification" operate side by side constituting what may be described as the two cardinal rules of the internal market: Member States must design and operate their direct tax systems and double tax conventions within these two parameters.[128] Failure to do so can lead to the Member State's tax rule, or double tax convention rule, being found to be incompatible with EU law.[129] Moreover, these cardinal rules apply from two distinct perspectives – from the standpoint of the "host" Member State[130] and from the perspective of an "origin Member State".[131] Understanding this distinction is the key to analysing the ECJ's case law relating to direct taxation and, therefore, the issues arising from the interaction between EU law and the direct tax laws of the Member States (including their double tax conventions).

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125 ECJ, 15 Jan. 2002, Case C-55/00, *Elide Gottardo v Istituto nazionale della previdenza sociale (INPS) ("Gottardo"),* [2002] ECR I-0413, paragraph 33.

126 It should be noted that the free movement of capital extends the internal market to third countries when certain capital movements are involved. See, for example, ECJ, 12 Dec. 2006, Case C-446/04, *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue, ("FII GLO"),* [2006] ECR I-11753, paragraph 166.

127 See the discussion above concerning Article 12 EC.

128 See Advocate General Lenz's Opinion in *Futura* paragraph 54. ECJ, 15 May 1997, Case C-250/95, *Futura Participations SA and Singer v Administration des contributions ("Futura"),* [1997] ECR I-2471.

129 For example, *Marks and Spencer* where the United Kingdom's rules on group relief were challenged and found to be incompatible in part with the freedom of establishment. Member States tax rules must comply also with the Community's competition rules and with any secondary Community legislation. ECJ, 13 Dec. 2005, Case C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes), ("Marks and Spencer"),* [2005] ECR I-10837.

130 In the area of double tax conventions, for example, see ECJ, 21 Sep. 1999, Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt, ("Saint-Gobain"),* [1999] ECR I-6161.

131 In the area of double tax conventions see, for instance, *De Groot.* ECJ, 12 Dec. 2002, Case C-385/00, *F.W.L. de Groot v Staatssecrataris van Financiën*, ("*De Groot*"), [2002] ECR I-11819.

Further, it is argued that these cardinal rules are merely "boundary" or "parameter" rules beyond which the Member States cannot transgress. The Member States are still competent to design their own direct tax systems and to conclude double tax conventions as long as they comply with EU law. Therefore, in terms of double tax conventions, the Member States may deal with the problems associated with overlapping tax jurisdiction by using double tax conventions or bilateral/multilateral agreements in the absence of EU legislation dealing with the problems of economic and juridical double taxation. In the words of the ECJ, as

> "no unifying or harmonising measure for the elimination of double taxation has yet been adopted at Community level"[132] (…) the Member States may "define the criteria for allocating their powers of taxation as between themselves, with a view to eliminating double taxation".[133]

Thus, a distinction must be made between this "allocation" of taxing rights and the subsequent "exercise" of those taxing rights. Once taxing rights have been allocated between the Member States or between the Member State and the non-member country, the exercise of those taxing rights must comply, in particular, with the two "cardinal rules" and with EU law rules in general. [134]

The next section examines the exercise of the fundamental freedoms, highlighting the distinction between origin and host Member State situations and demonstrates the interaction between the fundamental freedoms and the direct tax systems and double tax conventions of the Member States. A key outcome of this investigation is an appreciation that the "migrant/non-migrant" or "national treatment" test"[135] applies from both an origin Member State and a host Member State perspective. The test is applied by the ECJ in the direct taxation and double tax convention field to ascertain whether obstacles to the exercise of the fundamental freedoms are compatible with the EC Treaty. This analytical approach helps to decipher the jurisprudence of the ECJ in the area of direct taxation and double tax conventions

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132 ECJ, 12 May 1998, Case C-336/96, *Mr and Mrs Robert Gilly v Directeur des Services Fiscaux du Bas-Rhin, ("Gilly")* [1998] ECR I-2793, paragraph 23.

133 *Gilly* paragraph 30.

134 The two "cardinal rules" are clear from cases like *Futura* and *Truck Center* where the Court carried out both a discrimination and a restriction analysis. In *Futura*, the Court found first that there was no discrimination but went on to find that the Luxembourg rules were disproportionately restrictive of the freedom of establishment. In *Truck Center*, again the Court found that there was no discrimination but went on to hold that there was no restriction on the freedom of establishment. See ECJ, 15 May 1997, Case C-250/95, *Futura Participations SA and Singer v Administration des contributions ("Futura"),* [1997] ECR I-2471 and ECJ, 22 Dec. 2008, Case C-282/07, *Belgian State - SPF Finances v Truck Center SA ("Truck Center"),* [2008] ECR I-0000 (not yet reported).

135 See ECJ, 12 Dec. 2002, Case C-385/00, *F.W.L. de Groot v Staatssecrataris van Financiën*, ("*De Groot*"), [2002] ECR I-11819, paragraph 94.

and demonstrates the correct comparator.[136]

The Distinction between Origin and Host Member States

From its early case law in the direct tax area – *Avoir Fiscal* (host State)[137] and *Daily Mail* (origin State)[138] – the Court established a slight difference in approach between host and origin Member State situations where fundamental freedoms were exercised. This was necessary because different national tax rules were at stake: in relation to a host Member State, EU nationals were working, establishing, investing, or providing services in that host Member State where they were disadvantaged by a domestic tax rule or double tax convention rule of that Member State in comparison with a national of that Member State who was not similarly disadvantaged while conducting a similar activity; whereas in relation to origin Member States, EU nationals of those Member States were discouraged from exercising their fundamental freedom rights by a domestic or double tax convention rule of their origin Member State when compared with other nationals of that origin Member State.

Host Member States

The Court's settled case law indicates that it is the duty of a host Member State to ensure that EU nationals who are in a comparable situation to host State nationals and who have exercised their fundamental freedom rights in its territory receive no less favourable tax treatment than nationals of that host State, unless some objective reason can be demonstrated for that different treatment.[139] This will be referred to as the principle of national treatment and it applies also from perspective of the origin Member State. Equally, host Member States must avoid imposing obstacles on the exercise of the fundamental freedoms in their territory, in other words, disproportionate rules which restrict the fundamental freedoms in a way which are

136 See a discussion of the problems in determining the comparator in Michael Lang, "*Recent Case Law of the ECJ in Direct Taxation: Trends, Tensions and Contradictions", 98 EC Tax Rev. 2009/3.*

137 ECJ, 28 Jan. 1986, Case 270/83, *Commission v France ("Avoir Fiscal"),* [1986] ECR 0273.

138 ECJ, 27 Sep. 1988, Case 81/87, *The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc, ("Daily Mail"),* [1988] ECR 5483.

139 This "national treatment" obligation applies across the freedoms. It can be seen in relation to establishment in *Avoir Fiscal*; in relation to services in *Gerritse*; in relation to workers in *Schumacker*; and in relation to capital in *Bouanich*. See ECJ, 28 Jan. 1986, Case 270/83, *Commission v France ("Avoir Fiscal"),* [1986] ECR 0273; ECJ, 12 Jun. 2003, Case C-234/01, *Arnoud Gerritse v Finanzamt Neukölln-Nord, ("Gerritse"),* [2003] ECR I-5933; ECJ, 14 Feb. 1995, Case C-279/93, *Finanzamt Köln-Altstadt v Roland Schumacker Finanzamt Köln-Altstadt v Roland Schumacker ("Schumacker"),* [1995] ECR I-0225; and ECJ, 19 Jan. 2006, Case C-265/04, *Margaretha Bouanich v Skatteverket, ("Bouanich"),* [2006] ERC I-0923.

not capable of being justified by a public interest requirement.[140]

Three early ECJ cases illustrate the problems from a host Member State perspective and direct taxation point of view: *Avoir Fiscal*, *Futura,* and *Saint-Gobain*. *Avoir Fiscal* is an example of the national treatment obligation of a host Member State; *Futura* is an instance of a disproportionate and, thus, unjustifiable restriction of a fundamental freedom in the host Member State; and *Saint-Gobain* demonstrates the national treatment principle operating in relation to a double tax convention from a host State perspective.

In *Avoir Fiscal*, the Court examined French tax rules which denied a tax credit to branches of foreign insurance companies established in France. France, the host Member State, was obliged to give "no less favourable" treatment to French branches of companies resident in other Member States than it granted to French resident companies because the Court found that there was no objective difference for tax purposes between non-resident companies with such branches and French resident companies.[141] The Court decided that since the French tax rules placed French companies on the same footing as French branches of companies resident in other Member States "for the purpose of taxing their profits, those rules cannot, without giving rise to discrimination, treat them differently"[142] when it comes to granting the "avoir fiscal" (or tax credit). Thus, by taxing the two types of establishment in the same way for the purpose of taxing their profits, France "has in fact admitted that there is no objective difference between their positions" to justify different taxation treatment.[143]

The Court did not accept that the difference in treatment was the result of differences in the corporate tax systems of the Member States, or their double tax conventions, highlighting that

> "the rights conferred by Article [43] of the Treaty are unconditional and a Member State cannot make respect for them subject to the contents of an agreement concluded with another Member State. In particular, that article does not permit those rights to be made subject to a condition of reciprocity

140 See, for example, ECJ, 28 Feb. 2008, Case C-293/06, *Deutsche Shell GmbH v Finanzamt für Großunternehmen in Hamburg, ("Deutsche Shell"),* [2008] ECR I-1129, paragraph 32.

141 This is an application of the non-discrimination principle whereby "like situations" should be taxed in a similar way. See ECJ, 17 Jul. 1963, Case 13-63, *Italy v Commission* ("*Refrigerators*") case Part 4(a) of the judgment: *"*Discrimination in substance would consist in treating either similar situations differently or different situations identically*".* In the direct tax area, see *Schumacker,* paragraph 30.

142 *Avoir Fiscal*, paragraph 20.

143 *Avoir Fiscal*, paragraph 20.

> imposed for the purpose of obtaining corresponding advantage in other Member States".[144]

Accordingly, the Court held that France had breached its EC Treaty obligations by not granting the "avoir fiscal" to French branches of companies resident in other Member States. Such discrimination constituted a restriction on the right of establishment of companies whose registered office was in another Member State, contrary to Article [43].

In relation to double tax conventions, the Court dismissed the French argument that the "avoir fiscal" was available to branches of companies from other Member States in situations where that Member State had concluded a tax convention with France offering a similar tax advantage to French companies with branch in that other Member State. The Court noted that

> "the rights conferred by Article [43 EC] ... are unconditional and a Member State cannot make respect for them subject to the contents of an agreement concluded with another Member State. In particular, that article does not permit those rights to be made subject to a condition of reciprocity imposed for the purpose of obtaining corresponding advantages in other Member States. [145]

In other words, the national treatment obligation imposed on France was sufficient for companies resident in Member States other than France with a branch in France to be entitled to the "avoir fiscal" tax credit even in the absence of a double tax convention between France and that other Member State.

In *Futura*, Luxembourg loss relief rules came under scrutiny when a French company established a branch in Luxembourg and that branch incurred losses. The Advocate General[146] pointed out that Member States were free to design their own loss relief systems but in doing so they had to comply with EU law. He explained that

> "as long as there is no discrimination against non-resident companies and no restriction on the freedom of establishment, it is for the Member State to choose the way in which losses are to be determined".[147]

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144 *Avoir Fiscal*, paragraph 26.

145 ECJ, 28 Jan. 1986, Case 270/83, *Commission v France ("Avoir Fiscal"),* [1986] ECR 0273, paragraph 26.

146 The Opinion of the Advocate General is not binding on the ECJ but is generally very persuasive. His function is to provide the Court with a reasoned opinion on the issues involved in the case.

147 See paragraph 54 of the Opinion of Advocate General Lenz in *Futura*. ECJ, 15 May 1997,

The Court agreed. It carried out a two-prong assessment of the Luxembourg loss relief rules by, first, applying a discrimination analysis[148] and second, a restriction analysis.[149] The Court found that the Luxembourg rules were non-discriminatory.[150] However, it held that the Luxembourg requirement to keep a second set of accounts in order to obtain loss relief was a disproportionate response because the sole concern of the Luxembourg authorities was to ascertain

> "clearly and precisely that the amount of the losses carried forward corresponds (…) to the amount of losses actually incurred in Luxembourg by the taxpayer".[151]

Therefore, as long as the taxpayer showed to the satisfaction of the Luxembourg authorities that the amount of losses claimed to have been incurred in Luxembourg corresponded to the amount of losses actually incurred by that taxpayer in Luxembourg, then, the loss relief should be granted, and the Luxembourg rule in question went beyond what was necessary to enable the amount of loss relief to be ascertained, and breached the principle of proportionality.

