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A BRIDGE OVER MUDDLED WATERS

Coherence in the case law of the Court of Justice of the European Communities relating to discrimination against non-resident taxpayers.

Marc Quaghebeur[1]

The distinction between resident and non-resident taxpayers is one of the fundamental principles of international tax law. That the European Court of Justice appeared to be disregarding this principle to give precedence to another principle, that of the free movement of workers (and the interdiction of discrimination), has always been a cause of distress for tax lawyers. They were haunted by visions that the generalisation of this principle, as defined by the European Court, would bring down national tax systems which had been built up over the years.

When, in its recent *Schumacker* decision,[2] the European Court of Justice laid down more precise principles with regard to the discrimination against non-resident taxpayers, it reassured the international tax community by accepting the fundamental distinction between resident and non-resident taxpayers. Nevertheless, the Court held that this distinction is not absolute. Where there are no objective differences between a resident taxpayer and a non-resident taxpayer — who is a national of another Member State residing within the Community — the latter should not be distinguished from a resident of the State in which he works. This is, in particular, the case where he receives all or almost all of his income in that

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1 Marc Quaghebeur, Price Blanpain Quaghebeur Maeyaert, Bld Brand Whitlocklaan 114, 1200 Brussels.
Tel: (+32 2) 735 45 11 Fax: (+32 2) 735 37 13.

With special thanks to Marc Dunnewijk of Strik & Dunnewijk, Amsterdam.

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

State, and receives no significant income in his State of his residence. In such cases, Article 48 of the EC Treaty requires that non-resident to be treated equally.

In its decision in *Wielockx*, 11th August 1995,[3] the Court has now confirmed this decision and stated that a refusal to permit certain tax deductions by a non-resident taxpayer also constitutes discrimination contrary to Article 52 of the EC Treaty where the taxpayer is a national of another Member State residing within the Community and receives all or almost all of his income in the State where he works. When the Court refused to accept the need to ensure the fiscal coherence of the domestic tax system as a justification for this covert discrimination, the waters got even more muddled.

Wielockx: The Facts

Mr Wielockx is a Belgian national working in the Netherlands as a partner in a physiotherapists' practice. Although he is a Belgian resident, he earns all his income in the Netherlands, and is subject to tax there. Under the Dutch income tax legislation, Mr Wielockx was refused the deduction of any contributions to the so-called *old-age reserve* ("oudedagsreserve") by the tax inspector, because he is not a resident in the Netherlands.

Mr Wielockx appealed against this decision to the Gerechtshof te's-Hertogenbosch which asked the Court for a preliminary ruling under Article 177 of the EC Treaty as to whether Article 52 of the Treaty precludes a Member State from allowing residents to deduct from their taxable income business profits which they allocate to form a pension reserve, while denying that benefit to Community nationals liable to pay tax who are resident in another Member State but receive all or almost all of their income in the first State. A subsidiary question was whether that difference in treatment may be justified by the fact that any reductions of the reserve by the non-resident taxpayer are not taxed in the State in which he works but in the State of residence.

The Old-Age Reserve

The *old-age reserve* (in the English text referred to as 'pension reserve') is a tax incentive created in 1972 to give self-employed workers[4] a form of voluntary pension saving, whereby they can deduct from their taxable income the business

[3] Case C-80/94 *G.H.E.J. Wielockx v Inspecteur der directe belastingen*, judgment of 11th August 1995, not yet reported.

[4] Self-employed workers are strictly only those workers who derive profits from their own business, and are under Dutch Income Tax Law distinguished from freelance workers and workers who only receive miscellaneous income.

profits which they allocate to form a reserve for their old age. The old-age reserve is nothing more than a tax exemption of part of the profits realised by the self-employed, which is granted by the Dutch Income Tax Law of 16th December 1964. This allows the taxpayer to defer the payment of tax on the amounts contributed to the old-age reserve. It is not built up by any contributions to an external organisation, nor recorded as such in a specific account in the taxpayer's accounts.[5]

The maximum 'contribution to the old-age reserve' during a calendar year is computed as a percentage of the taxable profits, and can be limited by the premiums which the taxpayer pays pursuant to compulsory membership of an occupational pension scheme.

So-called "national" taxpayers (i.e., residents) are entitled to a fiscal deduction against their gross income, in respect of any amounts added to the old-age reserve. However, any amounts which they take out of the reserve are added to their taxable gross income (Article 3, para 3, sub a of the 1964 Law).

Indeed, the tax exemption ceases (partly or entirely) if the taxpayer ceases his enterprise (following retirement or otherwise), if he reduces the reserve, if the assets of the enterprise fall under a certain threshold, or when the taxpayer abandons his residence in the Netherlands.[6]

Although, in principle, any reductions in the tax exemption become taxable immediately, the self-employed worker has the right to purchase a so-called *'stamrecht'* from a third party (e.g., an insurance contract) thereby allowing the taxpayer to convert the reserve into a life interest. He then receives periodical payments, which will become taxable every year.

"Foreign" (i.e., non-resident) taxpayers, on the contrary, are not entitled to this tax advantage. Nevertheless, if at least 90% of their income is assessed in the Netherlands, non-resident taxpayers are entitled to certain personal advantages, but not to the old-age reserve.

The Decision

The Court first confirmed that direct taxation falls within the competence of the Member States, but that they must exercise that competence consistently with

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5 A J Van Soest, *Belastingen*, Gouda Quint BV, Arnhem, 1995, 284. In the Report for the hearing, this reserve is qualified as a 'réserve extra-comptable' (paragraph 4).

6 Article 44 f of the Dutch Income Tax Law, Van Soest, *op cit*, 287.

Community law and avoid any overt or covert discrimination by reason of nationality.[7] It thereby reaffirms its previous decision that:

> "It is settled law that discrimination arises through the application of different rules to comparable situations or the application of the same rule to different situations."[8]

A difference in treatment as regards direct taxation by a Member State between resident and non-resident taxpayers cannot in itself be categorised as discrimination within the meaning of the Treaty. Indeed, their situations in that Member State are not generally comparable, since

> "... there are objective differences between them from the point of view of the source of the income and the possibility of taking account of their ability to pay tax or their personal and family circumstances."[9]

Nonetheless, a non-resident taxpayer is objectively in the same situation as a resident of the State where he works, if he receives all or almost all of his income in that State. If both are undertaking the same work in that State, both are taxed in that State alone and their taxable income is the same. The Court concluded that:

> "If a non-resident taxpayer is not given the same tax treatment as regards deductions from his taxable income as a resident, his personal situation will be taken into account neither by the tax authorities of the State where he works — because he is not resident there — nor by the State of residence — because he receives no income there. Consequently his overall tax burden will be greater and he will be at a disadvantage compared to a resident."[10]

Consequently, the Court concluded that a non-resident taxpayer who, as in the case of Mr Wielockx, receives all or almost all of his income in the State where he works but who is not entitled to set up an old-age reserve qualifying for deductions under the same tax conditions as a resident taxpayer suffers discrimination.

