'EQUAL TREATMENT' IN SOURCE-STATE SITUATIONS: JUST ANOTHER ANGLE OF THE FREEDOMS OR A STEP TOWARDS CLOSER INTEGRATION?

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Introduction

This article discusses how the thinking of the European Court of Justice (ECJ) on equal treatment lately appears to have evolved in direct tax cases, when deciding source-state situations. The aim is to explore whether this new approach is simply another aspect of equal treatment or, instead, goes beyond the Freedoms and illustrates the need for harmonisation.

In two recently issued judgments on dividends[2], the ECJ and Advocate General Geelhoed put forward interesting ideas on how equal treatment should be understood within the European Internal Market (EIM). The two cases contain a new structure of the tests on equal treatment. Comparability appears to depart from its so far primarily intergovernmental form. Namely, the tests for Treaty compatibility appear to have moved away from setting one single Member State as point of reference. Rather, focus is now placed on the final tax liability of the non-resident dividends' recipient. As a result, the situation in the state of residence is taken into account before reaching decision on discrimination.

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2 *Test Claimants in Class IV of the ACT Group Litigation (Pirelli, Essilor and Sony) Test Claimants in Class IV of the ACT Group Litigation (BMW)* (Case C-374/04) [2006] ECR I-00000 (*hereinafter ACT IV GLO*); *Société Denkavit International BV and Denkavit France Sarl v Minister for Economic Affairs, Finance and Industry* (Case C-170/05) [2006] ECR I-00000 (*hereinafter Denkavit France*)

The starting point in the analysis below is the cases of *Avoir Fiscal*[3] and *Gerritse*[4]. Those judgments set the principles of the approach which has ruled on host-state situations up until recently. What follows is a comment on the challenges identified in the judgments of *ACT IV GLO* and *Denkavit France* on dividends. The aim is to discuss whether the new arguments mark a shift in the interpretation of equal treatment in source-state situations.

It will be shown that, in the dividends cases, the Court crosses the border of the Member State of source where the primary tax liability arises. The purpose is to consider the taxpayer's final tax liability prior to subjecting the state of source to an obligation to adjust its rules to the requirements of equal treatment. It is, however, doubtful whether the above establishes a principle or merely sketches a new trend, possibly limited to dividend distributions.

Contrasting the position taken in dividends, no change of the *Gerritse* line of thinking has occurred in the field of business expenses. Namely, judging from *Scorpio*[5], the ECJ continues to disregard the situation in the Member State of final tax liability where expenses are incurred in the Member State of source. Could this be an indication of the scope of the newly-construed test? Further, assuming that the new test applies to a limited array of facts, how could it be decided whether consideration of a non-resident's final tax liability is necessary?

Put in a broader context, another question relates to whether the new approach marks a shift towards understanding the EIM in a more integrated form. It will be shown that, in principle, the Freedoms are not there to accommodate uniformity. Namely, non-discrimination is understood within a state-by-state approach. In light of this, it should be explored whether the new test on equal treatment highlights an area where the Freedoms can no more offer solutions.

I. The Initial Approach

The initial approach taken to cases examined from a source-state perspective is clearly reflected in the *Avoir Fiscal* jurisprudence as well as in *Gerritse*. Both

3 *Commission of the European Communities v French Republic ('Avoir fiscal')* (C-270/93) [1986] ECR 273 (*hereinafter Avoir Fiscal*)

4 *Gerritse v Finanzamt Neukölln-Nord* (Case C-234/01) [2003] ECR I-05933 (*hereinafter Gerritse*)

5 *FKP Scorpio Konzertproduktionen GmbH v Finanzamt Hamburg-Eimsbüttel* (Case C-290/04) [2006] ECR I-00000 (*hereinafter Scorpio*)

cases involve discriminatory treatment, in the host/source state, against residents of another EC Member State who engage in commercial activity.

In *Avoir Fiscal*, the Court made a finding of discrimination, as French-located branches of foreign companies were deprived of a shareholders' credit, known as *"avoir fiscal"*. This was otherwise given to French-incorporated companies. For purposes of calculating liability to corporate tax, French Tax Law drew no distinction between French-incorporated companies and French-located branches of foreign companies. In light of this, the difference in treatment as regards entitlement to the benefits of "*avoir fiscal"* was found to be discriminatory against companies of other Member States wishing to establish in France. In *Avoir Fiscal* as well as in the line of subsequent cases decided on the same principle[6], the Court did not go any further than the host state to examine the situation at residence where final tax liability arises.