Futura indicates that even though a Member State tax rule may not be discriminatory; it may still constitute a rule which breaches a fundamental freedom by amounting to an unjustified restriction on that freedom. In this case although the Court found that the Luxembourg rule was not discriminatory, it still amounted to a restrictive rule in certain limited circumstances when the national rule was measured against the principle of proportionality.

Freedom of establishment and double tax conventions came into play in the Court's *Saint-Gobain* decision,[152] when Germany refused certain tax advantages to the

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Case C-250/95*, Futura Participations SA and Singer v Administration des contributions, ("Futura"),* [1997] ECR I-2471

148 *Futura,* paragraphs 19-22.

149 *Futura,* paragraphs 24 et seq.

150 *Futura,* paragraph 43 and the operative part of the judgment where the Court made it clear that the Luxembourg rules were not contrary to the freedom of establishment provisions "provided that resident taxpayers do not receive more favourable treatment". The rules were non-discriminatory because both Luxembourg and French companies were treated in a similar way – both had to establish that the losses were linked to Luxembourg economic activities; both had to provide precise figures in relation to the losses. Provided French companies were treated no less favourably than Luxembourg companies in this respect, there was no discrimination.

151 *Futura,* paragraph 39.

152 See Thommes, O., *"European Court of Justice to decide on discrimination of permanent establishments*", [1997] INTERTAX, 25(12), 452-453; Eggert, R., *"Discrimination against German permanent establishments of EU corporations*", I.T. Rev. 1997/98, 9(1), 54-55;

German branch of a French company that it ordinarily granted to German resident companies concerning certain dividends received from foreign companies. The dividends in question were received by the German branch from companies resident in the USA and Switzerland. Tax concessions which were designed to prevent such dividends from being taxed again in Germany[153] were refused to Saint-Gobain on the ground that the double tax conventions between Germany and the USA, and Germany and Switzerland, restricted the tax reliefs to German resident companies.[154] The national court, citing *Avoir Fiscal*, considered that the refusal to grant the tax advantages could constitute discrimination contrary to Article [43] EC and consequently sought a preliminary ruling from the ECJ.[155]

The ECJ asked whether Articles [43] EC and [48] EC precluded "the exclusion of a permanent establishment in Germany of a company (…) having its seat in another Member State (…) from enjoyment, on the same conditions as those applicable to companies (…) having their seat in Germany, of tax concessions (…)" [156] It observed that those two provisions

> "guarantee nationals of Member States of the Community who have exercised their freedom of establishment and companies or firms which are assimilated to them the same treatment in the host Member State as that accorded to nationals of that Member State".[157]

In this instance, it was the German branch of the French company which held the shares in the US and Swiss companies. As such, Germany refused the tax concessions on the ground that the tax reliefs were limited to German resident companies subject to unlimited/worldwide taxation. Thus, the German tax rules granted less favourable treatment on non-resident companies operating in Germany via a branch.[158] They made it less attractive for those companies to hold shares via

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Lausterer, M., "*Unlawful German tax discrimination of permanent establishments comes before the European Court of Justice",* EC T.J. 1998, 3(1), 35-51; Eicker, K., *"ECJ to decide on German discrimination of permanent establishments",* [1999] INTERTAX, 27(12), 488; Oliver, J.D.B., *"Entitlement of a permanent establishment to third state treaty benefits",* B.T.R. 2000, 3, 174-181.

153 ECJ, 21 Sep. 1999, Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt, ("Saint-Gobain"),* [1999] ECR I-6161, paragraph 15.

154 *Saint-Gobain,* paragraph 16.

155 *Saint-Gobain,* paragraph 24.

156 *Saint-Gobain,* paragraph 32.

157 *Saint-Gobain,* paragraph 34.

158 *Saint-Gobain,* paragraph 37.

their German branches and thus, restricted "the freedom to choose the most appropriate legal form for the pursuit of activities in another Member State, which the second sentence of Article [43 EC] expressly confers on economic operators".[159]

In relation to the arguments put forward by Germany that double tax conventions with non-member countries did not fall within the sphere of EU competence, and that the balance inherent in such double tax conventions would be disturbed if the benefit of their provisions was extended to companies established in Member States which were not parties to them,[160] the Court simply explained that even though Member States could enter into double tax conventions, their competence was restricted by the parameters established by EU law.[161] In other words, when Member States entered into double tax conventions with non-member countries,

> "the national treatment principle requires the Member State which is a party to the treaty 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".[162]

The ECJ also confirmed the Opinion of Advocate General Mischo[163] that

> "the obligations which Community law imposes on (…) Germany do not affect in any way those resulting from its agreements with the United States of America and the Swiss Confederation. The balance and reciprocity of the treaties concluded by (…) Germany with those two countries would not be called into question by a unilateral extension, on the part of (…) Germany, of the category of recipients in Germany of the tax advantage provided for by those treaties, (…) 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".[164]

The outcome of *Saint-Gobain* was that Germany was obliged to extend equivalent treatment to the dividend tax advantages reserved for its own resident companies, to German branches of companies resident in other Member States which were in an

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159 *Saint-Gobain,* paragraph 42.

160 Saint-Gobain, paragraph 55. (Note: this argument was put forward by Sweden).

161 *Saint-Gobain,* paragraph 57.

162 *Saint-Gobain,* paragraph 58.

163 See paragraph 81 of the Opinion of Advocate General Mischo in *Saint-Gobain.*

164 ECJ, 21 Sep. 1999, Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt, ("Saint-Gobain"),* [1999] ECR I-6161, paragraph 59.

objectively comparable situation. The Court, therefore, demonstrated that international tax law principles and practices, and double tax conventions with non-member countries, were equally capable of being incompatible with EU law and of falling within the scope of the EC Treaty.

Saint-Gobain is also interesting because the double tax conventions entered into by Germany were found to be compatible with EU law as the EU law obligations imposed on Germany were a separate matter and "do not affect in any way those resulting from its agreements with the United States of American and with the Swiss Confederation".[165]

The national treatment principle is therefore paramount from a host State perspective. When a national of another EU Member State exercises a fundamental freedom in the host Member State and is in a comparable situation to a national of that host Member State; the person exercising the freedom in the host Member State is entitled to no less favourable treatment in that host State than the host State national. This same national treatment principle also applies from the origin State perspective.

Origin Member States

Origin Member States must ensure that they do not treat an origin State national who exercises a fundamental freedom in another Member State ("migrant") in a less favourable way than an origin State national who carries on a similar activity in the origin Member State ("non-migrant") or in another Member State where the origin State's tax treatment is similar to that of a domestic situation.[166]

Comparability between the "migrant" and "non-migrant" origin Member State nationals must first of all be determined. Once comparability is established, the migrant/non-migrant or national treatment test is applied. In other words, the treatment of the migrant is compared with that of the non-migrant from the standpoint of the origin Member State's tax rules. The origin Member State's rules must ensure no less favourable treatment for the origin State national exercising a

165 *Saint-Gobain*, paragraph 59.

166 See, for instance, *Cadbury Schweppes,* paragraph 44. The United Kingdom's CFC rules did not bite in situations where the CFC was established in the United Kingdom or in other Member States which did not have a "lower level of taxation" within the meaning of the United Kingdom legislation. Consequently, establishment in certain other Member States received similar treatment to that of establishment in the United Kingdom. In other words, establishment in such instances was equated to establishment in the United Kingdom in terms of the United Kingdom's tax treatment. See Tom O'Shea, "*The United Kingdom's CFC rules and the freedom of establishment: Cadbury Schweppes plc and its IFSC subsidiaries – tax avoidance or tax mitigation?" (2007)* EC Tax Review, 1, 13-33. ECJ, 12 Sep. 2006, Case C-196/04, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, ("Cadbury Schweppes"),* [2006] ECR I-7995.

fundamental freedom right when compared with the treatment of a comparable origin State national not impacted upon by the rule at issue who is carrying on a similar activity. Also, the origin Member State's tax rules must not constitute an obstacle to the exercise of a fundamental freedom unless justified and proportionate in the general interest.[167]

The Court's jurisprudence in the area of double tax conventions and direct tax matters demonstrates that the internal market freedoms operate in a similar way for an origin Member State situation to that of a host Member State situation; the distinction primarily being one of an *exit* situation in relation to the former and one of *arrival* in relation to the latter. In relation to an origin Member State, it is that Member State's tax rules that are making less attractive, hindering, deterring or discouraging the exercise of a fundamental freedom; whereas in relation to a host Member State, it is the tax rules of the host Member State that are discouraging or hindering the exercise of a fundamental freedom of a person who is investing, establishing, working, residing or providing services in the host Member State. Therefore, from the point of view of both the origin and host Member States, the migrant/non-migrant or national treatment test is applied by the Court in determining the comparator for the Court's discrimination and restriction analyses.
The first origin State case involving a direct tax matter occurred in *Daily Mail*, [168] where a United Kingdom company wished to cease to be a resident of the United Kingdom for tax reasons. However, the United Kingdom rules required the consent of Her Majesty's Treasury before such action could be taken. In this instance, such consent was denied. Since the Daily Mail wished to transfer its residence to the Netherlands, it argued that its right of establishment was infringed by such United Kingdom tax rules. Consequently, it sought a declaration that the rules were incompatible with EU law, and in particular, with Article [43] EC.[169] The principal reason for the proposed transfer of the central management and control of the company to the Netherlands was to avoid the payment of taxes.[170]

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167 See *Bosman* for an example of a total restriction, and for a case involving an obstacle in the tax sphere see *Deutsche Shell*. ECJ, 15 Dec. 1995, Case C-415/93, *Union royale belge des sociétés de football association ASBL v Jean-Marc Bosman, Royal club liégeois SA v Jean-Marc Bosman and others and Union des associations européennes de football (UEFA) v Jean-Marc Bosman ("Bosman"),* [1995] ECR I-4921 and ECJ, 28 Feb. 2008, Case C-293/06, *Deutsche Shell GmbH v Finanzamt für Großunternehmen in Hamburg, ("Deutsche Shell"),* [2008] ECR I-1129, paragraph 32.

168 See Brigitte Knobbe-Keuk, "*Restrictions on the fundamental freedoms enshrined in the EC Treaty by discriminatory tax provisions – ban and justification*", (1994) EC Tax Rev. 3, 74-85.

169 ECJ, 27 Sep. 1988, Case 81/87, *The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc, ("Daily Mail"),* [1988] ECR 5483, paragraph 2.

170 This was agreed by the parties in the case. *Daily Mail,* paragraph 7.

The Court was faced with an origin State rule which hindered the transfer of the central management and control of a company formed under English law (and, for the purposes of Article [48] EC, the law of a Member State) to another Member State. It determined –

> "Even though those provisions [referring to the freedom of establishment] are directed mainly to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, *they also prohibit the Member State of origin* from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation which comes within the definition contained in Article [48] (…) the rights guaranteed by Articles [43] et seq. would be rendered meaningless if the Member State of origin could prohibit undertaking from leaving in order to establish themselves in another Member State".[171]

The Court noted that establishment was generally exercised by the setting up of agencies, branches or subsidiaries or the taking part in the incorporation of a company in another Member State.[172] In the *Daily Mail* situation, however, the United Kingdom rules did not restrict any of these forms of establishment: the United Kingdom rules merely required Treasury consent "only where such a company seeks to transfer its central management and control out of the United Kingdom while maintaining its legal personality and its status as a United Kingdom Company".[173]

Having noted that Article [48] of the Treaty placed the registered office, the central administration and principal place of business of a company on the same footing (in other words, that the EC Treaty recognised that the Member States used different connecting factors to link a company to their territory), the Court decided that the right of establishment did not resolve the problems related to the transfer of the registered office or real head office or the central administration from one Member State to another.[174] It regarded this as a matter for "future legislation or

171 *Daily Mail*, paragraph 16 (emphasis is added).

172 *Daily Mail*, paragraph 17. However, it is clear from the *Daily Mail* judgment that the participation in the formation of a new company in another Member State was not covered by Article 43 EC. The Court points out that this activity was covered by Article [294] EC, which provides for non-discrimination regarding participation in the capital of companies or firms. The *Daily Mail* judgment was approved by the Court in *Überseering* and in *Cartesio.* ECJ, 5 Nov. 2002, Case C-208/00, *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC) ("Überseering"),* [2002] ECR I-9919 and ECJ, 16 Dec. 2008, Case C-210/06, CARTESIO Oktató és Szolgáltató bt ("Cartesio"), [2008] ECR I-0000 (not yet reported).

173 *Daily Mail*, paragraph 18.