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7 ECJ, Case C-279/93, referred to in note 2, supra.

8 Paragraph 17. See the judgment in Case 283/83 *Racke v Hauptzollamt Mainz* [1984] ECR 3791, paragraph 7.

9 Paragraph 18; see also Case C-279/93, *Schumacker* (referred to in note 2).

10 Paragraph 21.

The Court then considered the arguments put forward by the Dutch Government to justify this discrimination between resident and non-resident taxpayers. It invoked the principle of fiscal cohesion which was developed in the *Bachmann* case.[11] It argued that the Dutch tax system makes a correlation between the contributions to the old-age reserve (which are deducted from the taxable income) and the sums taken out of this reserve (which are subject to tax). A non-resident is not entitled to deduct the contributions to an old-age reserve, but he is also not subject to taxation on this reserve. If a non-resident could build up an old-age reserve, and deduct the contributions, the pension would not be subject to taxation in the Netherlands.

The Court summarised this as follows:[12]

> "... If a non-resident could set up a pension reserve in the Netherlands and thus secure a right to a pension, that pension would not be taxed in the Netherlands since, by virtue of the double-taxation convention between Belgium and the Netherlands referred to above, such income is taxed in the State of residence."
> (paragraph 23).

This argument was rejected by the Court. It stated that fiscal cohesion must not be envisioned at an individual level, i.e., by a strict correlation between the deductibility of contributions and the taxation of pensions in respect of one and the same person. It held that, to appreciate the fiscal cohesion of the tax system, one must also consider the effects of the double-taxation conventions on the domestic tax systems.

> "Fiscal cohesion ... is shifted to another level, that of the reciprocity of the rules applicable in the Contracting States.
> (paragraph 24).

The Court examined the situation at issue and found that the Netherlands have concluded a double-taxation convention with Belgium, which is based on the OECD Model Treaty, and under which the authority to tax pensions and similar remuneration is given to the State of residence.[13]

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11 Case C-204/90, *Bachmann v Belgian State* [1992] ECR I-249.

12 It will be explained hereinafter why this summary is incorrect, see pp 129-130.

13 "Subject to the provisions of Article 19, paragraph 1, pensions and other similar remuneration paid to a resident of one of the States in consideration of past employment shall be taxable only in that State" (Article 18 of the double-taxation convention between the Netherlands and Belgium of 19th October 1970).

The effect of this provision in the double-taxation convention is that the State taxes all pensions received by residents in its territory, whatever the State in which the contributions were paid. Conversely, it also waives the right to tax pensions received abroad even if they derive from contributions paid in its territory which it treated as deductible.

The Court, therefore, concluded that "Since fiscal cohesion is secured by a bilateral convention concluded with another Member State, that principle may not be invoked to justify the refusal of a deduction such as that in issue" (paragraph 25).

The Court also took the opportunity to confirm that the issue of the cohesion of a tax system is not to be confused with the administrative difficulties faced by tax authorities in collecting all necessary information, and points to the Council Directive 77/799/EEC.[14]

The decision of the Court is, therefore, that:

> "A rule laid down by a Member State which allows its residents to deduct from their taxable income business profits which they allocate to form a pension reserve but denies that benefit to Community nationals liable to pay tax who, although resident in another Member State, receive all or almost all of their income in the first State, cannot be justified by the fact that the periodic pension payments subsequently drawn out of the pension reserve by the non-resident taxpayer are not taxed in the first State but in the State of residence — with which the first State has concluded a double-taxation convention — even if, under the tax system in force in the first State, a strict correspondence between the deductibility of the amounts added to the pension reserve and the liability to tax of the amounts drawn out of it cannot be achieved by generalising the benefit. Such discrimination is therefore contrary to Article 52 of the Treaty"

The decision raises a number of issues which are considered in the commentary below.

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[14] EC Council Directive 77/799/EEC of 19th December 1977, concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, OJ, 1977 L 336, p 15.

Discrimination[15]

The Court has gradually widened the protection granted by the four "fundamental freedoms" (free movement of persons and capital, freedom of establishment, and the freedom to provide services), established originally by the EEC Treaty. That these freedoms prohibited discrimination on the basis of nationality had been established in the Court's earlier decisions. Since *Sotgiu*, the Court has consistently held that the rules regarding equal treatment forbid not only overt discrimination by reason of nationality but also all *covert forms of discrimination* which, by the application of other criteria of differentiation, lead in fact to the same result.[16]

The Court introduced this concept of indirect discrimination in relation to direct taxation in its decision *Re Biehl*.[17] The case concerned the refusal by the Luxembourg tax authorities to refund an excess of tax withheld at source by Mr Biehl's employer in Luxembourg, based on a provision in the Luxembourg Income Tax Code, pursuant to which excess withholding tax is not refunded to employees who give up their residence in the course of a tax year. The Court stated that "Even though the criterion of permanent residence in the national territory [referred to in connection with the tax rule] applies irrespective of the nationality of the taxpayer concerned, there is a risk that it will work in particular against taxpayers, who are nationals of other Member States" (paragraph 14). In *Commerzbank*, the Court also based its decision on *Sotgiu* to condemn a tax rule which was covertly discriminatory vis-à-vis non-resident companies.[18]

Until the decision in *Schumacker*, the Court appeared to presume that when it discovers that a rule works to the detriment of a category of individuals which

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15 In an earlier issue of this *Journal*, Timothy Lyons has made an extensive study of the principle of discrimination on the basis of nationality: T Lyons, 'Discrimination against Individuals and Enterprises on Grounds of Nationality: Direct Taxation and the European Court of Justice', *The EC Tax Journal*, 1995, 27-51. See also B Knobbe-Keuk, 'Restrictions on the Fundamental Freedoms Enshrined in the EC Treaty by Discriminatory Tax Provisions - Ban and Justification', *EC Tax Review*, 1994, 74-85.

16 Case 152/73 *Sotgiu v Deutsche Bundepost* [1974] ECR 153 paragraph 11.

17 Case 175/88 *Klaus Biehl v Administration des Contributions Directes du Grand-duché de Luxembourg* [1990] ECR I-1789, paragraphs 11-13. Luxembourg was recently condemned for failure to adapt its tax legislation after *Biehl*; see Case C-151/94, *Commission of the European Communities v Grand-duché de Luxembourg, decision 26th October 1995* (not yet reported).