Surprisingly, despite *Avoir Fiscal* being one of the earliest ECJ cases in corporate taxation, the judgment contains traces of thinking on the regime of the origin/residence state:

> *"...Although it is true that in the absence of such harmonisation, a company's tax position depends on the national law applied to it, Article 52* [currently, 43] *of the EEC Treaty prohibits the Member States..."*[7].

The Court seems to be aware of the fact that, in principle, the overall tax liability of a taxpayer is determined at residence. It does not, though, seem to have incorporated such thinking into its interpretation of the Freedom of Establishment in *Avoir Fiscal*. Thus, the Court did not go any further than the host/source state, where equal treatment is tested through comparison to domestic situations of the above state.

The view taken by the Court in *Gerritse*, another host/source state case, did not differ significantly from *Avoir Fiscal*. The Court considered the deductibility of business expenses in the state where they arose but abstained from checking on their treatment in the state of the taxpayer's residence. The test of equal treatment was limited to the source/host state regime. This was so, in spite of the fact that the amount of business income earned at source would also be taxable in the state of residence.

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6 see, in particular: *R v IRC, ex parte Commerzbank AG* (Case C-330/91) [1993] ECR I-4017 (*hereinafter Commerzbank*); *Halliburton Services BV v Staatssecretaris van Financien* (Case C-1/93) [1994] ECR I-1137 (*hereinafter Halliburton*)

7 *Avoir Fiscal* at point 24

The ECJ started by establishing comparability between residents and non-residents in connection with the deductibility of business expenses and the 'progressivity' rule (in computing tax liability)[8]. It then found that non-residents' lack of entitlement to the deductibility of business expenses would be discriminatory to the extent that it led to a heavier tax burden than that of residents[9]. Comparison to residents was, however, limited to tax treatment in the state of source. The accuracy of such an approach can be challenged. Thus, it may follow from the wording of the EC Treaty provisions on the Freedoms but, in terms of tax principles, it appears flawed: it sets the final tax liability of a resident taxpayer against the limited liability of a non-resident. An outcome of this may well be that those foreign-incurred business expenses are totally ignored in the state of residence. That can especially be so if the state of residence gives relief for foreign taxes by exemption.

II. The Challenging New Ideas

Part A - The Judgments

The judgments in *ACT IV GLO* and *Denkavit France* set the principles of the ECJ's position as regards the treatment of a non-resident recipient of dividends in the state of source. The above cases followed years after *Metallgesellchaft*, the only corporate case dealing with outbound dividends up until *ACT IV GLO* and *Denkavit France*. *Metallgesellchaft* presented, however, less of challenge, as it dealt with the situation of the resident payer subsidiary. The Court was not, therefore, faced with the critical issues surrounding the (non-final) tax liability of a non-resident payee in the state of source. To the exception of *Fokus Bank*[10], there has been no precedent to *ACT IV GLO* and *Denkavit France* at European level. *Fokus* was, though, an EFTA Court case and did not typically bind the ECJ. Neither did it indirectly inspire the latter in its rulings in the above two dividends' cases. Indeed, the Court appears to have implicitly denounced the decision in *Fokus* through abstaining from any reference to it.

Fokus Bank

Fokus was about a claim placed by a parent company to the host/source state for a tax credit which was meant to offset the withholding tax due upon a distributed

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8 *Gerritse* at point 53

9 ibid at points 53 & 54

10 *Fokus Bank ASA v The Norwegian State, represented by the Directorate of Taxes* (Case E-1/04) of 23rd November 2004 (*hereinafter Fokus*)

amount. The outcome has been striking. The non-entitlement of non-resident parent companies to the tax credit, instead available to resident recipients in similar circumstances, was found to infringe Art. 40 of the EEA Agreement[11] (Free Movement of Capital). The tax credit involved a relief from economic double taxation, being available to resident shareholders against their general tax liability. The Court found that, for the purpose of complying with the Free Movement of Capital under the EEA Agreement, relief should be extended to non-residents. More specifically, it should be deducted from non-residents' liability to withholding tax. To this, no account needed be taken of final tax liability of non-residents. That was to be determined through their fiscal obligations at home.