174 *Daily Mail*, paragraph 23.

conventions".[175] The Court concluded that the freedom of establishment provisions of the Treaty did not confer on companies incorporated under the law of a Member State the right to transfer their central management and control to another Member State while retaining their status as companies in their origin Member State.[176] Thus, whilst the Court held that the freedom of establishment could not be restricted by an origin Member State, in this particular case, the United Kingdom rules did not fall within the scope of the freedom of establishment.[177]

Perhaps, the most significant outcome of the *Dail Mail* case was the Court's finding that an origin Member State's tax rule could restrict the freedom of establishment in a similar fashion to that of a host Member State. Although it took some considerable time for more origin State direct tax cases to come before it, the Court has continued to echo this thinking in its jurisprudence across all four fundamental freedoms and EU citizenship situations in cases like *ICI*,[178] *Terhoeve*,[179] *Baars*, *De Groot*,[180] *Eurowings*,[181] *Manninen*,[182] *Pusa*,[183] *Marks and Spencer v Halsey,*[184] *Keller*

175 *Daily Mail*, paragraph 23.

176 *Daily Mail,* paragraph 24.

177 For a more recent example, see *Cartesio.* Note that the Court extended the concept of freedom of establishment from an origin Member State perspective to cover situations where the host Member State allowed the origin State company to convert into company format recognised by the origin Member State. In such an instance, the origin State company would be continued in the host Member State. The Court noted that it would be a restriction on the freedom of establishment for the origin Member State to prevent the company from moving its seat in such circumstances in the absence of some general interest justification. See Tom O'Shea, "*Cartesio: Moving a Company's Seat Now Easier in the EU",* Tax Notes International, 23 March 2009, 1071-1075 and Tom O'Shea, *"Exit Taxes Post Cartesio",* The Tax Journal, 31 August 2009, 1-2.

178 ECJ, 16 Jul. 1998, Case C-264/96, *Imperial Chemical Industries plc (ICI) v Kenneth Hall Colmer (Her Majesty's Inspector of Taxes), ("ICI"),* [1998] ECR I-4695, paragraph 21. For analysis, see Thommes, O., "*European Court of Justice continues to dictate the pace for European tax harmonisation*", [1998] INTERTAX, 26(10), 320-321.

179 ECJ, 26 Jan. 1999, Case C-18/95, *F.C. Terhoeve v Inspecteur van de Belastingdienst Particulieren/Ondernemingen buitenland , ("Terhoeve"),* [1999] ECR I-0345, paragraph 39.

180 *De Groot* paragraph 78. For an excellent analysis of the *N case*, see Mattsson, N., "*Does the European Court of Justice understand the policy behind tax benefits based on personal and family circumstances?*" (2003) ET, 43(6), 186-194.

181 ECJ, 26 Oct. 1999, Case C-294/97, *Eurowings Luftverkehrs AG v Finanzamt Dortmund-Unna, ("Eurowings"),* [1999] ECR I-7447.

182 ECJ, 7 Sep. 2004, Case C-319/02, *Petri Manninen*, ("*Manninen*"), [2004] ECR I-7477.

183 ECJ, 29 Apr. 2004, Case C-224/02, *Heikki Antero Pusa v Osuuspankkien Keskinäinen Vakuutusyhtiö, ("Pusa"),* [2004] ECR I-5763.

184 ECJ, 13 Dec. 2005, Case C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)* (*"Marks and Spencer"), [2005] ECR I-10837,* paragraph 31.

Holding,[185] *Cadbury Schweppes,*[186] and *Cartesio.*[187] The Court's reasoning in relation to origin Member States was summed up in cases like *De Groot,* where it confirmed that

> "even if, according to their wording, the rules on freedom of movement for workers are intended, in particular, to secure the benefit of national treatment in the host State, they also preclude the State of origin from obstructing the freedom of one of its nationals to accept and pursue employment in another Member State".[188]

In, perhaps, its most significant statement of the law in relation to both host and origin Member State situations, the Court went on to confirm that the origin Member State is obliged to

> "respect the principle of national treatment of nationals of other Member States and of their own nationals who exercise the freedoms guaranteed by the Treaty".[189]

In other words, the national treatment principle applies from both an origin Member State and a host Member State perspective. The Court affirmed this point in subsequent cases like *Renneberg*,[190] and, in relation to EU citizenship rights, in *Turpeinen*, the Court highlighted that

> "Inasmuch as a citizen of the Union must be granted in all Member States the same treatment in law as that accorded to nationals of those Member States who find themselves in the same situation, it would be incompatible with the right to freedom of movement were a citizen to receive in the Member State of which he is a national treatment less favourable than he

185 ECJ, 23 Feb. 2006, Case C-471/04, *Finanzamt Offenbach am Main-Land v Keller Holding GmbH ("Keller Holding"),* [2006] ECR I-2107.

186 ECJ, 12 Sep. 2006, Case C-196/04, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, ("Cadbury Schweppes"),* [2006] ECR I-7995.

187 ECJ, 16 Dec. 2008, Case C-210/06, *CARTESIO Oktató és Szolgáltató bt, ("Cartesio"),* [2008] ECR I-0000 (not yet reported).

188 ECJ, 12 Dec. 2002, Case C-385/00, *F.W.L. de Groot v Staatssecrataris van Financiën*, ("*De Groot*"), [2002] ECR I-11819, paragraph 79.

189 *De Groot,* paragraph 94.

190 ECJ, 16 Oct. 2008, Case C-527/06, *R. H. H. Renneberg v Staatssecretaris van Financiën ("Renneberg"),* [2008] ECR I-0000 (not yet reported).

> would enjoy if he had not availed himself of the opportunities offered by the Treaty in relation to freedom of movement".[191]

Therefore, the national treatment principle applies from both a host and an origin Member State situation, and ensures that persons exercising the fundamental freedoms, or EU citizenship rights, receive no less favourable treatment than nationals of the host or origin Member State respectively who are in a similar situation and who are not disadvantaged by the origin or host Member State rule in question.

The National Treatment test

One important analytical tool resulting arising from of this research is the Migrant/Non-migrant or National treatment test which provides a deeper understanding of the Court's approach to both origin and host Member State situations.[192] The comparison used by the Court for the purpose of determining whether the different tax treatment at issue constitutes discrimination or amounts to a restriction of a fundamental freedom is between the person who exercises the freedom (the "Migrant") compared with the person who is in a comparable situation in either the host or the origin Member State (the "Non-migrant") who is conducting a similar activity but is not disadvantaged by the tax rule in question.[193] This will normally be another national of the host or origin Member State. This understanding of the correct comparator is significant given the difficulties encountered by Advocates General of the ECJ and academics in determining the comparator in ECJ cases related to direct taxation and double tax convention matters.[194]

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191 ECJ, 9 Nov. 2006, Case C-520/04, *Pirkko Marjatta Turpeinen ("Turpeinen"),* [2006] ECR I-10685, paragraph 20.

192 The notion of "Migrant/Non-migrant" test is referred to throughout the text. It is an analytical tool to assist with the interpretation of the Court's jurisprudence in the direct tax area across the fundamental freedoms and EU citizenship cases. It seems clear from *De Groot* that the Court is really performing a "national treatment" test. See ECJ, 12 Dec. 2002, Case C-385/00, *F.W.L. de Groot v Staatssecrataris van Financiën,* ("*De Groot*"), [2002] ECR I-11819, paragraph 94. The Court has reiterated this message in subsequent judgments, for instance, see ECJ, 16 Oct. 2008, Case C-257/06, *R. H. H. Renneberg v Staatssecretaris van Financiën*, ("Renneberg"), [2008] ECR I-0000, paragraph 51 (not yet reported).

193 This comparator is clear from the Court's *Terhoeve* judgment. ECJ, 26 Jan. 1999, Case C-18/95, *F.C. Terhoeve v Inspecteur van de Belastingdienst Particulieren/Ondernemingen buitenland, ("Terhoeve"),* [1999] ECR I-0345.

194 See footnote 134 above. See also the Opinion of Advocate General Eleanor Sharpston in ECJ, 28 Jun. 2007, Case C-212/06, *Government of the French Community and Walloon Government v Flemish Government,* [2008] ECR I-01683, paragraph 76; Opinion of Advocate General Sharpston in ECJ, 14 Feb. 2008, Case C-414/06, *Lidl Belgium GmbH & Co. KG v Finanzamt Heilbronn,* [2008] ECR I-3601, paragraph 7; Opinion of Advocate General Sharpston in ECJ, 8 Nov. 2007, Case C-293/06, *Deutsche Shell v Finanzamt für Großunternehmen in Hamburg,* [2008] ECR I-1129, paragraphs 28-34.

Looked at another way, when a national of Member State A establishes a business/starts work as an employee/provides services/makes an investment in Member State B, this is may constitute an origin State or a host State scenario depending on whether the rule causing the disadvantage is an origin Member State A rule or a host Member State B rule.

Applying the Migrant/Non-migrant test in a host State setting requires a comparison between the person who has exercised (say) the freedom of establishment in Member State B, and nationals of Member State B who are in a comparable situation but who are not disadvantaged by the tax rule in question. Thus, in *Avoir Fiscal*, companies resident in Member States other than France with branches in France were entitled to no less favourable treatment than French resident companies because they were taxed in a similar way to such companies and were, therefore, in an objectively comparable situation to such companies.

Applying the Migrant/Non-migrant test in an origin Member State setting, requires a comparison between a national of Member State A who has exercised (say) the freedom of establishment in Member State B, and nationals of Member State A who are in a comparable situation but who are not disadvantaged by the origin State tax rule. An example is seen in *Cadbury Schweppes*, where a United Kingdom resident parent company established a subsidiary in Ireland and fell within the United Kingdom's CFC regime and, accordingly, suffered a tax disadvantage when compared with a United Kingdom parent company that established a similar subsidiary in the United Kingdom (or in another Member State where the United Kingdom's CFC rules did not apply). In the absence of a public interest justification, this different treatment constituted a restriction on the freedom of establishment of the United Kingdom parent company establishing a subsidiary in Ireland falling within the United Kingdom's CFC regime.

In applying the test, the Court first checks for comparability in the situations of the *migrant* and the *non-migrant*, and examines their different (tax) treatment. If the *migrant* and the *non-migrant* are in a comparable situation, the disadvantageous tax treatment must be justified since any less favourable tax treatment is either discriminatory or liable to generate a restriction on the exercise of a fundamental freedom. This comparability test is used by the Court across the fundamental freedoms and EU citizenship situations. This is demonstrated in the following analysis of the Court's jurisprudence.

Origin Member State situations

Use of the test may be seen in relation to free movement of workers in *Terhoeve*, where the Court pointed out that the payment of the extra social security contributions relating to the employment income in the other Member State did not provide any increased social security benefits. As such the *migrant* and the *non-*

migrant were objectively comparable.[195] Citing *Bosman*,[196] the Court said,

> "Provisions which preclude or deter a national of a Member State from leaving his country of origin in order to exercise his right to freedom of movement therefore constitute an obstacle to that freedom even if they apply without regard to the nationality of the workers concerned".[197]

In *Eurowings*, the Court applied a similar comparison test in the area of free movement of services when German legislation provided for additional taxation of leasing services acquired in a Member State other than Germany, in other words, a German company which leased goods from an Irish company was treated less favourably from a tax point of view than a comparable German company that leased similar goods from a German resident company. The Court noted that

> "The legislation at issue … contains tax rules which are less favourable to German undertakings leasing goods from lessors established in other Member States, who may thus be dissuaded from having recourse to such lessors.[198] (…) any legislation of a Member State which (…) reserves a fiscal advantage to the majority of undertakings which lease goods from lessors established in that State [the origin-State] whilst depriving those leasing from lessors established in another Member State of such an advantage gives rise to a difference of treatment based on the place of establishment of the provider of the services, which is prohibited by Article [49] of the Treaty".[199]

The Court developed the test further in *Baars* where the freedom of establishment was at stake. Repeating its *Daily Mail* mantra in relation to hindering the freedom of establishment by origin State rules, the Court pointed out that "Article [43] of the Treaty prohibits a Member State from hindering the establishment in another Member State of nationals of Member States residing on its territory".[200]

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195 *Terhoeve,* paragraph 42.

196 ECJ, 15 Dec. 1995, Case C-415/93, *Union royale belge des sociétés de football association ASBL v Jean-Marc Bosman, Royal club liégeois SA v Jean-Marc Bosman and others and Union des associations européennes de football (UEFA) v Jean-Marc Bosman ("Bosman"),* [1995] ECR I-4921, paragraph 95.

197 *Terhoeve,* paragraph 39.