18 Case C-330/91 *The Queen v Inland Revenue Commissioners (ex parte Commerzbank AG)* [1993] ECR I-4017; see also Case C-1/93 *Halliburton Services BV v Staatssecretaris van Financiën* [1994] ECR I-1137.

comprises principally nationals of another Member State, there is a form of covert discrimination, and it gave the national government an opportunity to justify the discriminatory national rule at issue.[19]

Indeed, in both *Biehl* and *Commerzbank*, the Court held that the tax rule was (indirectly) discriminatory on the basis of nationality, because there was a risk that it would work to the particular detriment of taxpayers who are nationals of other Member States. And, in *Bachmann*,[20] the Court did not explicitly condemn the Belgian tax rule as covertly discriminatory, but in fact it came to that conclusion on the basis of the same reasoning as it used in *Biehl*.[21]

In *Schumacker*,[22] the Court started from the presumption of *indirect discrimination against non-residents* which it had put forward in *Biehl*. However, it also took a more specific approach. It tested the domestic tax rule against its definition of discrimination: "discrimination can arise only through the application of different rules to comparable situations or the application of the same rule to different situations."[23] For the first time, the Court also made it clear that the situations of resident and non-resident taxpayers must be distinguished. By doing so it allowed for a difference in treatment between resident and non-resident taxpayers, given that each is in an objectively different situation.

> "Consequently, the fact that a Member State does not grant to a non-resident certain tax benefits which it grants to a resident is not, as a rule, discriminatory since those two categories of taxpayer are not in a comparable situation." (paragraph 34).

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19 See also D Fosselard, 'L'obstacle fiscal à la réalisation du marché intérieur', *Rev Trim Dr Eur* 1993, p 484.

20 Case C-204/90 *Bachmann* (full reference in note 11); Case C-300/90 *Commission of the EEC v Kingdom of Belgium* [1992] ECR I-305. It is to be noted that, in *Bachmann*, the national tax rule was not directed against non-resident taxpayers. The deduction of certain life insurance premiums was refused to certain taxpayers, not on the basis of residence but because they paid the premiums to a foreign insurance company or abroad (see p 125 infra).

21 Case C-204/90 (reference in note 11): "... there is a risk that the provisions in question may operate to the particular detriment of those workers who are, as a general rule, nationals of other Member States." (paragraph 9). See also Fosselard, *loc cit* in note 19, p 489.

22 Case C-279/93, *Schumacker* (referred to in note 2).

23 Case C-279/93 *Schumacker* (reference in note 2), paragraph 30. See also Case 283/83 *Racke v Hauptzollamt Mainz* [1984] ECR 3791, paragraph 7.

The Court found objective differences which justify that the overall taxation of taxpayers, taking account of their personal and family circumstances, be left with the State of residence. Generally speaking, it is the State of residence which has all the information needed to assess his personal ability to pay tax, and this ability is determined by reference to his aggregate income and his personal and family circumstances. The major part of a resident's income is, indeed, normally concentrated in that State, and it is also more easy to assess the ability to pay tax at the place where he has centred his personal and financial interests: usually this is the place of his residence.[24]

Nonetheless, when the non-resident receives all or almost all of his income in another Member State, and when he obtains no significant income in the State of his residence, he is in a comparable situation to a resident of the Member State of activity who does the same work. He then is at a disadvantage compared to the resident of the State where he works because his State of residence cannot take account of his personal and family circumstances, and because the State where he works (as an employee or as a self-employed) refuses to do so. The fact that, in that situation, his personal and family circumstances are taken into account neither in the State of residence nor in the State where he works constitutes a form of covert discrimination.

The reasoning of the decision in *Schumacker* was taken over in *Wielockx*, although the conclusion lacks the precision of the first decision. In these decisions, the Court appears to have been influenced by the Commission's Recommendation of 21st December 1993,[25] although it takes a different approach.

This Recommendation is a policy instrument in which the Commission gives guidelines to the Member States to avoid the *risk that very divergent new rules will be introduced in various Member States*.[26] The Commission assumes that an individual derives the major part of his income in the country where he works if this income constitutes at least 75% of his total taxable income. In that case, the non-resident may not be subject to higher taxation in the State where he works than

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[24] See B Knobbe-Keuk, 'ECJ Bans Discrimination against Non-residents', *Intertax*, 1995, 236.

[25] Commission Recommendation of 21st December 1993 on the taxation of items of income received by non-residents in a Member State other than that in which they are resident, 94/79/EC, *O J* 1994 L 39, p 22.

[26] Fifth recital of the Recommendation.

a resident, insofar as his income in that Member State exceeds that threshold of 75% of his total income.[27]

Which Principles can be distinguished?

When defining principles relating to the equal treatment of resident and non-resident taxpayers, one must not only keep in mind the guidelines proposed by the Commission, but also the Court's decisions, which are developed independently, but which will inspire further initiatives of the Commission.[28] Some principles can already be distinguished, although there still are a number of uncertainties.

In the first place, one should always keep in mind the principle, which the Court has highlighted, that there is no discrimination unless either different rules are applied to comparable situations or the same rule is applied to different situations.

Since the issue will generally be one of the application of different rules to comparable situations, one will first have to establish when the non-resident taxpayer is in the same situation as a resident taxpayer. This is objectively the case where he receives all or almost all of his income in another Member State, and when he obtains no significant income in his State of residence. It is understood, of course, that the income obtained in each State is subject to tax in that State and that the relevant double-taxation convention does not provide that frontier workers are exclusively assessed in the State of residence.

At what level of income does the non-resident risk discriminatory treatment? Germany and the Netherlands require that he obtains at least 90% of his worldwide income there, before he can benefit from the same tax regime as a resident. The Commission proposed to put the threshold at 75% of the overall income. Such rules can, however, only be used as rules of thumb, and a factual approach is required.

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27 See B Gouthière, 'Removal of Discrimination - a Never-Ending Story', *European Taxation*, 1994, 298; O Thömmes, I Kiblböck, 'A Solution to the Problem of the Taxation of Non-Residents and Frontier Workers?', *European Taxation*, 1994, 203; P Schonewille, 'Commission Recommendation on the Taxation of Non-Residents', *EC Tax Review* 1994, 63.

28 The Commission has already announced that it will implement its recommendation and *decide to take further action if necessary, taking account, inter alia, of how the Court's case law develops in this field.* (Eleventh recital of the Recommendation).