ACT Class IV GLO

ACT IV GLO concerned a number of questions of which one has been whether the Freedom of Establishment (or Free Movement of Capital) was breached by the UK provisions on ACT. More specifically, a tax credit equal to the amount of ACT paid by the dividends' distributor was allowed to UK-resident dividends' recipients. By contrast, the credit was, in principle, refused to non-resident recipients. An exception to this applied only where provision for a credit was incorporated into a DTC concluded between the UK and the state of residence of the dividends' recipient.

The ECJ, in line with the A.G., established comparability between a resident and non-resident dividends' recipient, where the latter is subjected to income tax in the Member State of source. The exercise of taxing jurisdiction over the dividends' recipient by the state of source is consequently a prerequisite for comparability. Otherwise, differential treatment is allowed[12]. According to the Court, the UK legislation, making ACT due upon dividend distributions, does not amount to a tax charge.

It is further left to the national court to determine whether the tax charge imposed on the dividends' recipient complies with equal treatment[13]. To reach a conclusion in that regard, the Court clarified that account should not only be taken of the tax charge in the state of source. Instead, referring to *Bouanich*[14], it explained that DTCs in force between the Member States of source and residence should also be

11 European Economic Area Agreement

12 *ACT IV GLO* at point 68

13 ibid at point 71

14 *Margaretha Bouanich v Skatteverket* (Case C-265/04) [2006] ECR I-00000

examined[15]. The aim should be to compute the dividends' recipient's tax liability following possible tax reliefs allowed at DTC level. Indeed, the A.G. noted that it suffices that the state of residence, in a DTC context, relieves *"the economic double taxation resulting from the imposition of ACT and UK income tax"*[16].

Denkavit International BV and Denkavit France SARL

In *Denkavit France*, the Court followed the principles set out in *ACT IV GLO*. However, the facts led to a finding of discrimination this time. Thus, the French regime applying to dividend distributions was found discriminatory where payment is made from a French-resident subsidiary to a parent company resident in the Netherlands. The comparison was between the position of a French-resident dividend recipient and a recipient resident in the Netherlands, both receiving dividends derived in France.

Comparability was established on the finding that France imposes a tax liability on dividend distributions[17]. This has been the crucial point of distinction from *ACT IV GLO* where differential treatment was allowed in the absence of a tax charge. Consequently, to the extent that the relief granted domestically was not made available to non-resident recipients, the latter were discriminated against.

To conclude that there was an obligation for relief with the state of source, the Court looked at the DTC between France and the Netherlands. In addition, it examined the relevant Netherlands' legislation[18] to ensure that no relief was provided unilaterally. The Netherlands exempted foreign dividends. That did not allow tax withheld at source to be relieved by the state of residence either under the DTC or unilaterally[19]. Therefore, following consideration of the payee's final tax liability, the discriminatory result remained. The Court placed the burden of rectifying discrimination onto the state of source.

Part B - The New Test

The test for equal treatment developed in the two cases on dividends is essentially the following: where a Member State charges income tax on dividend distributions

15 *ACT IV GLO* at point 71

16 ibid in the A.G.'s Opinion at point 89

17 *Denkavit France* at points 36-37

18 ibid at point 47

19 ibid at point 46

to non-residents, but not on distributions made to residents, it bears the obligation to rectify unequal treatment. To decide on the existence of unequal treatment, it should be examined whether (or, to what extent) inequality is relieved by the state of the recipient's residence.

The elements featuring in the test can be set out as follows:

(i) There is a requirement that taxing jurisdiction has been exercised over the non-resident taxpayer[20]. Namely, the Member State which differentiates treatment between resident and non-resident dividends' recipients should have imposed a tax charge, in the form of income taxation, onto the latter. A tax charge imposed by the host state suffices to establish comparability between resident and non-resident recipients.