198 ECJ, 26 Oct. 1999, Case C-294/97, *Eurowings Luftverkehrs AG v Finanzamt Dortmund-Unna, ("Eurowings"),* [1999] ECR I-7447, paragraph 37.

199 *Eurowings* paragraph 40. At the time of the judgment Article 49 of the EC Treaty was numbered as Article 59.

200 ECJ, 13 Apr. 2000, Case C-251/98, *C. Baars v Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem ("Baars"),* [2000] ECR I-2787, paragraph 29.

The use of the phrase "nationals of Member States residing on its territory" is interesting because of the relationship between host and origin States. In relation to its nationals, clearly the Member State's rules are origin State rules, but from the perspective of nationals of other Member States established in its territory, that same Member State is a host State for such persons normally because they have generally moved from another Member State and established themselves there. If such persons decide to exercise their fundamental freedom rights in another Member State and they are hindered from so doing, the judgment in *Baars* makes it clear that they are entitled also to the same treatment as that Member State's own nationals. This is a clarification of the migrant/non-migrant test rather than an extension because the rules involved from an origin State perspective are usually "exit" rules of one kind or another that hinder, dissuade, deter, discourage, or make less attractive the exercise of a fundamental freedom.[201]

In relation to the free movement of capital, the Court applied the test in cases like *Verkooijen*[202] and in *Manninen.*[203] *In Verkooijen,* a Dutch resident was denied a dividend tax exemption/relief because he received his dividend from a Belgian company and not a Dutch company: the Court applied the test to compare the tax treatment of a Dutch resident who had made an investment in a company established in another Member State (the *migrant* because he exercised his free movement of capital to make an investment another Member State) and who was refused a tax advantage compared to a similar Dutch resident investor who invested capital in a Dutch company (the *non-migrant,* in these circumstances relating to capital movement).

The Court reiterated this thinking in relation to the free movement of capital provisions of the EC Treaty in *Manninen* where a Finnish investor who had invested capital in a Swedish company was denied a tax credit under Finnish rules (the origin State) compared with Finnish investors who invested in Finnish companies, who received the tax credit. Thus, the Finnish resident who invested capital cross-border (the "*Migrant*") was treated differently and generally less favourably (without proportionate justification) than a similar Finnish resident investor who had invested in a Finnish company (the "*Non-migrant*").[204]

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201 Perhaps, a good contrast is seen in *Halliburton* where the closing down of a branch in the Netherlands was seen by the Court as a situation requiring "national treatment" for the Dutch company purchasing the branch of a German company situated in the Netherlands. ECJ, 12 Apr. 1994, Case C-1/93, *Halliburton Services BV v Staatssecretaris van Financiën ("Halliburton"),* [1994] ECR I-1137.

202 ECJ, 6 Jun. 2000, Case C-32/98, *Staatssecretaris van Financiën v B.G.M. Verkooijen, ("Verkooijen"),* [2000] ECR I-4071.

203 ECJ, 7 Sep. 2004, Case C-7477, *Petri Manninen, ("Manninen"),* [2004] ECR I-7477.

204 Generally less favourably in situations where the economic double taxation was relieved in a domestic situation but not in a cross-border one. Should the economic double taxation be taken care of in the Member State in which the dividend arises, then the residence Member State would not be required to grant the tax credit cross-border.

Finally, the Court has also applied the *migrant/non-migrant* test in the area of EU citizenship rights. In *Pusa*, a Finnish resident left his origin-State to reside in Spain. In doing so, he fell foul of Finnish tax rules that failed to properly take into account the fact that he was paying tax also in Spain on his pension. The Court stated that

> "it would be incompatible with the right of freedom of movement were a citizen, in the Member State of which he is a national, to receive treatment less favourable than he would enjoy if he had not availed himself of the opportunities offered by the Treaty in relation to freedom of movement".[205]

Furthermore the Court went on to point out that

> "National legislation which places at a disadvantage certain of its nationals simply because they have exercised their freedom to move and to reside in another Member State would give rise to inequality of treatment, contrary to the principles which underpin the status of citizen of the Union, that is, the guarantee of the same treatment in law in the exercise of the citizen's freedom to move".[206]

In other words, a Finnish resident who has exercised his EU citizenship rights of movement to move to another Member State cannot be treated worse than a Finnish resident (in a similar situation) who stays in Finland unless some justification is shown that is proportionate. Thus, in *Pusa*, the Court extended the test into the sphere of EU citizenship rights and direct taxation matters.

More recently, the test has been applied in relation to "exit" taxes in the *N case*[207] and in *De Lasteyrie du Saillant;*[208] in *Marks and Spencer*[209] in relation to establishment and cross-border loss relief rules; in *Keller Holding*[210] in relation to

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205 ECJ, 29 Apr. 2004, Case C-224/02, *Heikki Antero Pusa v Osuuspankkien Keskinäinen Vakuutusyhtiö ("Pusa"),* [2004] ECR I-5763, paragraph 18.

206 *Pusa,* paragraph 20.

207 See the excellent discussion in Bert Zuijdendorp, "*The N case: the European Court of Justice sheds further light on the admissibility of exit taxes but still leaves some questions unanswered"* (2007) EC Tax Review, 16, 5-12

208 ECJ, 11 Mar. 2004, Case C-9/02, *Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie ("De Lasteyrie du Saillant),* [2004] ECR I-2409, paragraph 46.

209 ECJ, 13 Dec. 2005, Case C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes), ("Marks and Spencer"),* [2005] ECR I-10837, paragraphs 33-34.

210 ECJ, 23 Feb. 2006, Case C-471/04, *Finanzamt Offenbach am Main-Land v Keller Holding GmbH, ("Keller Holding"),* [2006] ECR I-2107, paragraphs 33-34. *Keller Holding* is a very clear example of the relevant comparator – both parent companies involved in the comparison received dividends from their indirect subsidiary on a "tax-free" basis (although via slightly different routes); but it was only the parent company which had exercised its right

the establishment of indirect subsidiaries, finance expenses and double tax conventions; in *Cadbury Schweppes*, [211] in relation to establishment and the United Kingdom's CFC rules and in *Cartesio* in relation to establishment and Hungarian company law rules which prevented companies from moving their real seats to another Member State.[212]

Host Member State situations

From a host State perspective, the Migrant/non-migrant or National treatment test has been applied by the Court consistently across both the freedoms and EU citizenship situations. Thus, in *Schumacker*,[213] the Court examined "comparability" between residents and non-residents in the context of a Belgium resident who worked in Germany where he earned the major part of his income. As the Belgo-German double tax convention exempted income of Belgian residents that was earned abroad, Schumacker had no taxable income in his residence-State.[214]

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of establishment that was disadvantaged when it came to the deduction of expenses related to the indirect subsidiary. The cross-border investment was denied a deduction in circumstances where both parent companies were in a comparable situation – a parent company establishing an indirect subsidiary in another Member State (the "migrant") might be deterred from establishing such an indirect subsidiary in other Member States because establishment in the origin State ("Non-migrant") would have attracted a tax deduction/advantage denied to it because its activity took place cross-border. The judgments in *Keller Holding* and *Cadbury Schweppes* demonstrate that post-*Marks and Spencer*, the case law of the Court in relation to origin-State situations has not changed and the "Migrant/Non-migrant Test"/ "National Treatment" test holds good. ECJ, 12 Sep. 2006, Case C-196/04, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue ("Cadbury Schweppes"),* [2006] ECR I-7995.

211 For an excellent discussion of the United Kingdom's CFC rules post Cadbury Schweppes, see Simon Whitehead, "*Practical implications arising from the European Court's recent decisions concerning CFC legislation and dividend taxation",* (2007) EC Tax Review, 16, 176-183; and Philip Baker, "*Are the 2006 amendments to the CFC legislation compatible with Community law?*" (2007) BTR, 1, 1-6.

212 ECJ, 16 Dec. 2008, Case C-210/06, *CARTESIO Oktató és Szolgáltató bt ("Cartesio"),* [2008] ECR I-0000 (not yet reported).

213 ECJ, 14 Feb. 1995, Case C-279/93, *Finanzamt Köln-Altstadt v Roland Schumacker ("Schumacker"),* [1995] ECR I-0225.

214 This begs the question what if Belgium had operated the ordinary credit method for the relief of double taxation. In such a case, the income earned in Germany would be included in the Belgian tax assessment and a credit would be granted for the German taxes. If the German taxes were higher, the tax credit would be limited to the Belgian taxes on the income and the taxpayer would have no taxable income. In such circumstances, it might be argued that the discriminatory tax treatment was not resolved because no personal allowances may have been granted in the taxpayer's residence Member State. If the German taxes were lower than the Belgian taxes, the tax credit for the lower taxes would leave taxable income in Belgium. It would then have to be assessed whether this taxable income was sufficient to ensure that personal and family circumstances were taken into account in Belgium. For a discussion of these issues see John F. Avery-Jones, *"Carry on discriminating",* (1996) European Taxation

Consequently, there was "no objective difference"[215] between Schumacker and a German resident carrying on the same employment. Accordingly, the Court held that it was discriminatory for Germany, in such a case, not to grant him personal allowances which were restricted to German residents, because Schumacker, like most German residents, earned almost all his family income in Germany, the source State. The State of residence could not "take account of the taxpayer's personal and family circumstances because *the tax payable there* was insufficient to enable it to do so".[216] Therefore, the Court determined that the principle of equal treatment required that

> "in the State of employment, the personal and family circumstances of a foreign non-resident be taken into account in the same way as those of resident nationals and that the same tax benefits should be granted to him".[217]

Thus, the Court examined the situation of the *migrant*, Schumacker, the non-resident exercising his free movement of worker rights in Germany, and compared his situation with that of a *non-migrant*, a German resident worker carrying on a similar employment in Germany. As Schumacher was in a comparable situation, he had to receive similar tax treatment in Germany.

The Court's approach in *Schumacker* may be contrasted with *Gschwind,*[218] where the non-resident seemed to be in a similar situation to *Schumacker* except Gschwind's income in the source State (Germany) represented only 58% of his family's total income. The Court noted that for tax purposes residence "is the connecting factor on which international tax law, in particular" the OECD Model

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46; John F. Avery-Jones, *"What is the difference between Schumacker and Gschwind?"* B.T.R. 2000, 4, 195-197 and John F. Avery-Jones, *"What is the difference between Schumacker and Gilly?"* B.T.R. 1999, 1, 11-14.

215 If there were an "objective difference" in situation, then Germany would be entitled to treat the resident and the non-resident differently without causing discrimination. However, it would still have to be assessed whether such treatment amounted to a restriction. See, for example, *Futura* where the Court found that there was no discrimination but went on to find a restriction; and *Truck Center*, where the Court found that there was an objective difference in situation, and therefore, no discrimination, and went on to find that there was no restriction. ECJ, 14 Feb. 1995, Case C-279/93, *Finanzamt Köln-Altstadt v Roland Schumacker ("Schumacker"),* [1995] ECR I-0225, paragraph 37; ECJ, 15 May 1997, Case C-250/95*, Futura Participations SA and Singer v Administration des contributions, ("Futura"),* [1997] ECR I-2471; and ECJ, 28 Dec. 2008, Case C-282/07, *Belgian State - SPF Finances v Truck Center SA, ("Truck Center"),* [2008] ECR I-0000 (not yet reported).

216 *Schumacker,* paragraph 41 (emphasis added).

217 *Schumacker*, paragraph 41.

218 ECJ, 14 Sep. 1999, C-391/97, *Frans Gschwind v Finanzamt Aachen-Außenstadt, ("Gschwind"),* [1999] ECR I-5451.

Tax Convention, "is normally founded in order to allocate powers of taxation between States involving extraneous elements".[219] Next, it conducted a comparability analysis and found that as 42% of the family's total income was received in the residence State (Netherlands), the residence State could take into account the personal and family circumstances of the Gschwind family because the "tax base[220] is sufficient there to enable them to be taken into account".[221] Consequently, the Court distinguished *Schumacker* and found that the situation of the non-resident was not comparable to that of a German resident for the purposes of the application of the German tax rules because the Gschwinds were able to obtain their personal allowances in the Netherlands. The comparability analysis of the resident and the non-resident revealed that there was an objective difference in their situation which entitled the Member State in question to apply the different tax treatment. Therefore, Germany was not obliged to grant the personal allowances in contrast to the *Schumacker* situation.

This investigation of the Court's jurisprudence has determined that the Court has conducted similar resident/non-resident (migrant/non-migrant) comparability assessments in relation to host Member State situations involving all the other fundamental freedoms, including EU citizenship situations.