What must be examined is, indeed, not which part of his total taxable income the taxpayer receives in the State of activity. On the contrary, the relevant issue is the level as from which the non-resident has sufficient income in his State of residence so that the tax authorities can take account of his personal circumstances. It is only when the non-resident has not reached that threshold in his State of residence that he can be placed on the same footing as a resident of the State of employment, where he receives the major part of his income.[29]

This conclusion is important as it means that the exposure of the non-resident very much depends on the level of the advantages, deductions and tax exemptions granted by the State of residence. The non-resident who would have received substantial advantages relating to his personal and family situation if he had derived his income in his State of residence, and would therefore have needed a high income to fully benefit from these, will be more exposed to discrimination than a taxpayer who is a resident in a Member State which hardly grants any advantages at all.

The Commission's Recommendation has ignored the concrete situation of the non-resident in his State of residence, and that is understandable, as this cannot be translated in elementary guidelines. Moreover, it is obvious that, when transposing the Recommendation in its domestic law, it would be difficult for a Member State to take account of the situation in the non-resident's State of residence.

The 75% criterion can, indeed, be maintained as a principle, but the Court can dismiss it if the non-resident does not have sufficient income in his State of residence to allow the tax authorities to take account of his personal circumstances. Indeed, if a resident of Member State A derives less than 75% of his total taxable income in Member State B, but derives the rest of his income from Member State C, he may not have any income in his State of residence. In that specific situation, State A will not be able to take account of his personal circumstances, and he risks discrimination.[30]

The Court has not examined the level of income in *Wielockx*, but this was not relevant, as Mr Wielockx earned all or almost all of his income in the Netherlands.[31] In this respect the decision in case C-107/94 which is pending

[29] See opinion of Advocate General Léger in *Schumacker*, paragraph 76.

[30] Any justification relating to administrative difficulties risks being brushed away with a reference to Council Directive 77/799/EEC, see note 14.

[31] See paragraph 10 of the decision.

before the Court[32] could be interesting. The case resembles the situation in *Wielockx*: Mr Asscher is a Dutch national who has lived in Belgium since 1986 but derives less than 90% of his income in the Netherlands. Because he does not come to this threshold, he cannot benefit from certain tax rules under the Dutch Income Tax Law. This could give the Court the opportunity to clarify the expressions 'almost all of his income in the State of activity' and 'no significant income in the State of his residence'.

However, Mr Asscher is a Dutch national who is discriminated against by the Dutch Income Tax Law. One should not forget that, both in *Werner* and in *Schumacker*, the Court clearly stated that it limits its decision to the discriminatory taxation of a national of another Member State. A Member State can thus continue to discriminate against its own nationals if they are not residents.

Again the Commission does not address this issue in its Recommendation. We can assume it is not even an issue. Once a Member State eliminates all measures which work to the detriment of non-residents, one can only anticipate that this discrimination will automatically disappear. It is hardly conceivable that its domestic tax rules (and in particular the obligation to treat all taxpayers equally) would allow for a distinction between non-residents who are nationals of another Member State and its own nationals who are residing abroad.

Until now, the Court has only considered situations relating to income from employment or from self-employed activities. The Commission extends its guidelines also to other categories of income from an activity: pensions and similar remuneration received from past employment (including social security pensions), income from agricultural and forestry activities, and income from industrial and commercial activities (Article 1, paragraph 1 of the Recommendation), and it specifies that income from professional occupations or other self-employed activities also include those of performing artists and sportsmen and sportswomen.

Other types of income (e.g., dividends, interest, ...) are not, in principle, included in these guidelines,[33] and we can see two reasons for this. In the first place, the double-taxation conventions do not give the exclusive authority to assess the income to one State, but split it between the two. The taxpayer can claim a

32 Case C-107/94 *Re Asscher*, a reference by the Dutch Hoge Raad, 23rd March 1994.

33 In Article 2, paragraph 3 the Commission recommends that the Member State where the taxpayer receives at least 75% of his income applies the same tax provisions to this other income.

reduction of the tax withheld at source, but he remains fully liable to income tax on the full income in his State of residence.

Secondly, these types of income are not related to the principle of free movement of workers and services, whereas the categories referred to in the Recommendation are related to an activity which is protected by this fundamental principle of free movement of workers and services. The taxpayer cannot invoke this principle against a discriminatory fiscal treatment of, e.g., dividends and interest. It could be argued that these may be protected under the principle of the free movement of capital, but the situation is more complex since Article 73d of the EC Treaty was inserted by the Treaty of Maastricht.[34]

If it appears that the non-resident is in the same situation as a resident of the State where he works, and if they perform the same work in that State, it is established that the non-resident is theoretically exposed to discrimination. Any heavier taxation of the non-resident taxpayer will then be condemned as discriminatory.

The examination of the discrimination must, however, be raised to the level of the double-taxation conventions. The Commission's Recommendation defines the term 'resident' by reference to these conventions (Article 1, paragraph 2). As these conventions are part of and prevail on the domestic tax legislation,[35] the concept of residence used by the Court can only be the same. Furthermore, when examining the concrete situation of the taxpayer, the domestic tax rules can only be validly examined in the light of the relevant provisions of the double-taxation conventions.

It was therefore only logical that the concept of fiscal coherence was also examined at the level of the double-taxation treaties.

The Bull in the China Shop

The use of the concept of non-discrimination could very easily result in the disintegration of national tax systems. By taking a very factual approach, and advancing with great circumspection, in both *Wielockx* and *Schumacker*, the Court

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[34] See P Farmer, R Lyal, *EC Tax Law*, Clarendon Press, Oxford, 1994, p 333. We cannot, therefore, agree with van Thiel's hasty conclusion that the application of withholding taxes on gross amounts may constitute covert discrimination and be in conflict with Community law. S van Thiel, 'The Prohibition of Income Tax Discrimination in the European Union: What does it Mean?' *European Taxation*, 1994, 308.

[35] See L Hinnekens, 'The Compatibility of Bilateral Tax Treaties with European Community Law, The Rules', *EC Tax Review*, 1994, 146.

acknowledges that risk. The comparison with the bull in a china shop seems, therefore, appropriate.[36] "Even were the Court to limit itself to the elimination of the differences in tax treatment between taxpayers based on nationality or on, residence, the resulting chaos in income tax would be considerable."[37]

Vanistendael concluded that the Court put the concept of fiscal coherence forward to avert that very danger in the *Bachmann* case. The decision in that case must certainly have been a relief for the Belgian Tax Authorities. Nevertheless, this concept of fiscal coherence has left many uncertainties as to when a Member State may rely upon it.[38] Indeed, if this argument is taken to the extreme, it could render the direct effect and the primacy of the Community law void, and it could become an impediment to consistent and transparent national tax solutions in common areas (such as insurance and finance) which are governed by the basic principles of the EC Treaty.[39]

What has puzzled most commentators is that it had always been understood that forms of overt or covert discrimination can only be justified under the exceptions of Articles 48(3), 56(1) and 66 of the EC Treaty (public policy, public security and public health).[40] Some have tried to explain this apparent contradiction by an extension of the '*Cassis de Dijon*' jurisprudence.[41] A couple of months before the decision in *Schumacker* was handed down, van Gerven and Wouters argued that

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36 W van Gerven, J Wouters, 'De rechtspraak van het Hof van Justitie inzake directe belastingen: Een olifant in de porseleinkast?', *Tijdschrift voor Fiscaal Recht*, 1995, p 1.