The condition for comparability, being merely that of a tax charge on the dividends' recipient, imposed by the state of source, makes a broad test. It should be noted, though, that, ever since the *'Avoir Fiscal'* line of cases, criteria for comparability have been relaxed. It was then required that identical rules exist for computing the tax base. In more recent source-state cases, though, such as *Asscher* and *Gerritse*, a change in the above strict construction appears to have occurred. The mere fact of engaging in commercial activity at source seems to suffice for entitlement to a tax treatment equal to residents. In *Fokus*, the EFTA Court extended comparability to holdings[21]. Citing *RBS*, it made the following bold statement: *"the mere fact that the resident shareholders have general tax liability in Norway while non-resident shareholders are subject to tax in Norway only with respect to profits which they earn there, is not sufficient to prevent the two categories from being considered as comparable situations"*[22].

In light of the above, making the exercise of taxing power by the state of source the sole condition for comparability has come as a predictable development.

(ii) The test involves a computation of the non-resident's final tax liability in connection with the distribution in question. That should involve examination of both DTC provisions and unilateral domestic measures of the state of residence.

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20 *ACT IV GLO* at points 56 & 61; *Denkavit France* at point 36

21 *Fokus* at points 29-30

22 ibid at point 29

The judgments in *ACT IV GLO* and *Denkavit France* do not deal with the possibility of absence of a DTC. It is not, therefore, certain whether, in that case, domestic law in the state of residence should still be considered on an individual basis. Yet, arguments in favour of an affirmative answer could be derived from the Court's approach to the two already decided cases.

More specifically, it could be suggested that the Court has gone some way towards granting unilateral relief measures of the state of residence with individual status. In *ACT IV GLO*, neither the Court nor the A.G. went to such length as to place an obligation for the consideration of residence-state domestic law. Rather, relying on the judgment in *Bouanich*, it was held that equal treatment may be complied with through the provisions of DTCs between the host and residence Member States[23].

However, in the *Denkavit France* decision, delivered two months later, the facts allowed a broader view to be adopted. Namely, the prospect was left open to cross the line of the source state's legal order and examine the home-state situation. The ECJ is explicit in that[24]. It is noteworthy, though, that the Opinion of the A.G. does not make any express reference to domestic law in the state of residence. It is instead very broadly construed, quoting that equivalent treatment may be achieved *"pursuant to the applicable DTC, or otherwise"*[25]. In light of this, the steps taken by the Court in making explicit the consideration of domestic provisions mark a development. It could thus be asserted that DTCs and unilateral residence-state provisions are placed on an equal footing.

Part C - The Scope of Application

A first point for discussion is about the scope of applicability of the above test: is it of relevance only to cross-border dividends or may, instead, be extended to source-state facts in general? The case law of the ECJ does not suggest that the consideration of taxpayers' final liability should be a principle of general application when examining source-state facts.

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23 *ACT IV GLO* at point 71 and in the A.G.'s Opinion at point 70

24 *Denkavit France* at point 47

25 ibid in the A.G.'s Opinion at point 52

Jurisprudence of the ECJ on the deductibility of business expenses

Recent case law[26] on the deductibility of business expenses in the state of source has not followed the thinking mastered in the decisions on dividends.

Business income in a cross-border setting is likely to be subject to taxation in both the host and origin states, as part of a taxpayer's worldwide tax liability. Actually, where a DTC is in force, tax liability for business income, in principle, arises exclusively in the state of residence, unless there is a Permanent Establishment (PE). Where business activity is taxable by the state of source, it is a frequent occurrence that a flat-rate withholding tax applies and that no expenses are deductible.

In *Gerritse*, the ECJ established comparability, as regards the tax treatment of business expenses, between the situation of residents and non-residents[27]. Discriminatory treatment was found to exist against non-residents who were not given a deductibility entitlement. Yet, room was left for exception to the above prohibition: no infringement arose where the resulting tax liability at source was lower than what it would have been had the tax-free bracket plus progressive tax rate applied[28].

Broadly speaking, business expenses, possibly taxable in both the states of source and residence, do not differ from the dividend cases analysed earlier. Under both sets of circumstances, consideration confined to the host state is not likely to produce a neutral effect, insofar as tax liability arises in two jurisdictions. In evaluating the facts in *Gerritse*, the ECJ ruled in favour of deducting the relevant expenses in the state of source. The decision provides for immediate deduction whereas treatment in the origin/residence state is ignored. Yet, the same amounts of business income were probably included in the tax base of Mr Gerritse in his state of residence (except if territoriality and exemption applied there). Considering the divergence in tax bases across EC Member States, relief by credit could lead to deducting parts of the source-incurred expenses twice. Conversely, where foreign income is exempt in the state of residence, business expenses not deducted at source will remain unrelieved.