Thus, in *Asscher*,[222] where freedom of establishment was at stake, Dutch rules imposed a higher rate of tax on a Dutch non-resident (Belgian resident) than on a Dutch resident. The higher rate was imposed in order to offset the fact that certain non-residents escaped the progressive nature of the tax.[223] However, the Netherlands failed to take into account the effect of the Netherlands-Belgium double tax convention, which provided for an "exemption with progression" mechanism for the relief of double taxation. The consequence was that in relation to the rule of

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219 *Gschwind,* paragraph 24.

220 In its later *Wallentin* judgment, Wallentin did not have taxable income in his residence State as the monthly allowance received from his parents and the German State grant did not amount to taxable income in Germany. Consequently, Germany, his State of residence, could not take his personal and family circumstances into account because there was no liability for tax there. Thus, Wallentin's employment State (Sweden) had to grant the personal allowance: such an allowance would not give him a fiscal advantage because he had no liability to tax in his residence State entitling him to a similar personal allowance in Germany. The determining criterion appears to be the availability of taxable income in the State of residence. *Wallentin* paragraphs 18, 21 and 23. See also *Meindl.* ECJ, 1 Jul. 2004, Case C-169/03, *Florian W. Wallentin v Riksskatteverket ("Wallentin"),* [2004] ECR I-6443, and ECJ, 25 Jan. 2007, Case C-329/05, *Finanzamt Dinslaken v Gerold Meindl ("Meindl"),* [2007] ECR I-1107.

221 *Gschwind,* paragraph 29.

222 ECJ, 27 Jun. 1996, Case C-107/94, *P. H. Asscher v Staatssecretaris van Financiën ("Asscher"),* [1996] ECR I-3089.

223 *Asscher,* paragraph 46.

progressivity "[b]oth categories of taxpayers are therefore in comparable situations with regard to that rule".[224] Accordingly, the different treatment had to be justified. In this situation the Court applied the migrant/non-migrant test, comparing the *migrant*, Asscher, the person exercising the freedom of establishment in the host Member State who was disadvantaged by the host State tax rule, with the tax treatment of a comparable Dutch resident carrying on a similar activity and not disadvantaged by the tax rule in question.

Similarly, in the freedom to provide services area, a non-resident has been found to be comparable to a resident in certain circumstances. In *Gerritse*,[225] a Dutch resident who performed services in Germany was subjected to a 25% withholding tax on a gross income basis with no deduction for his business expenses, whereas a German resident providing similar services was taxed on net income after deduction of business expenses. According to the German Government, the German rules existed because residents and non-residents were taxed differently: residents were taxed on worldwide income whilst non-residents were taxed on German source income. The *Gerritse* case thus generated two key issues: (i) whether non-residents were entitled to have their business expenses deducted in determining taxable income in the same way as residents; and (ii) whether non-residents were entitled to be taxed in a similar way to residents rather than having to suffer a withholding tax of 25%. The Court noted in relation to (i), that such business expenses were

> "directly linked to the activity that generated the taxable income in Germany, so that residents and non-residents are placed in a comparable situation in that respect".[226]

Consequently, the German rules operated mainly to the detriment of nationals of other Member States and were indirectly discriminatory contrary to the freedom to provide services provisions.[227] The *migrant*, therefore, was treated less favourably by the host State tax rule than a comparable resident service provider (the *non-migrant*).

In relation to (ii), the Court accepted that, generally, residents and non-residents were not comparable. [228] However, it went on to analyse whether there was an objective difference in situation between residents and non-residents to justify the

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224 *Asscher,* paragraph 48.

225 ECJ, 12 Jun. 2003, Case C-234/01, *Arnoud Gerritse v Finanzamt Neukölln-Nord ("Gerritse"),* [2003] ECR I-5933.

226 *Gerritse,* paragraph 27.

227 *Gerritse,* paragraph 28. See also ECJ, 15 Feb. 2007, Case C-345/04, *Centro Equestre da Lezíria Grande Lda v Bundesamt für Finanzen, ("Centro Equestre"),* [2007] ECR I-1425.

228 *Gerritse,* paragraph 43.

German rules imposing a definitive 25% withholding tax on non-residents and taxing the income of German residents according to progressive rates including a tax-free allowance.[229] In coming to its answer, the Court took into account (a) the fact that Gerritse was entitled to a personal allowance in the Netherlands and (b) that the German-Netherlands double tax convention applied an exemption with progression method for the relief of double taxation and consequently, the Netherlands did take the German income into account for the purposes of progressivity. Thus, the Court found that "with regard to the progressivity rule non-residents and residents are in a comparable situation".[230]

Accordingly, the Court applied the test to determine that the *migrant* (Gerritse, who had exercised the freedom to provide services) and the *non-migrant*" (a German resident providing similar services in Germany) were in a comparable situation in respect to the business expenses that were directly linked to the provision of services.

In the free movement of capital arena, the Court similarly has found comparability between residents and non-residents. In *Bouanich*,[231] the Swedish-French double tax convention came into play when Swedish-resident shareholders were treated differently to French-resident shareholders in the same Swedish company. Bouanich, a French resident, had her shares repurchased by the Swedish company. The payment she received was treated as a dividend under the double tax convention, taxed at the rate of 15%, and she was allowed to deduct only the nominal value of the shares. A Swedish resident receiving a similar payment was taxed on a capital gains' basis at the rate of 30%, but was allowed to deduct the acquisition cost of the shares.

The Court checked to see if a resident and a non-resident investor in the Swedish company were in a comparable situation and determined that as the "cost of acquisition is directly linked to the payment made on the occasion of a share repurchase";[232] there was no objective difference between a resident and a non-resident investor in the company. The existence of the Swedish-French double tax convention was significant however, as the dividend treatment of the non-resident under the double tax convention might be more favourable than the capital gains

229 *Gerritse,* paragraph 47.

230 *Gerritse,* paragraph 53. To compare comparable situations, the Court referred the matter back to the national court to determine whether the 25% withholding tax was greater than that which would follow from the application of the progressive rate table in Germany. In other words, were the German progressive rates applied to the net-income earned in Germany plus the German personal allowance higher than 25%.

231 ECJ, 19 Jan. 2006, Case C-265/04, *Margaretha Bouanich v Skatteverket, ("Bouanich"),* [2006] ECR I-0923.

232 *Bouanich,* paragraph 40

treatment of the resident. The national treatment principle required that the non-resident be treated no less favourably[233] than the resident in a comparable situation. Accordingly, the treatment of the non-resident under the double tax convention who exercised her free movement of capital rights (the *migrant*) had to be examined and compared with the capital gains treatment of the comparable resident in Sweden (the *non-migrant*).[234]

Lastly, in relation to EU citizenship rights, in *Martinez-Sala,*[235] the Court examined the situation of a Spanish national who had worked in Germany for a number of years and had been authorised to reside there. However, when she applied for a child-raising allowance after the birth of her child, she was denied the allowance on the ground that she did not have a formal residence permit. The ECJ held that she was a national of a Member State lawfully residing in the territory of another Member State. Accordingly, she was entitled "not to suffer discrimination on grounds of nationality".[236] As Germany did not require its own nationals to produce a residence permit in order to obtain the allowance in question, it could not stipulate that Martinez-Sala had to produce such a document in order to qualify for the advantage. In other words, the German rules at issue favoured their own nationals to the detriment of nationals of other Member States who had exercised their EU citizenship right to reside in Germany. Thus, the Court applied the migrant/non-migrant test and compared the treatment of the person (Spanish national) who exercised the right of EU citizens to move and reside in the host Member State (Germany) and was treated less favourably than comparable German nationals.
The "migrant/non-migrant" test, therefore, applies across all the fundamental freedoms and in relation to EU citizenship situations and from the perspective of both host and origin Member States. The test is an important analytical tool for analysing the Court's jurisprudence in the tax area. It helps demonstrate the role that double tax conventions play in the regulatory framework for tax in the EU and for ascertaining the correct comparator in order to determine whether there is discrimination occurring or whether a Member State's tax rule constitutes a restriction or obstacle on the fundamental freedoms or EU citizenship rights. This investigation also revealed the consistency of the ECJ in direct taxation matters given that the same test is applied in relation to each of the fundamental freedoms from both an origin and a host Member State perspective. This is contrary to the views of most academic writers who generally argue that the Court's jurisprudence is incoherent, misleading, contradictive, inaccurate, and even unconvincing. This investigation of the Court's jurisprudence in the area of direct taxes and double tax

233 *Bouanich,* paragraph 53.

234 This assessment had to be carried out by the referring court and accordingly, the case was referred back to it for this assessment to be carried out.

235 ECJ, 12 May 1998, Case C-85/96, *María Martínez Sala v Freistaat Bayern ("Martinez-Sala"),* [1998] ECR I-2691.

236 See *Martinez-Sala,* paragraph 62.

conventions suggests that such writers may need to adjust their opinions.

The next section examines Article 293 EC and the elimination of double taxation within the EU.

Article 293 EC: Abolition of double taxation within the Community[237]

Article 293 EC Treaty provides (*inter alia*) that

> "Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals (…) the abolition of double taxation within the Community".[238]

In *Gilly*,[239] the Court declared that Article 293 EC was not directly applicable[240] but merely defined a number of matters on which the Member States were obliged to enter into negotiations with each other "so far as is necessary". The Court went on to say that the abolition of double taxation within the Community was an objective of any such negotiations and of the Community.[241] The ECJ noted: "(…) it cannot itself confer any rights on individuals on which they might be able to rely before their national courts".[242] Consequently, although this provision of the EC Treaty does not have direct effect, it does generate an objective of the Community. Other provisions of the EC Treaty which confer individual rights, such as the fundamental freedoms, therefore, must be interpreted in the light of the objective contained in Article 293 EC.[243]

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237 Editor's note: Article 293 EC has been repealed by the Lisbon Treaty.

238 Article 293 EC, second indent.

239 ECJ, 12 May 1998, Case C-336/96, *Mr and Mrs Robert Gilly v Directeur des services fiscaux du Bas-Rhin ("Gilly"),* [1998] ECR I-2793.

240 The Court noted in paragraph 11 of its judgment in *Mutsch* that, "It must be pointed out that Article 220, which was mentioned in the question submitted by the cour d ' appel, is not intended to lay down a legal rule directly applicable as such, but merely defines a number of matters on which the Member States are to enter into negotiations with each other ' so far as is necessary '. Its only effect is to define as an objective the extension by each Member State to the nationals of the other Member States of the relevant guarantees accorded by it to its own nationals". Article 220 is now Article 293 EC Treaty. ECJ, 11 Jul. 1985, Case 137/84, *Criminal proceedings against Robert Heinrich Maria Mutsch, ("Mutsch),* [1985] ECR 2681.

241 *Gilly,* paragraphs 15-16.

242 *Gilly,* paragraph 15, upholding its approach in *Mutsch* paragraph 11.

243 In *Baten* paragraph 44, the Advocate General observed that it was "very difficult to contest the 'Community' nature of the Convention" when considering the nature of the Brussels Convention and Regulation 1408/71. He added that the need to interpret the Convention in tandem with the Court's case law and secondary legislation was "clearly warranted by the link established between the Convention and the Community legal order by article 220 of the

The Court's understanding of the concept of "double taxation" is seen from its *Gilly* judgment where it pointed out that the object of a double tax convention was to simply "prevent the same income from being taxed in each of the two States party to the convention. It is not to ensure that the tax to which the taxpayer is subject in one State is no higher than that to which he or she would be subject in the other". Consequently, as long as taxation in one of the double tax convention States is relieved that is sufficient in the Court's eyes to relieve the double taxation.

Clearly, the concept of double taxation in Article 293 EC, second indent, goes beyond the scope of the concept contained in a double tax convention as the reference to double taxation clearly covers all types of double taxation, not simply the juridical[244] and economic[245] double taxation concepts encountered in double tax conventions. Under the EC Treaty, double taxation is simply another barrier to trade, investment and free movement of persons, in whatever form it manifests itself [246] and, therefore, the abolition of double taxation within the Community is seen as an essential Community objective.[247] The Member States are obliged to enter into negotiations "so far as is necessary" to achieve this objective.[248]

EC Treaty (now article 293 EC)". Moreover, in *SISO,* paragraph 39, the Court confirmed that the "principle of legal certainty in the Community legal system and the objectives of the Convention in accordance with Article 220 of the EEC Treaty, which is at its origin, require a uniform application in all Contracting States of the Convention rules and the relevant case-law of the Court". See ECJ, 14 Nov. 2002, Case C-271/00, *Gemeente Steenbergen v Luc Baten, ("Baten"),* [2002] ECR I-10489, and ECJ, 11 Aug. 1995, Case C-432/93, *Société d'Informatique Service Réalisation Organisation v Ampersand Software BV ("SISO"),* [1995] ECR I-2269.