37 F Vanistendael, 'The Limits of the New Community Tax Order', *CLM Rev*, 1994, 310-311.

38 B Knobbe-Keuk, *loc cit* in note 15, p 76-77; B Gouthière 'Removal of Discrimination - A Never-Ending Story', *European Taxation*, 1994, 296-302; M Dassesse, 'The *Bachmann* case: a Major Setback for the Single Market in Financial Services?', *Butterworths Journal of International Banking and Financial Law*, 1992, 261.

39 A Dourado, 'Free Movement of Capital and Capital Income Taxation within the European Union', *EC Tax Review*, 1994, 182; B Knobbe-Keuk, *loc cit* in note 15, p 74; L Hinnekens, D Schelpe, *EC Tax Review*, 1992, p 62.

40 J Wouters, 'The Case-law of the European Court of Justice, Variations upon a Theme', *Maastricht Journal of European and Comparative Law*, 1994, (179), p 189; D Fosselard, *loc cit* in note 19, p 481.

41 See J Wouters (previous footnote); I J I Burgers, *Sociaal Economische Wetgeving*, 1995, (416) 418; see also L Hinnekens, 'Compatibility of Bilateral Tax Treaties with European Community Law. The Rules', *EC Tax Review*, 1993, (146) 150.

Bachmann was a first application in tax matters of a recent, more general, development in the Court's case law.[42]

In the last couple of years, the Court has condemned national measures which may not be discriminatory, but are nevertheless *restrictive of the basic freedoms granted by the EC Treaty*.[43] This condemnation is not, however, unconditional, and the Court applies a proportionality test based on the case law developed in *Cassis de Dijon*.[44]

This would mean that the Court would have the power to examine whether there are any imperative reasons relating to the public interest which justify a national rule of direct taxation which affects all relevant taxpayers and which restricts the basic principles. The Court would then have to assess whether the national rule is appropriate to achieve the objective concerned and whether the same result cannot be obtained by less restrictive rules.[45]

The distinction is important as it would allow the Court to strike down national measures which hinder the fundamental freedoms of the EC Treaty or discourage Community nationals from exercising them, even if the measure works against the State's own nationals.

Moreover, if the Court qualifies a national measure as covertly discriminatory, it would not be able to look for justifications apart from the exceptions provided by the EC Treaty.[46] If the national measure can now be condemned because it

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42 W van Gerven, J Wouters, *loc cit* in note 36, p 2; J Wouters, *loc cit* in note 40, 186.

43 This analysis is based on the jurisprudence developed in the cases C-76/90 *Säger v Dennemeyer* [1991] ECR I-4221; C-106/91 *Ramrath* [1992] ECR I-3351; C-370/90, *Singh* [1992] ECR I-4265; C-19/92, *Kraus v Land Baden-Württemberg*, [1993] ECR, I-1663; C-275/92 *Her Majesty's Customs and Excise v Schindler* [1994] ECR I-1039.

44 Case 120/78 *Rewe v Bundesmonopolverwaltung für Branntwein* [1979] ECR 649 ('Cassis de Dijon'); see also Case 205/84 *Commission v Germany* [1986] ECR 3755, paragraphs 27-29.

45 See also I J I Burger, *loc cit* in note 41, at 45: Farmer and Lyal go a step further and already foresee that the Court might be *unwilling to extend the scope of the basic freedoms to tax rules which affect all relevant taxpayers in the same manner in law and in fact*, by analogy with its decision of 24th November 1993 in *Keck* and *Mithouard* (Cases C-267/91 and C-368/91): P Farmer, R Lyal, *EC Tax Law*, Clarendon Press, Oxford, 1994, p 329. This conclusion seems a bit hasty.

46 See p 122.

restricts the fundamental freedoms (without being discriminatory), the Court could also examine whether this rule can be justified by objectives of national interest, and balance such justification against the Community interest on the scale of the proportionality test.[47]

The discussion appears to be purely academic,[48] and in its earlier decisions relating to direct taxation the Court has indeed examined whether arguments advanced by the national governments could justify a distinction which it had qualified as a discrimination.[49] It may also be significant that Advocate General Léger simply acknowledges that the need to ensure the cohesion of a domestic tax system is a legitimate objective of public interest under Community law, which can, in certain specifically described circumstances, justify restrictions to the free movement of persons, and even discriminatory measures.[50]

After *Bachmann*, the Court continued to strike down national legislation in *Commerzbank*[51] and *Halliburton Services*[52], on the basis of covert discrimination. It is true that in neither case, had the principle of *coherence* been put forward as a justification for the discrimination. Furthermore, in *Werner*,[53] the Court clearly avoided condemning the German tax rule which discriminated against a German national residing abroad, which it could have done if it had taken this new route to condemn rules of direct taxation because they would be restrictive of the basic freedoms.

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47 See J Wouters, *loc cit* at note 40, 189.

48 In this respect, see also R Joliet, 'Coopération entre la Cour de Justice des Communautés Européennes et les Jurisdictions nationales', *Journal des Tribunaux - Droit Européen* 1993, (2) 6, where the Judge confirmed that the Court is not bound by its previous decisions, that it can change its case law, and even that the Court will not hesitate to abandon an earlier decision if it is erroneous.

49 See also B Knobbe-Keuk, *loc cit* in note 24, p 237. These justifications are examined in the studies referred to in note 15.

50 Opinion of Advocate General Léger in *Wielockx*, paragraph 39; he quotes J Wouters (*loc cit* in note 40), 203: "The '*Bachmann*' cases are no more than a recognition by the Court that Member States, in devising a coherent national tax regime, pursue a goal which is justified under Community law."

51 See reference in note 18.

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

53 Case C-112/91 *Werner v Finanzamt Aachen-Innenstadt* [1993] ECR I-429.

The Principle of Fiscal Coherence[54]

The Court also did not take the opportunity to use this analysis in both *Schumacker* and *Wielockx*. It appears to have continued on the route that the discriminatory effect of the domestic rule must be examined. In both cases, though, the Court has examined the discriminatory rules against the justification of the fiscal coherence of the domestic tax system which was first put forward in *Bachmann*.