The jurisprudence of the ECJ on business expenses contrasts the rulings on dividends. Thus, whereas the recent decisions on dividends have contributed fresh

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26 *Scorpio; Centro Equestre da Lezíria Grande Lda v Bundesamt für Finanzen* (Case C-345/04) [2006] ECR I-00000

27 *Gerritse* at point 53

28 ibid at point 54

thinking to the understanding of equal treatment, case law on business expenses (i.e. *Scorpio* and *Conijn*[29]) has stayed firm to the *Gerritse* line. *Scorpio*, being closer to *Gerritse* in terms of facts, follows the same line of thinking. Thus, a position, rather generous to the taxpayer, is adopted in considering what constitutes an obstacle to the Freedoms[30]. Procedural requirements for expenses' deductibility, such as additional administrative and economic burdens in the state of source[31], were struck down by the ECJ as incompatible with the Freedoms.

The above ruling demonstrates a strong position of the ECJ: the deductibility of business expenses incurred at source should not only abstain from considering the regime at residence. Indeed, delays occurring at source and causing administrative and cash flow issues also infringe the EC Treaty. *Scorpio* follows, therefore, the strict construction of *Metallgesellschaft* in connection with cash flows. It is worth mentioning that the ECJ distinguished its understanding from that of the A.G. in *Scorpio*. More specifically, it was then suggested that *"...the expenses in question may be taken into account ex post..."*[32]. The A.G. was of the opinion that the Freedoms are not breached where business tax is, at a first stage, payable and then refundable through an administrative procedure[33]. The Court disagreed.

Case law in other areas

The EFTA Court in *Fokus* refused to place a requirement to consider the tax regime in the state where final tax liability arises: *"...the disadvantage at source cannot be offset by advantage which the shareholders must obtain in their countries of residence..."*[34]. Similar issues have been considered in several judgments of the ECJ (*'Avoir Fiscal'*, *Saint Gobain*[35], *Eurowings*[36], *Asscher*, *Gerritse*). The outcome has been that the offset of disadvantages against

29 *RH Conijn v Finanzamt Hamburg-Nord* (Case C-346/04) [2006] ECR I-00000

30 *Scorpio* at points 41-49

31 ibid at point 47

32 *Gerritse* at point 76

33 *Scorpio* at point 49

34 *Fokus* at point 37

35 *Compagnie de Saint-Gobain v Finanzamt Aachen-Innenstadt* (Case C-307/97) [1999] ECR I-6161 (*hereinafter Saint Gobain*)

36 *Eurowings Luftverkehrs AG v Finanzamt Dortmund-Unna* (Case C-294/97) [1999] ECR I-7447 (*hereinafter Eurowings*)

advantages, or the other way around, should be allowed where a direct link can be established[37]. That also brings considerations of coherence into the picture.

Commentary

The question is whether this "piecemeal" approach of the ECJ is contradictory or, instead, conforms to an underlying rationale. The 'direct link' theory could provide some thinking in this regard.

The direct link is premised on the offset of a disadvantage against an advantage. In dividend distributions to non-residents, a link may be established between a tax charge imposed at source and the relief available in the state of residence. There is an inherent link between source and residence where relief at residence takes the form of an ordinary credit. Further, if a distribution is tax exempt at residence, the link theory is still applicable. Yet, in this case, final tax liability is already fixed in the state of source.

By contrast, an attempt to identify a direct link in the *Avoir Fiscal* line of cases does not work. For instance, any relief granted by the state of residence is, in principle, unrelated to the refusal of *"avoir fiscal"* at source. An exception to this would be to conclude a DTC clause which allocates tax jurisdiction over an amount equal to *"avoir fiscal"* to the host state. Otherwise, a direct link does not seem possible to establish.

In a different set of facts, a disadvantage may be borne by non-residents in the state of source due to limited deductibility of business expenses. If final tax treatment of the activity which gave rise to those expenses had to be considered, the tax charge corresponding to discrimination at source could possibly be rectified. This would be achieved through deducting the relevant expenses in the state of residence. It would not, however, be based on the existence of a direct link between liability in the host state and relief at residence. Rather, it would merely show that, due to relief entitlement at residence, the additional burden suffered at source by non-residents disappears at the level of final tax liability.