244 For instance, the taxation of the same person by two different States.

245 For example, the taxation of the same income stream by two different States.

246 Double taxation may occur in cases concerning road transport, vehicle registration, VAT, inheritances, and document or stamp taxes to name just a few. Whilst such taxes may be covered by the non-discrimination provision of a double tax convention (which usually covers all taxes) they would not otherwise be covered by double tax conventions concluded by the Member States relating to capital and income.

247 For example, ECJ, 12 May 1998, Case C-336/96, *Mr and Mrs Robert Gilly v Directeur des services fiscaux du Bas-Rhin ("Gilly"),* [1998] ECR I-2793, paragraphs 16 and 23.

248 To date, the Member States have entered into one multilateral convention in pursuance of the objective contained in Article 293 EC second indent – the Arbitration Convention (90/436/EEC), which deals with transfer pricing disputes involving associated enterprises in different Member States, together with a Code of Conduct for its effective implementation (OJ C176/02). The Code of Conduct is a political agreement and does not affect the Member States' rights and obligations or the respective spheres of competence of the Member States and the Community. See:
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:176:0008:0012:EN:PDF (last visited 15 September 2009). See also a proposal to revise the Code of Conduct put forward by the Commission on the 14 September 2009 in COM(2009) 472 final available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/transfer_pricing/COM(2009)472_en.pdf (last visited 15 September 2009).

However, it appears clear from the Court's case law that distortions caused by the non-elimination of juridical double taxation (seen in *Kerckhaert-Morres*[249] and *Damseaux*,[250] for instance) are, in the absence of harmonised rules at the Community level, acceptable to the Court under the current regulatory framework for tax in the EU. Such distortions are no different from the distortions caused by the different rates of tax charged in each individual Member State. As competence in relation to such matters remains with the Member States, in the absence of double tax convention rules dealing with the problem of double taxation or harmonised Community law rules, such distortions remain. Here, it is important to note that this is a two-State problem, caused by the differences between the tax rules of two Member States. This differs from the double taxation caused by the rules of one Member State (as seen in *Denkavit Internationaal*[251] or *Amurta*[252]) where the economic double taxation at issue was generated by the tax rules of a single Member State rather than by the rules of two Member States. Thus, in *Amurta*, the Court pointed out that

> "Clearly, the economic double taxation, to which dividends distributed to companies not established in the Netherlands are subject, stems solely from the exercise by the Kingdom of the Netherlands of its taxing powers, which subject those dividends to dividend tax, whereas that Member State elected to prevent such economic double taxation in respect of recipient companies with their seat in the Netherlands or having a permanent establishment there which owns the shares in the company making the distribution".[253]

In relation to the meaning of the words "so far as is necessary", the Court has not had the opportunity to interpret[254] that phrase in relation to the second indent of

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249 ECJ, 14 Nov. 2006, Case C-513/04, *Mark Kerckhaert and Bernadette Morres v Belgische Staat ("Kerckhaert-Morres"),* [2006] ECR I-10967.

250 ECJ, 16 Jul. 2009, Case C-128/08, *Jacques Damseaux v Belgian State ("Damseaux"),* [2009] ECR I-0000 (not yet reported).

251 ECJ, 14 Dec. 2006, Case C-170/05, *Denkavit Internationaal BV, Denkavit France SARL v Ministre de l'Économie, des Finances et de l'Industrie, ("Denkavit Internationaal"),* [2006] ECR I-11949.

252 ECJ, 8 Nov. 2007, Case C-379/05, *Amurta SGPS v Inspecteur van de Belastingdienst/Amsterda, ("Amurta")* [2007] ECR I-9569.

253 *Amurta,* paragraph 40.

254 In relation to the Brussels Convention, the Court has noted that it must be interpreted "having regard both to its principle and objectives and to its relationship with the Treaty". *Industrie Tessili Italiana Como v Dunlop AG* paragraph 9. See also the Court's comments in *Krombach v Bamberski* paragraph 20, concerning the "uniform application in all Contracting States of the Convention rules". ECJ, 6 Oct. 1976, Case 12/76, *Industrie Tessili Italiana Como v Dunlop AG,* [1976] ECR 1473, and ECJ, 28 Mar. 2000, Case C-7/98, *Dieter Krombach v André Bamberski,* [2000] ECR I-1935.

Article 293 EC. However, in *Überseering*,[255] concerning the third indent of Article 293 EC which relates to the "mutual recognition of companies", the Court said that it did not see Article 293 EC as a "reservoir of legislative competence vested in the Member States".[256] The Court stated:

> "Although Article 293 EC gives Member States the opportunity to enter into negotiations with a view, inter alia, to facilitating (…) the mutual recognition of companies (…) it does so solely 'so far as is necessary', that is to say if the provisions of the Treaty do not enable its objectives to be attained".[257]

Applying this statement in an Article 293 EC "second indent" context, means that the Community and the Member States have a responsibility for abolishing double taxation within the Community, because it is an obstacle to the fundamental freedoms. However, in the event of the Community being unable to achieve this objective, the Member States are under a Community obligation to enter into negotiations to secure the benefit of the elimination of this obstacle for the benefit of their nationals within the Community.

The two main reasons why the Community might be unable to act are (a) it lacks the necessary competence and (b) legislative measures cannot be adopted because of insufficient votes[258] in the Council of Ministers. Clearly, the Community has the competence to take "appropriate measures"[259] to achieve a Community objective, but as Article 293 EC is not a competence granting provision, any Community action would fall under another legal base read in conjunction with Article 293 EC.[260] Therefore, the Member States are placed under an obligation to negotiate in good faith to deal with the problem of double taxation in situations where the Community has not (or cannot) take action. One might argue that this imposes a

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255 ECJ, 5 Nov. 2002, Case C-208/00, *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC) ("Uberseering"),* [2002] ECR I-9919.

256 *Uberseering,* paragraph 54. The Advocate General in *Uberseering* saw it as an "admonition to Member States" to overcome the problems arising from the lack of mutual recognition of companies.

257 *Uberseering,* paragraph 54.

258 Unanimity is required for the adoption of direct taxation measures under Articles 94 EC or 308 EC.

259 For instance, Article 308 EC.

260 For example, *Mund and Fester* paragraph 22, where the Court read the obligation under Article 7 EEC (now Article 12 EC) of non-discrimination on grounds of nationality in conjunction with Article 220 EEC (now Article 293 EC) and the Brussels Convention. ECJ, 10 Feb. 1994, Case C-398/92, *Mund & Fester v Hatrex Internationaal Transport, ("Mund and Fester"),* [1994] ECR I-0467.

"positive" obligation on the part of the Member States pursuant to Article 10 EC read in conjunction with Article 293 EC. This is emphasised by the use of the word "shall" in Article 293 EC. Thus, when double taxation occurs because of the actions of one Member State, it becomes that Member State's responsibility to deal with the problem in a cross-border setting if it deals with it domestically. This is evident from the Court's case law (seen in *ACT IV GLO*,[261] *Denkavit Internationaal* and *Amurta*) on dividends where the Court plays a "negative harmonisation" role in relation to the abolition of double taxation within the Community when it interprets the freedoms.[262]

Thus, in some situations, double taxation may represent an obstacle to the exercise of a fundamental freedom. This is clear from the Court's *FII GLO* judgment[263] where the United Kingdom's tax treatment of foreign-sourced dividends received by United Kingdom residents was less favourable than its treatment of dividends received from United Kingdom sources. The Court noted that Member States can use a variety of systems (credit mechanism, exemption method, etc.) to eliminate or reduce the problem of double taxation, or a series of charges to tax on distributed profits and that these choices do not necessarily lead to the same result.[264] However, in establishing a system for the relief of double taxation, the Member States must still comply with Community Law.[265] A further example is seen in *Denkavit Internationaal*, where the Court stated that

> "as soon as a Member State, either unilaterally or by way of a convention, imposes a charge to tax on the income, not only of resident shareholders, but also of non-resident shareholders, from dividends which they receive from a resident company, the situation of those non-resident shareholders becomes comparable to that of resident shareholders".[266]

Thus, the extended tax jurisdiction of a residence Member State over dividends received from foreign sources under a double tax convention (or unilaterally

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261 ECJ, 12 Dec. 2006, Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v Commissioners of Inland Revenue, ("ACT IV GLO"),* [2006] ECR I-11673.

262 *ACT IV GLO,* paragraph 70.

263 ECJ, 12 Dec. 2006, Case C-446/04, *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue, ("FII GLO"),* [2006] ECR I-11753.

264 *FII* GLO paragraph 43. For a more in-depth analysis of the Court's judgment in *FII GLO* see: Tom O'Shea, "*Dividend Taxation Post-Manninen: Shifting Sands or Solid Foundations?"* (2007) Tax Notes International*,* March 5,887-918 at 889.

265 *FII GLO* paragraphs 45-47. See also *Denkavit Internationaal,* paragraph 44.

266 ECJ, 14 Dec. 2006, Case C-170/05, *Denkavit Internationaal BV, Denkavit France SARL v Ministre de l'Économie, des Finances et de l'Industrie, ("Denkavit Internationaal"),* [2006] ECR I-11949, paragraph 35.

through domestic legislation) triggers comparability of residents with foreign-sourced dividends to those with domestic-sourced dividends, and, therefore, such residents with foreign dividend income are entitled to no less favourable treatment in the residence Member State. The Court pointed out that

> "since the French Republic has chosen to relieve its residents of such a liability to tax, it must extend that relief to non-residents to the extent to which an imposition of that kind on those non-residents results from the exercise of its tax jurisdiction over them".[267]

In *Denkavit Internationaal*, the residence Member State (France) had argued that the French-Netherlands double tax convention ensured equal treatment by providing for a credit of the French withholding taxes against Dutch taxes on the French dividend income (even though the Netherlands exempted such French income and accordingly, no credit was available in the Netherlands for the French withholding taxes). The Court noted this fact and determined that

> "The combined application of the Franco-Netherlands Convention and the relevant Netherlands legislation does not serve to avoid the imposition of a series of charges to tax to which, unlike a resident parent company, a non-resident parent company is subject and, accordingly, does not serve to overcome the effects of the restriction on freedom of establishment".[268]

Consequently, the French withholding taxes were incompatible with the freedom of establishment.

To conclude, Article 293 EC provides another objective of the Community in addition to those contained in Articles 2 EC and 3 EC. The significance is that all other provisions of Community law must be interpreted in the light of this objective. Although the provision lacks direct effect and consequently impacts little on double tax conventions in its own right, the provision makes it clear that double taxation is another obstacle which Member States must take into account when designing their double tax conventions and accordingly, in situations where a series of charges are imposed on an income stream by one Member State, that Member State may be obliged to provide relief for double taxation caused by it in a cross-border situation where it taxes the non-resident recipient of such dividends and where it provides relief in a domestic setting. As the Member States have put in place a comprehensive network of double tax conventions, it might be argued that the objective of Article 293 EC has been achieved. This may explain why Article 293 EC does not appear in the Treaty on the Functioning of the European Union.

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267 *Denkavit Internationaal,* paragraph 37.

268 *Denkavit Internationaal*, paragraph 54.

The next section concludes with an investigation of the obligations imposed on the Member States in relation to international agreements entered into by Member States prior to accession to the EU. These are termed "pre-EU agreements".

Pre-EU Agreements and double tax conventions

Article 307 EC concerns pre-EU international agreements, including double tax conventions, entered into by Member States with non-member countries prior to the establishment of the EU, or prior to their accession.

Article 307 EC provides for the setting aside of EU law in certain circumstances: (a) the agreement must have been entered into between the Member State and a non-Member country prior to 1 January 1958, or prior to the accession by the Member State to the EU; (b) the Member State must be under an international law obligation to the non-Member country; that means the non-Member country must have a "right" under[269] the international agreement; and (c) the non-Member country must be able to demand performance of its right by the Member State.

This setting-aside of the Member State's EU law obligations is a transitional measure designed to ensure that "rights and obligations under an agreement concluded between a Member State and a non-member country before the date of accession of that Member State are not affected by the Treaty provisions".[270] In other words, the application of the EC Treaty "does not affect the duty of the Member State concerned to respect the rights of non-member countries under an earlier agreement and to perform its obligations thereunder".[271]

However, the Member State is under the obligation set out in the second paragraph of Article 307 EC to eliminate any such incompatibilities, by amending or terminating the agreement.[272] Significantly, all the other Member States are under a

269 For instance, see *Budvar* paragraphs 149 and 162 where the Court examined a pre-Community agreement of Austria with Czechoslovakia. The question arose as to whether the Czech Republic acquired rights under this international agreement of its predecessor State which it could require Austria to respect. ECJ, 18 Nov. 2003, Case C-216/01, *Budéjovický Budvar, národní podnik v Rudolf Ammersin GmbH , ("Budvar*"), [2003] ECR I-13617.