Bachmann[55]

Mr Bachmann, a German national employed in Belgium, had concluded sickness and invalidity insurance contracts and a life insurance contract in Germany, before moving his residence to Belgium. He paid contributions for these insurance contracts in Germany, and claimed the deduction of these contributions from his total occupational income in Belgium.[56]

Under the Belgian income tax law, voluntary sickness and invalidity insurance contributions and pension and life insurance contributions are only deductible in Belgium if they are respectively paid to a mutual insurance company recognised by Belgium or paid in Belgium. The same rules apply in respect of contributions for individual life insurance schemes and employee's contributions to group pension plans.[57]

The Court held that such provisions which refuse the deduction of premiums paid to a foreign insurer, or paid outside the Member State, "are justified by the need to ensure the cohesion of the tax system of which they form part, and that such provisions are not, therefore, contrary to Article 48 of the Treaty" (paragraph 28). This coherence was found in the connection between the deductibility of contributions and the liability to tax of sums payable by the insurers under pension and life insurance contracts.

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54 The term 'coherence' is preferred over the term 'cohesion' used in the decision; it is closer to the terms 'cohérence' and 'Kohärenz' used in the French and German texts (see T Lyons, *loc cit* in note 15, note 4).

55 Case C-204/90 reference in note 11 (see also Case C-300/90) *Commission of the EEC v Kingdom of Belgium* [1992] ECR I-305.

56 It should be noted that the discrimination is not a discrimination against a non-resident taxpayer: Mr Bachmann was a Belgian resident but he was treated differently because he had taken out his insurance in Germany.

57 In respect of these, a similar decision was rendered on the same day in Case C-300/90 *Commission v Belgium* [1992] ECR I-305.

It has been argued before that this conclusion cannot be generalised to other types of insurance contracts, for several reasons.

In the first place, this correlation did not exist at the time for *employer's* contributions to group pension plans.[58] The capital received from group insurance which was financed by the employer's contributions was taxable whether or not these contributions were tax deductible.

As for *employee's* contributions to group pension plans, the Belgian Tax Authorities were already stating that there was no correlation any more between the deduction of the contributions and the taxation of the pension; this position was criticised as it was contradicted by the text of the Belgian Tax Code.[59] This correlation was in fact abandoned as of tax year 1990.[60]

It must be pointed out that the correlation was really tenuous: it was sufficient that one contribution had been deducted for the entire pension to become taxable.[61] Furthermore, the Belgian State had itself waived — or at least loosened — the application of this strict rule. As Advocate General Mischo pointed out, Belgium has concluded agreements with France, Luxembourg and the Netherlands whereby insurance contributions paid out to an undertaking established in one of those countries could be deducted in Belgium in respect of French, Luxembourg or Dutch employees.[62] Unfortunately for Mr Bachmann, Germany was the only bordering country with which Belgium has never signed such an agreement, and the deduction which was refused to him was effectively granted to French, Luxembourg and Dutch taxpayers.

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58 L Hinnekens, D Schelpe, *loc cit* in note 39, p 60; L Hinnekens, D Schelpe 'Is belastingdiscriminatie in de EEG geoorloofd omwille van de coherentie van het nationaal belastingstelsel?', *Algemeen Fiscaal Tijdschrift*, 1992, 225-229; M Quaghebeur 'Extra-Legale pensioenededen mobiele werknemers', *Tijdschrift voor Fiscaal Recht*, 1990, 58.

59 Reply by the Minister of Finance to a Question by Senator Blanpain of 28th April 1988, *Q et R Senat* 1987-88, 14th June 1988, 255. *Circular Circ, Ci R H* 241-403, O23, 10th January 1989, referred to in Quaghebeur, *loc cit* (note 58), 64.

60 Article 12 § 2, 1° of the Law of December 7th, 1988; see also Quaghebeur, *loc cit* (note 58), p 57.

61 Article 32 bis of the Belgian Income Tax Code qualified as pension income: "pensions, periodic payments, capital sums and the redemption value of life insurance contracts which are entirely or *partially constituted* either by personal contributions ...".

62 Paragraph 27 of the Advocate General's opinion. Circulars nr. Ci.R.9F/275.262 of 31st October 1975, Bull. Bel., 535/12.75, 2239, Ci.R.9NL/280.209 of 19th October 1978, Bull. Bel., 568/12.78, 2207.

Finally, there has never been a correlation between the deduction of contributions for *voluntary sickness and invalidity insurance* and the taxation of any payments received from the insurance company. Whether these payments are taxable or not depends on the nature of the income which it replaces and certainly not on the earlier deduction of the premiums.[63]

It is only with regard to *individual insurance contracts* that the correlation between the deduction of the contributions and the taxation of a capital sum received from the insurance company could have explained the need of a coherent tax system. As explained above, this correlation was tenuous: if the taxpayer had deducted one contribution, the entire pension became taxable under Article 32 bis of the Belgian Income Tax Code.

Moreover, the Court acknowledged that these rules only applied as of 1976, and left it to the national court to assess whether these provisions were necessary in order to achieve the objective of protecting the public interest by using the same analysis.

When putting forward the principle of fiscal coherence, the Court made it clear that this principle was not absolute. The national rule must pass the proportionality test,[64] and it must find that the same result cannot be ensured by alternatives which are less restrictive. The Court found that the cohesion of a tax system based on the correlation between the deduction of premiums and the subsequent taxation of payments received could not be ensured by less restrictive measures.

However, the Court has not given any thought to the fact that the justification itself seems hardly proportional to the discrimination which it had to justify. As explained above, the Tax Authorities had largely abandoned the correlation in favour of taxation of the capital payments regardless of whether or not the premiums have been deducted.

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[63] M Dassesse, 'L'arrêt Bachmann et la loi du 28 décembre; une victoire à la Pirrhus?', *Journal de Droit Fiscal*, 1992, p 323; see also M Dassesse 'The *Bachmann* case: a major setback for the single market in Financial Services?' *Butterworths Journal of International Banking and Financial Law*, 1992, 257.

[64] Paragraph 36 of Advocate General Léger's opinion in *Wielockx*, J Wouters, *loc cit* (in note 40), p 203; L Hinnekens, D Schelpe, *loc cit* (in note 39), p 61; see also H van den Hurk, 'Buitenlandse belastingplicht en Europees Recht', *Sociaal Economische Wetgeving*, 1995, p 123.

In *Bachmann*, the Court does not seem to have considered the fiscal coherence in the light of the double-taxation conventions[65] as it has done now in *Wielockx* (see page 131). It did effectively consider the effect of the specific agreements between Belgium and France, Luxembourg and the Netherlands, but only in order to conclude that such agreements, where they were concluded, could constitute less restrictive measures. This only demonstrates that, in this case, the Court has shown more concern for the effective enforcement of tax regulations than for the actual extent of the coherence.[66]

Schumacker[67]

Mr Schumacker is a Belgian national, who was working as an employee in Germany. As a non-resident taxpayer, he was only assessed in Germany on the income he derived from that country, but he was not entitled to the same advantages, benefits and deductions as a resident employee.