In light of the above examples, a number of conclusions could be reached.

Where discrimination at source consists of denying a fiscal advantage, otherwise available to residents, correlation to relief at residence is not obvious. For instance, such denial may take the form of refusing entitlement to *"avoir fiscal"* or rejecting the deduction of source-incurred business expenses. In such cases, tax

37 B Larking 'Fokus Bank: the end of Withholding Tax as we know it?' (2005) 14 EC Tax Review 69, 73-74

liability at residence is, in principle, determined independently from the taxpayer's exclusion from the tax advantage at source. Such a context cannot normally accommodate the 'direct link' requirement.

The outcome may however be different if unequal treatment at source is structured as a disadvantage which is only borne by non-residents. That could be a higher tax rate applied to non-resident taxpayers. Residents of that same state may be either tax exempt or subject to a lower rate. Dividend distributions are a common example here. Under these sets of facts, relief at residence is likely to aim at specifically offsetting the discriminatory charge borne at source, especially where a DTC is in place. That may allow a direct link to be identified between taxation in the host state and relief at residence.

Part D - Any Changes in the Perception of 'Equal Treatment'?

Confirmation of the Freedoms as an inter-governmental concept

The new test could be perceived as incorporating the essence of equal treatment in the EC Treaty. That is, the Freedoms are applied within an intergovernmental setting where the Member States, in principle, hold an exclusive power to determine the contours of their tax jurisdiction. Checking whether discrimination at source is cured, through a taxpayer's final tax liability, respects the Member States' will in allocating their taxing power. So, that is a less restrictive measure than imposing an obligation onto the state of source to amend its taxing entitlement to non-residents for the purpose of eliminating discrimination.

The tax rules of the state of source have to be adjusted to deal with Treaty infringements where residence-state relief, or absence of that, does not rectify discrimination. The facts of *Denkavit France* are demonstrative of such a situation. Exemption in the Netherlands does not allow the withholding tax, levied in France, to be offset. Therefore, steps should be taken to take the discriminatory charge out of the picture. As said, the comparison, in the context of equal treatment, is between a domestic situation in the state of source and a cross-border one. It is, therefore, that state which should bring its treatment of cross-border facts in line with domestic settings.

Is there a new comparison?

Apart from confirming the inter-governmental nature of the Freedoms, the new test could also give rise to thinking that, possibly, a novel construction of the 'comparison' is in process.

In *ACT GLO*, A.G. Geelhoed set forth the framework for discussion:

> "72. *As a more general point, in my view the combination of home State and source State obligations under the free movement provisions should properly be seen as a whole, or as achieving a type of equilibrium. Examination of the situation of an individual economic operator in the framework of just one of these States – without taking into account the Article 43 EC obligations of the other State – may give an unbalanced and misleading impression, and may fail to capture the economic reality in which that operator is acting*".

The same A.G. reiterated, in word-by-word detail, the above argument in *Denkavit France* two months later.

The system set out by the Freedoms does not limit the test for compliance with EC Law to residence/origin state situations. Rather, equal treatment is also examined from a source/host state perspective. In those cases, the comparison is typically drawn between a domestic (source-state) situation and that of a non-resident investor. Given, though, that tax within the EC is imposed at the national level, tax liability at source is, in principle, not final for non-residents. It is apparent that, unless the situation in the residence state is also examined, comparability appears flawed – at least, pursuant to the principles of international taxation. That is because it places cases of final and non-final tax liability on an equal footing.

If decision on the equal treatment of non-residents is reached through considering the domestic law in their origin state, the current test will need to be reshaped. That could, in practice, lead to a re-definition of 'comparison' in applying the Freedoms. In the recent cases on dividends, the ECJ construed a test for equal treatment[38] which determines the tax burden of non-residents by reference to final liability in their state of residence. The result is that one of the two comparators of the test on equal treatment, as so far known, is altered. The two ends are now domestic source-state facts, on the one hand, and residence-state final tax liability, on the other.