270 *Budvar,* paragraph 144.

271 *Budvar,* paragraph 145.

272 ECJ, 4 Jul. 2000, Case C-62/98, *Commission v Portugal* [2000] ECR I-5171, where the Court was faced with a number of international agreements entered into by Portugal prior to its accession to the Community relating to maritime shipping services. The Community had adopted Regulation 4055/86 and Portugal had renegotiated two of the incompatible agreements in order to comply with the Commission's request, but had failed to have its agreement with Angola amended.

duty to assist and to adopt a common approach if necessary.[273] This was made clear by the Court in *Matteucci,* where the Court noted that if

> "a provision of Community law is liable to be impeded by a (…) bilateral [cultural] agreement, even where the agreement falls outside the field of application of the Treaty, every Member State is under a duty to facilitate application of that provision and, to that end, to assist every other Member State which is under an obligation under Community law".[274]

Pre-EU double tax conventions between Member States and non-member countries qualify for Article 307 EC treatment if they fall within the criteria mentioned above. If they contain provisions incompatible with EU law, then, such double tax conventions have to be amended or denounced. The ECJ has made it clear in Gottardo[275] that all international agreements, between Member States and other Member States, [276] and between Member States and non-member countries, must comply with EU law obligations unless Article 307 EC applies.[277] This signifies that all double tax conventions entered into by the Member States must comply with EU law. The ECJ has confirmed that EU law is supreme but is obviously in some difficulties when a Member State has entered into a binding international agreement with a non-member country, under which it has assumed certain obligations and granted the certain rights to that non-member country. The fact that non-member countries are not required to comply with EU law is not of any relevance.[278]

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273 ECJ, 27 Sep. 1998, Case 235/87, *Annunziata Matteucci v Communauté française of Belgium and Commissariat général aux relations internationales of the Communauté française of Belgium, ("Matteucci"),* [1998] ECR 5589, paragraph 19.

274 *Matteucci,* paragraph 19 and *Gottardo,* paragraph 31. ECJ, 15 Jan. 2002, Case C-55/00, *Elide Gottardo v Istituto nazionale della previdenza sociale (INPS) ("Gottardo"),* [2002] ECR I-0413.

275 *Gottardo,* paragraph 33.

276 See ECJ, 27 Feb. 1962, Case 10/61, *Commission v Italy* [1962] ECR 0001 (English Special Edition), where the ECJ said that "in matters governed by the EEC Treaty, that Treaty takes precedence over agreements concluded between Member States before its entry into force".

277 For a discussion of the issues involving direct taxation, tax conventions and third countries, see: Ana Paula Dourado, Daniel Gutmann, Klaus Vogel, "*Tax treaties between Member States and Third States: 'reciprocity' in bilateral tax treaties and non-discrimination in EC law",* (2006) *EC Tax Review, 15,* 83-94; Martha O'Brien, *"Taxation and the third country dimension of free movement of capital in the EU: the ECJ's rulings and unresolved issues", B.T.R. 2008, 6, 628-666;* Daniel S. Smit*, "The relationship between the free movement of capital and the other EC Treaty freedoms in third country relationships in the field of direct taxation: a question of exclusivity, parallelism or causality?* EC T.R. 2007, 16(6), 252-267.

278 *Gottardo,* paragraph 33.

Article 307 EC strives to balance the EU's interest with that of the Member State concerned and provides the Member State with a right to set aside its EU law obligations for a transitional period so that it may fulfil its obligation under the double tax convention or international agreement. It also allows the Member State the choice of how to render the double tax convention, or international agreement, compatible with EU law. This can be achieved either through negotiation with the non-Member country, leading to the amendment of the relevant provision; or by denouncing or terminating the agreement.[279] Other than this temporary period of adjustment to full compatibility with EU law, double tax conventions of the Member States must be fully compliant with their EU law obligations.[280]

This investigation has revealed that justifications or excuses such as diplomatic reasons for the lack of amendment, or a difficult political situation in the non-Member country, have been put forward by Member States and rejected by the ECJ.[281] The argument that terminating the double tax convention or international agreement with the non-Member country is a "disproportionate disregard of the foreign policy interests of the Member State" compared to the protection of the EU's interest, has also been rejected by the Court.[282] Similarly, the fact that the non-Member country is not obliged to comply with the EU law obligation is of no relevance in this situation[283] because the Member States have already taken on their EU law obligations and are obliged to fulfil them in their entirety.

Arguing that an incompatible double tax convention is necessary for the economic interests of the Contracting Member State is also not acceptable, as the Court has made it clear that the balancing of the interests of the Member States and that of the EU is taken care of by Article 307 EC. This allows the Member State to choose the means of ensuring compatibility of the double tax convention with EU law: amendment or termination.[284] Similarly, arguing that the double tax convention is necessary because the Member State needs the double tax convention to eliminate

279 ECJ, 4 Jul. 2000, Case C-62/98, *Commission v Portugal* [2000] ECR I-5171.

280 For recent examples in relation to bilateral investment treaties and their incompatibility with Article 307 EC, see: ECJ, 3 Mar. 2009, Case C-205/06, *Commission v Austria*, [2009] ECR I-0000 (not yet reported); and ECJ, 3 Mar. 2009, Case C-249/06, *Commission v Sweden*, [2009] ECR I-0000 (not yet reported).

281 *Commission v Portugal,* paragraph 50. The Court had noted earlier, in paragraph 46, that the contested agreement contained a termination clause which expressly enabled the agreement to be denounced. Consequently, if Portugal denounced the agreement, that would not "encroach upon the rights which the Republic of Angola derives from the agreement".

282 ECJ, 4 Jul. 2000, Case C-62/98, *Commission v Portugal* [2000] ECR I-5171.

283 ECJ, 15 Jan. 2002, Case C-55/00, *Elide Gottardo v Istituto nazionale della previdenza sociale (INPS) ("Gottardo"),* [2002] ECR I-0413, paragraph 33.

284 ECJ, 4 Jul. 2000, Case C-62/98, *Commission v Portugal,* [2000] ECR I-5171.

double taxation with the non-Member country is equally unattractive because of the double tax convention's incompatibility with EU law. If a Member State wishes to eliminate double taxation by using its competence in direct tax matters, it must do so in a way, which ensures compliance with EU law, unless it can provide some objective justification for not so doing. Furthermore, economic arguments, such as the need to assist its nationals to reduce or eliminate double taxation, are insufficient.

Article 307 EC does not apply to double tax conventions or to international agreements involving only the Member States. EU law rules and obligations take precedence over such agreements.[285] This includes double tax conventions entered into by "new" Member States,[286] prior to accession, with "old" Member States.[287] Such double tax conventions, post-accession, do not qualify for Article 307 EC treatment. In *Commission v Italy*,[288] the Court confirmed the principle of international law requiring an EU Member State to set aside rights held under an international agreement to the extent necessary to ensure the performance of its EU law obligations:

> "by virtue of the principles of international law, by assuming a new obligation which is incompatible with rights held under a prior treaty a State ipso facto gives up the exercise of these rights to the extent necessary for the performance of its new obligations".[289]

Therefore, the EC Treaty takes precedence over other international treaties subject to the protected rights of non-member countries under Article 307 EC. Incompatibilities between a Member State's double tax conventions (and other pre-EU agreements) with non-member countries and EU law may be avoided if the double tax convention provision can be interpreted in such a way that it complies with international law, and is consistent with EU law. Otherwise, the Member State

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285 ECJ, 15 Jan. 2002, Case C-55/00, *Elide Gottardo v Istituto nazionale della previdenza sociale (INPS) ("Gottardo"),* [2002] ECR I-0413. See also *Deserbais,* where the ECJ concluded that "provided that (…) the rights of non-member countries are not involved, a member state cannot rely on the provisions of a pre-existing convention of that kind in order to justify restrictions on the marketing of products coming from another member state where the marketing thereof is lawful by virtue of the free movement of goods provided for by the Treaty." ECJ, 22 Sep. 1988, Case 286/86, *Ministère public v Gérard Deserbais, ("Deserbais"),* [1988] ECR 4907, paragraph 18.

286 Like Latvia and Lithuania.

287 Like the United Kingdom and Germany.

288 ECJ, 27 Feb. 1962, Case 10/61, *Commission v Italy* [1962] ECR 0001 (English Special Edition), paragraph 16 et seq.

289 ECJ, 27 Feb. 1962, Case 10/61, *Commission v Italy* [1962] ECR 0001 (English Special Edition), Part B of the judgment.

involved will have to amend or terminate the double tax convention as necessary. If the double tax convention "allows" but does not "require", the Member State to adopt a measure which appears to be contrary to EU law, the Member State must refrain from adopting such a measure.[290]

EU law applies to any double tax convention entered into by a Member State with a non-Member country prior to that country's accession to the EU. Any such double tax conventions must be set aside insofar as they contain provisions which are incompatible with EU law.[291] Accession States who entered into international agreements prior to joining the EU have their obligations to non-member countries respected under the Article 307 EC procedure, but any such agreements with other Member States must be set aside to ensure full compliance with their EU law obligations.[292]

National courts have the responsibility of interpreting such agreements and must ascertain whether incompatibility between the double tax convention and the EC Treaty "can be avoided by interpreting that convention, to the extent possible and in compliance with international law, in such a way that it is consistent with Community law".[293] If this is impractical, then the Member State must take the steps necessary "to eliminate any incompatibilities existing between the earlier agreement and the Treaty", terminating the agreement if adjustment is not possible.[294]

If the double tax convention or international agreement is replaced after the Member State has acceded to the EU, Article 307 EC does not apply to the new agreement replacing the pre-EU agreement with the same non-Member country. The Court dealt with this situation in the *Commission v United Kingdom ("Open Skies")* judgment,[295] and was satisfied that Article 307 EC could not apply to the new "Bermuda II" air transport agreement, concluded by the United Kingdom with the

290 ECJ, 28 Mar. 1995, Case C-324/93, *The Queen v Secretary of State for Home Department, ex parte Evans Medical Ltd and Macfarlan Smith Ltd. ("Evans Medical"),* [1995] ECR I-0563.

291 ECJ, 15 Jan. 2002, Case C-55/00, *Elide Gottardo v Istituto nazionale della previdenza sociale (INPS) ("Gottardo"),* [2002] ECR I-0413, paragraph 33.

292 ECJ, 5 Mar. 1996, Joined Cases C-46/93 and C-48/93, *Brasserie du Pêcheur SA v Bundesrepublik Deutschland and The Queen v Secretary of State for Transport, ex parte: Factortame Ltd and others, ("Factortame (No. 3)")* [1996] ECR I-1029 and ECJ, 18 Nov. 2003, Case C-216/01, *Budéjovický Budvar, národní podnik v Rudolf Ammersin GmbH , ("Budvar*"), [2003] ECR I-13617.

293 *Budvar,* paragraph 169.

294 *Budvar,* paragraph 170.

295 See ECJ, 5 Nov. 2002, Case C-466/98, *Commission of the European Communities v United Kingdom of Great Britain and Northern Ireland, ("Commission v United Kingdom -Open Skies"),* [2002] ECR I-9427.

USA to replace an earlier agreement entered into prior to the United Kingdom's accession to the EU.[296]

To conclude, Article 307 EC provides some leeway for the Member States which have pre-EU agreements with non-member countries containing provisions which are incompatible with EU law. However, when such agreements are challenged by the European Commission, the Member State, in the absence of an acceptable justification, must respond by either amending the incompatible provision or by terminating the double tax convention in question.

This review has considered the main EC Treaty provisions which generate EU law obligations for the Member States in the double tax convention area with emphasis on the fundamental freedoms and the principle of "national treatment" and has demonstrated that although competence in relation to direct taxation matters and to the negotiation and conclusion of double tax conventions remains with the Member States, they must still exercise that competence in a way which complies with EU law.

These two categories – compliance and competence – generate most of the issues that appear before the Court in relation to direct taxation, with compliance issues forming the bulk of the Court's jurisprudence. Understanding the variety of situations where compliance issues arise is fundamental to understanding how tax is regulated in an EU framework. The next Part attempts to draw some conclusions from this research and highlights the main issues arising in relation to double tax conventions in an EU context.

Part III: Conclusions

This examination of the compliance obligations of the Member States generates a number of interesting interactions between the EC Treaty and the double tax convention network of the Member States.