When his employer calculated the tax to be withheld at source, he could not take account of the so-called "splitting regime" (whereby each of the spouses is assessed on half of the aggregate income from employment), nor of the procedure of annual adjustment of wages tax by the employer or by the Tax Authorities (so that the tax withheld at source always constituted the final tax). Finally, non-resident employees were not entitled to deduct the same social expenses (premiums in respect of old-age, sickness or invalidity insurance) where they exceeded the flat rates laid down in the taxation scale.

The need for the coherence of the tax system was also advanced as a justification for this covert discrimination. The German Government explained that there is a connection between the taking into account of personal and family circumstances and the right to tax worldwide income (in respect of residents). Because only the Member State of residence is entitled to tax worldwide income, it is only that State that can take account of those circumstances. If the Member State where the taxpayer works as a non-resident would have to take account of his personal and family circumstances, the taxpayer could invoke these circumstances twice, and he could enjoy the corresponding tax benefits in both States.

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65 M Dassesse, *loc cit* in note 38, p 260; L Hinnekens, D Schelpe, *loc cit* in note 39, p 61.

66 Supra; see also W H Roth, *Case C-204/90204/90, Common Market Law Review*, 1993, p 394; see also Dassesse, *loc cit* in note 38, p 259.

67 For a full reference see note 2.

This justification was inept. The German Government attempted to justify the discrimination by the specific elements which the Court considered to constitute discrimination against the non-resident taxpayer. The Court dismissed this justification by pointing out that this is exactly the problem: the *State of residence cannot take account of the taxpayer's personal and family circumstances because the tax payable there is insufficient to enable it to do so*, and that, in those circumstances, the personal and family circumstances of a foreign non-resident must be taken into account in the State of employment.[68]

Wielockx

In its most recent decision relating to direct taxation to date, the Court gave two important clarifications. The Court pointed out that the principle of coherence is shifted to a higher level. Fiscal coherence must, in the first place, be examined at a general level, and not just at the level of one and the same person. Moreover, one must not consider the coherence at the level of the domestic tax legislation but at an even higher level, i.e., that of the reciprocity of the rules applicable in the Contracting States.

However, by doing so, the Court not only contradicts in fact the position it had taken in the *Bachmann* case, it appears also to be beside the point in the case at hand, however correct its legal analysis may be. The Court found that the Netherlands had waived the right to tax any pensions in the double-taxation convention it had signed with Belgium, and had thereby secured the fiscal coherence by which it justified the discrimination of non-residents. However, without criticising the accuracy of the principle, this conclusion raises the following comments.

In the first place, the Gerechtshof was considering 'the connection between the deductibility of contributions to the *oudedagsreserve* and the liability to taxation of sums removed therefrom' (i.e., the taxation of reductions of the reserve) at a purely domestic level (see its second question to the Court). The arguments of the Dutch Government also appear to be based on the notion of coherence at the national level.[69] The Court appears to have incorrectly summarised the position of the Dutch Government in paragraph 23 of its decision, and to have ignored the facts of the situation as submitted by the national court.

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[68] Paragraph 41 of the decision in *Schumacker*.

[69] The Dutch Government had made a reference to the OECD Model Treaty to explain that there was no discrimination; the German Government had advanced the same theory in *Schumacker* (see p 128). It seems to be only by way of a subsidiary argument that it invoked the principle of fiscal coherence from *Bachmann*, without referring to the double-taxation conventions (see paragraphs 22 to 27 of the Report for the Hearing).

It is, indeed, quite surprising that the Court has taken the initiative to examine the case at the level of the double-taxation conventions, as these cannot apply to the old-age reserve. As set out above (pages 110-111), this reserve is a tax exemption granted by the Dutch Income Tax Law, and taxation occurs when the tax exemption ceases. The taxpayer never actually pays any contributions and never receives an income from the old-age reserve. In the circumstances listed in Article 44 f of the Dutch Income Tax Law, the tax exemption is reversed and any reductions of the reserve qualify as income.[70]

Double-taxation conventions, however, only apply in situations where an 'income' is paid out; Article 18 of OECD Model Treaty (1977) applies to '*pensions and other similar remuneration paid* ...' This would certainly have been the case if the contributions had been paid out to a third party (e.g., an insurance company), which would then pay out a capital sum at a later stage; this was actually the situation examined in *Bachmann* (see above).

Moreover, double-taxation conventions are concluded to prevent double-taxation. In respect of the old-age reserve, there is never even a risk of double-taxation: no other State has a legal basis to assess this 'reversal' of the tax exemption in the Netherlands. The old-age reserve is purely a question between the Dutch Tax Authorities and the taxpayer.

The fact that the self-employed worker has the right to purchase a so-called '*stamrecht*' from, e.g., an insurance company, does not alter this analysis. When he does so, the tax exemption is reversed but, at the same time, the taxpayer is entitled to another tax exemption which neutralises the taxation of the old-age reserve. He then also acquires an entitlement to periodic payments, which are assessed as and when he receives these, so that, in fact, he defers the taxation again.

The fact that most taxpayers defer the taxation of the old-age reserve by purchasing a *stamrecht*, and converting it into an income, does not change the fact that the old-age reserve becomes taxable as such in the circumstances mentioned in Article 44 f of the Dutch Income Tax Law. The taxpayer cannot be obliged to convert the old-age reserve in a *stamrecht*: old-age reserve and *stamrecht* are two separate issues. The Court seems, however, to have considered both issues as one; if the old-age reserve was automatically and obligatorily converted into a *stamrecht*, its

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70 The Court may have been confused by the explanation that the advantage of the old-age reserve is that the amounts set aside each year remain in the business, and that Mr Wielockx was working as a partner in a physiotherapists' practice. This does, however, not mean that this practice would at any time pay out a pension. The tax exemption is granted to the self-employed on the income received from the practice. The Advocate General's analysis in paragraph 61 is, in that respect, totally inaccurate.

analysis would have been appropriate. However, the *quod plerumque fit* cannot be taken as a fact or a legal rule.

It appears, therefore, that in this particular case, the Court should not have lifted the examination of the fiscal coherence of the old-age reserve to the higher level of the double-taxation treaties. Whether the fiscal coherence is ensured is, indeed, a purely domestic matter, and by referring to the double-taxation conventions, the Court has not answered the question. It would seem that there is, indeed, a correlation between the deduction of the contributions to the old-age reserve and the liability to taxation in respect of any reductions of the reserve, and that this correlation could ensure the fiscal coherence. However, it is not certain whether this coherence could not be ensured by alternatives which are less restrictive and whether it would pass the proportionality test (see page 127).[71]

These comments do not, however, invalidate the argument laid down by the Court that the fiscal coherence must be raised from the individual situation to a general level, and from there to the level of the double-taxation conventions.