The new scheme has a limited scope of application, as clarified earlier in Part C. Yet, in the cases to which it applies, it could barely fit the wording of the Freedoms' provisions. The above clearly demonstrates that, in a number of settings (e.g. dividend distributions), the tests for equal treatment, from the perspective of the state of source, reach a limit.

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38 see *Avoir Fiscal; Commerzbank; Halliburton; Gerritse*

Bringing the state of residence into the comparison could lead to a misleading result. Namely, the test on equal treatment may no more be clearly distinguishable from disparities between Member States' national systems. It should be clarified that equal treatment does not aim at producing an equal tax burden for a domestic situation and its comparable cross-border one. This is illustrated by A.G. Geelhoed who explicitly distinguished between disparity and discrimination/restriction and excluded the former from the scope of the Freedoms[39]. Cases *Lindfors* and *Schempp* were quoted:

> *"...the Treaty offers no guarantee to a citizen of the Union that transferring his activities to a Member State other than that in which he previously resided will be neutral as regards taxation"*[40].

Thus, the fiscal costs of taxpayers will most probably not remain the same after the taxpayers cross the border to subject themselves to the tax system of another Member State. The above comment is made from an origin/residence state viewpoint. It contains an implicit comparison between the fiscal situation of a taxpayer before transferring activities to another Member State and after this is done. By effect, though, it also is relevant to source-state situations.

It follows that the new test should have the sole purpose of checking whether the disadvantage borne by a non-resident is offset through relief against final tax burden at residence. Therefore, the actual comparison does not extend to the final liability itself. Rather, it only involves the relief granted by the origin state against tax charges imposed at source.

Conclusion

The recent judgments on dividends illustrate that, from a source-state viewpoint, traditional tests on equal treatment fail to provide a solution where the status of non-residents is in issue. As explained above, the new scheme, in principle, confirms the inter-governmental nature of the comparisons attached to the Freedoms. The situation across the border is only considered to allow the comparison to be drawn in the host state (i.e. domestic situation and similar cases of non-residents). Such a process should normally reduce the cases in which the source-state is called upon to adjust its tax rules for the purpose of eliminating discrimination.

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39 *ACT IV GLO* at points 46-47

40 *Marie Lindfors* (Case C-365/02) [2004] ECR I-7183 at point 34; *Egon Schempp v Finanzamt München* (Case C-403/03) [2005] ECR I-00000 at point 45

As put forward in the dividends' cases, the test on equal treatment does not seem to take steps towards closer integration. Indeed, it retains a state-by-state approach and presupposes the existence of taxing jurisdiction.

Considerations on equal treatment have pioneered in *M&S*[41]. The outcome of the case was to place taxing power – even under very restrictive terms – under the scrutiny of EC Law. Briefly, the Court found that, where a deduction of losses in the host state is not possible, the origin state should take action to relieve them. This should be so, irrespective of the absence of jurisdiction to tax the revenue out of which the losses arose. The judgment recognised the need to preserve the *"balanced allocation of the power to impose taxes"*[42], which was also admitted as a justification for disallowing the loss-transfer. However, the existence of losses which were impossible to relieve led to a finding of disproportional restriction. In any case, the existence of losses that cannot be surrendered into the system undermines the notion of *"balance"*.

Yet, the *Gilly*-established rule, which provides that the allocation of taxing power falls under the exclusive competence of the Member States[43], is still valid in principle. *M&S* has only a limited scope of application. Further, the relief granted is premised on thinking deriving from state sovereignty. Still though, the override of the allocation of taxing power highlights an effort to bring equal treatment at the level of the Community. That is, the symmetry of the system should be perceived within a cross-border (EC) framework.

The cases on dividends, albeit not ground-breaking, could be placed on the same path as *M&S*. It is true that the former may fundamentally follow a state-by-state approach. Yet, they contain features of a thinking that goes beyond the frontier of the host state from the perspective of which the comparison is drawn. It remains to see what the direction and momentum will be in future judgments.

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41 *Marks & Spencer v David Halsey (HM Inspector of Taxes)* (Case C-446/03) [2005] ECR I-00000

42 ibid at point 46

43 *Mr and Mrs Robert Gilly v Directeur des Services Fiscaux du Bas-Rhin* (Case C-336/96) [1998] All ER (EC) 826, [1998] 3 CMLR 607 at point 30