(1) Compliance, Competence and Double Tax Convention Issues

The issues concerning the EU and double tax conventions can be broken-down into two main categories: compliance issues (analysed above) and competence issues.[297]

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296 *Commission v United Kingdom -Open Skies,* paragraphs 26-29

297 For an analysis, see: Tom O'Shea, "*Double Tax Conventions and the European Community: Competence Issues", (*forthcoming*).*

A third category, double tax convention issues,[298] is also necessary because specific issues relating to tax conventions must be examined in a different light in an EU context. This is apparent from cases like *Saint-Gobain*[299] which concerned the notion of "resident" for the purposes of a double tax convention. Member States have concluded many double tax conventions with other Member States and with non-member countries on the basis that only a residents of one of the two contracting States will benefit from the advantages of the double tax convention in question because double tax conventions, by their nature, are based on reciprocity and the advantages of the tax convention are usually limited to residents of one of the contracting States.

It is clear from this research that the concept of "resident" needs some further consideration in an EU environment because branches and agencies of companies resident in other Member States may be in a comparable situation to a resident and may thus qualify for national treatment in the Member State of establishment. This reasoning may also apply to individuals who are non-residents of a particular Contracting Member State; if they are in a comparable situation to a resident of that Member State then they may have to receive national treatment in the Member State of employment or establishment.

Furthermore, it seems clear that the notion of "tax avoidance" used by the ECJ in an EU context differs from the concept of "tax avoidance" used by many Member States in their domestic rules and in their double tax conventions. Thus, the idea that a double tax convention can contain a "limitation on benefit" ("LoB") provision based on a "nationality" clause may be perfectly acceptable under international tax law rules and be contained in double tax conventions based on the OECD Model Tax Convention entered into by the EU Member States, but in an EU setting such a "nationality" clause may be incompatible with EU law. On the other hand, it is clear from *ACT IV GLO* that not all limitation on benefit clauses in double tax conventions are incompatible with EU law.

Lastly, the use of a credit mechanism to relieve double taxation in a cross-border context may have to be reviewed in an EU situation because the use of such a mechanism for the relief of double taxation may interact with the EU law obligation to provide no less favourable treatment to EU nationals who are entitled to national treatment in either a host or origin Member State situation. This is apparent from the Court's decision in *FII GLO* where the credit method was used by the United

298 A detailed analysis of these issues goes beyond the scope of this article and is only touched on briefly here because they generate interesting developments in the international tax law arena in situations involving an EU Member State. For a detailed analysis of double tax conventions and Community law see: Tom O'Shea, *"EU Tax Law and Double Tax Conventions",* (London, Avoir Fiscal Ltd., 2008).

299 ECJ, 21 Sep. 1999, Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt, ("Saint-Gobain"),* [1999] ECR I-6161.

Kingdom in a cross-border context but an exemption method was preferred in a purely domestic context. However, from the Court's *Gilly* case, it is clear that there is nothing inherently wrong with using the credit method as a method for relieving double taxation.

(2) The regulatory framework for direct tax and double tax conventions in an EU context

This research demonstrates that in the absence of harmonised rules at the EU level, the double tax conventions of the Member States form a necessary part of the regulatory rules governing the internal market in relation to direct tax matters. Double tax convention rules eliminate or reduce the incidence of double taxation and, consequently, are part of the regulatory framework for direct taxation matters in the EU. Thus, the tax regulatory framework of the EU comprises EU law rules, double tax convention rules and direct tax rules at the Member State level.

One outcome of this research is that in an EU context whenever a Member State concludes a double tax convention, the tax rules contained in that double tax convention form a necessary part of the direct tax rules of the EU and, whilst each double tax convention entered into by a Member State will give different results (generally speaking) depending on the bargain struck with the double tax convention partner, these different rules must be accepted in an internal market where harmonised EU rules have not been adopted at the EU level.

From the Court's jurisprudence, it is apparent that all double tax conventions must comply with EU law, whether they are between two or more Member States, or between a Member State and a non-Member country. Article 307 EC provides only limited relief in relation to double tax conventions concluded by Member States with non-member countries prior to accession, and even that safeguard is temporary and transitional in nature because all such double tax conventions must be made compatible with EU law through an appropriate amendment or by termination.

(3) Limits placed on the Member States when they conclude double tax conventions

The compliance obligations imposed on the Member States by EU law place certain parameters on their direct tax competence when they conclude double tax conventions. Member States must respect primary and secondary EU law rules.[300] This means that EU rules must be taken into account when Member States design and operate their direct tax systems and conclude their double tax conventions.

By creating an internal market which endeavours to be "an area without internal frontiers", the Member States have agreed in the EC Treaty to abolish all obstacles

300 This includes the State aid rules of the EC Treaty, which are not discussed here.

to the fundamental freedoms which are not justified in their general interest. The "negative" rules of the EC Treaty, therefore, impose certain boundaries on the exercise of the direct tax competence of the Member States. Member States may, therefore, not have double tax convention rules which breach the fundamental freedoms (or EU citizenship rights) of EU nationals, or the State aid provisions of the EC Treaty, or any other EU rule.[301] Furthermore, it is clear from *Saint-Gobain*, that Member States which enter into double tax conventions with non-member countries are capable of breaching EU law if they fail to respect the principle of national treatment of non-residents who are in a comparable situation to residents qualifying for tax convention advantages. In other words, the advantages granted to residents under the tax convention also may have to be granted to non-residents in a comparable situation by the Member State in question (not by the non-member country).

This research also has identified that two cardinal rules of the EU, in particular, must be respected: Member States must (a) not discriminate on grounds of nationality (Article 12 EC as implemented more specifically by the fundamental freedoms) and (b) not have (tax) rules which represent obstacles to, or restrictions of, the fundamental freedoms (including the rights granted to EU citizens). Significantly, these cardinal rules apply from the perspective of both a host and an origin Member State.

A further key outcome of this analysis is the recognition that all discrimination on grounds of nationality is not prohibited within the EU. It is clear that Article 12 EC is merely a general provision which has certain limits built into its provisions. In particular, it is without prejudice to the special provisions of the EC Treaty, such as the fundamental freedom provisions. The fundamental freedoms equally have certain limits built into their wording which limit their scope. However, it is important to recognise that EU citizenship rights have expanded the scope of Article 12 EC as there is now no need for EU nationals to be economically active within the EU as they have been granted the right to simply move and reside within the territory of another Member State, but this right to move and reside is not an absolute one and remains subject to certain limitations. If all discrimination on grounds of nationality is not prohibited under the current regulatory framework for tax, this implies that there may be many occasions when discriminatory rules will be assessed by the ECJ as being rules which are acceptable despite being discriminatory in nature. Examples have already been seen in the Court's jurisprudence such as *Gilly*, the *D case*, *ACT IV GLO*, *Kerckhaert-Morres* and *Damseaux*. The regulatory framework for tax in the EU is therefore not without distortions. All the rules are not at the EU (harmonised) level. Distortions will occur often and double tax conventions will deliver results which appear at odds with the concept of an "area of without internal frontiers".

301 Fiscal obstacles to research and development are prohibited by Article 163(2) EC.

Another significant outcome of this research is the identification of the fact that national treatment must be granted in both origin and host Member State situations.[302] The analysis conducted above demonstrates that the Court applies a "national treatment" test across the fundamental freedoms and EU citizenship situations. In applying this test, the Court has demonstrated consistency at the highest level contrary to the views of many academics and commentators.

Although under international tax law principles, residents and non-residents are generally not in a similar or comparable situation as regards the tax rules of a Member State, in an internal market context, there are situations where non-residents may have to be treated in a similar way to residents. This applies also in the area of double tax conventions. For example, in adopting the methodology for the relief of double taxation in a double tax convention, such as the ordinary credit method, the Member State must still comply with EU law. If a Member State decides to extend its tax jurisdiction to cover the dividend income of a non-resident received from a company resident on its territory, it is that Member State which may have triggered the incidence of economic double taxation (corporate taxation of the dividend paying company followed by withholding tax on the dividend). If that Member State deals with the problem of economic double taxation for the benefit of its own residents, it must also ensure that non-residents, who are in a comparable situation, are not given less favourable treatment under its domestic or double tax convention rules.

It is also important to note that the concept of relief of double taxation as interpreted by the Court in *Gilly* and subsequent cases, can be simply the elimination of taxes in one Member State (from *Gilly*, these can be the higher taxes or the lower taxes). The Court sees the primary responsibility for the reduction or elimination of double taxation resting with the residence Member State. However, a source Member State may acquire an obligation deal with the problem of double taxation in situations where it has extended its tax jurisdiction to cover the dividend income non-residents because, in such circumstances, the source Member State may have made such non-residents comparable to its residents in an internal market setting (in relation to its rules dealing with the relief of economic double taxation) and, therefore, may be responsible for the double taxation in question. Consequently, Member States acting in a source State capacity have assumed additional responsibilities in an internal market environment to deal with the problem of economic double taxation in

302 This is clear from the Court's jurisprudence in relation to the exercise of the fundamental freedoms. See ECJ, 12 Dec. 2002, Case C-385/00, *F.W.L. de Groot v Staatssecrataris van Financiën*, ("*De Groot*"), [2002] ECR I-11819, paragraph 94. It is also clear from its EU citizenship case law; see ECJ, 9 Nov. 2006, Case C-520/04, *Pirkko Marjatta Turpeinen ("Turpeinen"),* [2006] ECR I-10685, paragraph 20.

situations where it relieves the economic double taxation problem of its own residents. [303]

(4) Double Tax Convention rules

In an EU setting, the regulatory framework concerning the direct taxes does not exist simply at the level of the Member State or at the level of the double tax convention. Legal norms also exist at the EU level and in the internal market these EU norms are supreme and take precedence over double tax convention rules and the domestic tax rules of the EU Member States. All double tax conventions entered into by Member States after they joined the EU must comply with EU law, subject to the very limited transitional derogation contained in Article 307 EC.

Double tax convention rules perform a necessary and valuable function in the internal market regulatory framework because, in the absence of harmonised rules at the EU level, they endeavour to eliminate or reduce the incidence of double taxation in the EU. Moreover, from a coherence of the tax system perspective, the Court sees double tax convention rules as providing significant stability to Member States direct tax systems.[304]

As competence in direct tax matters remains with the Member States and as the rules adopted at the EU level are generally minimum harmonisation directives, double tax conventions allow Member States to encourage cross-border investment, establishment and free movement within the internal market and to put in place better rules dealing with cross-border direct tax issues than the EU can provide at the present time. The double tax conventions entered into by the Member States can provide relief from double taxation, enhanced exchange of information, and more targeted responses to cross-border tax avoidance and tax evasion. Double tax conventions, therefore, enhance the internal market in the absence of harmonised rules at the EU level and form a necessary part of the regulatory framework for tax in the EU.

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303 See, for example, ECJ, 12 Dec. 2006, Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v Commissioners of Inland Revenue*, ("*ACT IV GLO*"), [2006] ECR I-11673 and ECJ, 14 Dec. 2006, Case C-170/05, *Denkavit Internationaal BV, Denkavit France SARL v Ministre de l'Économie, des Finances et de l'Industrie, ("Denkavit Internationaal"),* [2006] ECR I-11949. The approach of the Court in relation to outbound interest payments shows the difference in approach and confirms the difference obligations of source and residence Member States first explained by the Court in its *ACT IV GLO* judgment. For a recent application of the source/residence principle, see ECJ, 22 Dec. 2008, Case C-282/07, *Belgian State - SPF Finances v Truck Center SA ("Truck Center"),* [2008] ECR I-0000 (not yet reported).

304 *Wielockx* and *Danner* are two examples of situations where the Court accepted that the coherence of the tax system of two different Member States was held in place by their respective double tax convention network. ECJ, 11 Aug. 1995, Case C-80/94, *G. H. E. J. Wielockx v Inspecteur der Directe Belastingen, ("Wielockx"),* [1995] ECR I-2493 and ECJ, 3 Oct. 2002, Case C-136/00, *Rolf Dieter Danner, ("Danner"),* [2002] ECR I-8147.

It is this absence of harmonised rules at the EU level, to deal with the problems associated with the overlapping tax jurisdiction of the Member States, which ensures that double tax conventions play a vital and necessary role in the development of the internal market. Double tax conventions ensure that rules are in place at Member State level (on a reciprocal basis) which enhance trade and investment in the EU by eliminating or reducing juridical and economic double taxation. They represent an example of the Member States exercising a competence in the area of direct taxes which has remained with them despite the creation of the internal market. However, in an EU context the "exercise" of this direct tax competence is subject to the fundamental requirement that EU law must be complied with at all times. This compliance obligation applies to Member States' domestic tax rules and their double tax conventions whether with other Member States or with non-member countries.