That the fiscal coherence could not be validly examined at the individual level had implicitly been decided in *Bachmann*. The Court examined this case together with Case C-300/90 (*Commission v Belgium*), and it found a general connection between the deductibility of contributions and the liability to tax of sums payable by the insurers under pension and life assurance contracts; this connection was certainly not envisioned at a purely individual level.[72]

Examining this principle in relation to the reciprocity of the rules applicable in the Contracting States appears to be a new concept. However, when the Court considers the discrimination of non-resident taxpayers in comparison to resident taxpayers at an international level, the obvious conclusion could only have been that the concept of fiscal coherence should also be examined at the level of the double-taxation conventions. Moreover, it is generally accepted that the domestic

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[71] One could, indeed, consider a change in the Dutch income tax law to the effect that the tax exemption of the *oudedagsreserve* would be reversed in the last year a non-resident taxpayer works in the Netherlands (in the same way as the emigration of a resident taxpayer automatically makes the entire old-age reserve taxable). This taxpayer would then also have to 'pass at the cash counter before leaving the Netherlands'. Of course, the non-resident taxpayer should also be allowed to defer his tax liability by purchasing a so-called '*stamrecht*' and, under the double taxation treaties, the regular payments which he would then receive would normally only be taxable in the State where he has his residence.

[72] Case C-204/90, *Bachmann*, (note 11), paragraphs 21 to 22; Case C-300/90, *Commission of the EEC v Kingdom of Belgium* [1992] ECR I-303.

tax legislation of a Member State includes the double-taxation conventions which that State has concluded with other States. These conventions prevail over the domestic tax legislation, and a taxpayer may invoke them to overrule a rule of the domestic tax legislation.

In retrospect, it is therefore surprising that the Court has not taken account of the effect of these conventions in the *Bachmann* case. It would then presumably have concluded that, under the double-taxation conventions, Belgium has the right to tax all pensions received by its residents, whether the contributions had been paid in Belgium or not, but that Belgium also waives the right to tax pensions received abroad (i.e., by non-residents) even if they derive from contributions paid in Belgium which it treated as deductible (see paragraph 24 of the decision in *Wielockx*).[73]

Although these three levels can theoretically be separated, they are interrelated. Even when examined at a higher level, the fiscal coherence cannot be seen apart from the individual situation at hand, not least because it will determine whether a double-taxation convention applies to the taxpayer's specific situation. It is only then, in a general examination of the domestic rules and of the provisions of the relevant convention, that one can examine whether there is any coherence of the domestic tax rules which can justify the discrimination.

The Court has, until now, only accepted this coherence in situations where the taxation is deferred from one tax year to another with the same taxpayer (e.g., the correlation between the deduction of contributions to a pension scheme, or an old-age reserve, and the taxation of the payments received from that scheme or reserve). The same correlation also exists where the deduction of payments with one taxpayer is set off by the taxation of the same payments received by another taxpayer. It is, however, unclear how this could constitute a form of indirect discrimination, and how this correlation can be maintained in the light of a bilateral convention.

In the *Schumacker* case, the German Government proposed that the link between the taking into account of personal and family circumstances and the right to tax worldwide income be considered as a sufficient justification. Although this correlation has been the basic justification in international tax law to discriminate against non-residents, it cannot justify a form of discrimination which is contrary to the principles of the EC Treaty (see page 12).

It is difficult to anticipate which other tax rules could be the basis of a coherent tax system, apart from another form of correlation between a tax deductible deduction and the taxation of the resulting payments. The difficulty is that, generally

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73 Hinnekens and Schelpe already came to this conclusion in 1992, *loc cit* (in note 39), p 61. See also M Dassesse, *loc cit* in note 38, p 260.

speaking, the national government will have relinquished such correlation under the double-taxation convention. Moreover, any justification will have to pass the proportionality test: the tax authorities will have to explain why the same result cannot be ensured by alternative domestic regulations which are less restrictive.

Conclusion

International tax law has a specific concept of equal treatment of taxpayers who find themselves in the same or in comparable situations. Because there are objective differences between a resident and a non-resident, it has always been accepted that a tax system can treat resident and non-resident taxpayers differently and that this does not constitute discrimination under international tax law.

The distinction between resident and non-resident taxpayers, is quite objective: it is the place of their usual abode. This criterion has also been used as the basis for the double-taxation conventions, and because most conventions follow the OECD Model, the principles of international tax law have been harmonised to a certain extent.

The Court's case law relating to direct taxes, and the equal treatment of non-residents, therefore touches a very sensitive area. Although there may be discussions between tax lawyers as to where a taxpayer has his residence, the principle is generally acknowledged. The German government must have been quite taken aback in *Schumacker* when the Court disregarded this basic principle of international tax law, and when it even refused to accept it as a justification for a difference in treatment in the specific circumstances of that case.

Although direct taxation remains within the competence of the Member States, the European Court of Justice had to remind them that they cannot disregard the fundamental freedoms to which they had subscribed in the EC Treaty. In its decisions in *Schumacker* and *Wielockx*, the Court has come closer to the principle of equal treatment developed in international tax law. It accepts the basic criterion but it submits it to a closer examination in the light of the principles of the EC Treaty.

Contrary to tax lawyers, the Court does not accept the criterion of residence as the basic principle which it is in tax law. This principle is subjected to another higher principle. Any tax rules which follow this principle can only be upheld insofar as they do not infringe the fundamental freedoms. Tax lawyers cannot continue to see their area as an autonomous legal order, where they can limit themselves to the restrictive interpretation of tax rules they have become used to. The Court takes a different approach and uses a teleological interpretation method:[74] it looks for the explanation which is most apt to contribute to the realisation of the objectives of the EC Treaty.

When negotiating double-taxation conventions between themselves, or when changing their domestic tax law, the Member States will have to keep in mind that the principle of equal treatment as laid down in the EC Treaty supersedes the basic principles of their tax legislations. The Commission may have been slow in recognising that there is an EC dimension in the double-taxation conventions between the Member States, but at least its Recommendation of 21st December 1993 has given the Member States a base to work on. They should, however, never ignore the case law of the Court, as the last guardian of the fundamental freedoms.

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74 F Schockweiler, 'La Cour de Justice des Communautés Européenes dépasse-t-elle les limites de ses attributions?', *Journal des Tribunaux - Droit Européen*, 1995, (73), 74.