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Recent Case Law of the ECJ in Direct Taxation:
Trends, Tensions and Contradictions

I. The Freedoms and Direct Taxation

The number of direct tax cases the ECJ has to decide is increasing every year. Most of these cases concern the compatibility of domestic tax provisions with the freedoms. A large number of the cases are referred by domestic courts or tribunals under the procedure provided for by Art. 234 EC. In addition, the Commission is more and more often initiating infringement procedures against Member States that, in the view of the Commission, do not comply with EC law.

The obvious result of these developments is that the Court is getting more opportunities to provide answers to questions of the interpretation of Community law which had been raised in academic writing or by practitioners. However, at the same time the risk is growing that the Court is creating tensions between different lines of its case law or that individual judgments even contradict each other. Like for every other court, it is important for the ECJ to see how academics and practitioners react to its judgments. These reactions enable the Court to reconsider its case law and, as a consequence, either to adjust a certain line of case law, or maintain a certain case law, by either revising the reasoning or being even more convinced that opposing arguments are not too strong. The ECJ therefore needs to receive criticism. Hence, it is the responsibility of academics not so much to praise the Court where its case law is convincing but to point at possible tensions or contradictions.

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In that light the following considerations have to be examined. I will focus on the more recent judgments, delivered within the last 18 months. However, I do not intend to provide a full analysis but highlight some issues which I find specifically interesting. Inter alia, I have omitted the case law on third-country relations and the case law on the scope of the different freedoms which is also mostly relevant for third-country situations.

II. Comparability

1. In Search of the Comparator

One of the key elements of ECJ judgments in the area of direct taxation is usually the comparability analysis. The Court gives judgment on the comparability of the tax treatment in a certain intra-Community situation with the tax treatment in other situations, taking into account the specific legal environment in a Member State, as described by a domestic court. However, in *Deutsche Shell* both the Advocate General and the ECJ had problems in applying this approach[1]. The case was about the currency loss which arose in a foreign permanent establishment and which was not deductible under the tax law of the state of residence. It is obvious that in a mere domestic situation a currency loss would not have arisen and would therefore not have been deductible, either.

Although Advocate General Sharpston acknowledged that "the decision as to whether there is (or is not) discriminatory treatment often turns upon the precise choice of comparator"[2], she ultimately took the position that "in the specific circumstances of this case a lengthy discussion of discrimination is unnecessary. For the Commission, the decisive factor in reaching an answer to the preliminary question referred by the Finanzgericht is not whether there has been discriminatory treatment, but whether the German national law produces a situation which has a restrictive effect on those who wish to exercise their freedom of

[1] ECJ, 18 February 2008, Case C-293/06, *Deutsche Shell* [2008] ECR I-1129, para. 31; Opinion of Advocate General Sharpston, 8 November 2007, Case C-293/06, *Deutsche Shell* [2008] ECR I-1129, points 29 et seq.

[2] Opinion of Advocate General Sharpston, 8 November 2007, Case C-293/06, *Deutsche Shell* [2008] ECR I-1129, point 34.

establishment."[3] It is of course true that it is sometimes quite burdensome to determine the right comparator. However, the Advocate General convincingly assumes that the decision as to whether there is discriminatory treatment depends on the choice of comparator. Therefore, she implicitly takes – and in my view completely correctly[4] – the position that in the freedoms cases it is always possible to identify comparable situations, even in situations, which, at first sight, give the impression that a mere "restriction approach" is required. Having accepted that premise, however, one would have expected that the comparability question had been dealt with in *Deutsche Shell* as well.

The ECJ did not avoid that issue; however, its reasoning is misleading. For the Court it was crucial that "because it exercised its freedom of establishment Deutsche Shell suffered financial loss which was not taken into account either by the national tax authorities for the purposes of calculating the basis of assessment for corporation tax in Germany or with respect to the assessment for tax of its permanent establishment in Italy."[5] Losses that are nowhere taken into account do not lead to discrimination as such. Certain expenses may not be deductible in the state of residence or in the state of source, without constituting an infringement of the freedoms. A state of residence not permitting the deduction of certain expenses complies with the freedoms, as long as that state treats domestic and cross-border situations alike. The same is true for a state of source that does not permit non-residents to deduct these expenses, as long as its resident taxpayers have to suffer from the same treatment. Expenses that can be deducted nowhere should be treated like income or property which is taxed twice. The Court has recently convincingly summarized its case law in *Block* "that, in the current stage of the development of Community law, the Member States enjoy a certain autonomy in this area provided they comply with Community law, and are not obliged therefore to adapt their own tax systems to the different systems of tax of the other Member States in order, inter alia, to eliminate the double taxation arising from the exercise in parallel by those Member States of their fiscal sovereignty".[6]

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[3] Opinion of Advocate General Sharpston, 8 November 2007, Case C-293/06, *Deutsche Shell* [2008] ECR I-1129, points 30 et seq.

[4] Lang, *Die Rechtsprechung des EuGH zum direkten Steuerrecht* (2007) pp. 96 et seq.

[5] ECJ, 18 February 2008, Case C-293/06, *Deutsche Shell* [2008] ECR I-1129, para. 31.

[6] ECJ, 12 February 2008, Case C-67/08, *Block*, para. 31.

However, in *Deutsche Shell* the ECJ has dealt with the comparability issue as well[7]: "As the Advocate General observed in points 43 and 44 of her Opinion, the tax system concerned in the main proceedings increases the economic risks incurred by a company established in one Member State wishing to set up a body in another Member State where the currency used is different from that of the State of origin. In such a situation, not only does the principal establishment face the normal risks associated with setting up such a body, but it must also face an additional risk of a fiscal nature where it provides start-up capital for it." Thus, the Court emphasized that "a company established in one Member state wishing to set up a body in another Member state where the currency used is different from that in the State of origin" is in a different situation as a company setting up a body in its own state, since in "such a situation, not only does the principal establishment face the normal risks associated with setting up such a body, but it must also face an additional risk of a fiscal nature where it provides start-up capital for it." Therefore, the Court in substance had activated its often repeated but rarely used phrase according to which "discrimination can arise only through the application of different rules to comparable situations or the application of the same rule to different situations"[8]. The cross-border situation in which the currency loss may arise is different from the domestic situation where the taxpayer does not have to face such an additional risk. Discrimination arises since the currency loss cannot be deducted in either situation, despite the additional risk existing in cross-border situations[9]. Since the situation is

[7] ECJ, 18 February 2008, Case C-293/06, *Deutsche Shell* [2008] ECR I-1129, paras. 29 et seq.

[8] ECJ, 14 February 1995, Case C-279/93, *Schumacker* [1995] ECR I-225, para. 30; ECJ, 29 April 1999, Case C-311/97, *Royal Bank of Scotland* [1999] ECR I-2651, para. 26; ECJ, 22 March 2007, Case C-383/05, *Talotta* [2007] ECR I-2555, para. 18; ECJ, 17 July 2007, Case C-182/06, *Lakebrink and Peters-Lakebrink* [2007] ECR I-6705, para. 27; see Dommes/Metzler, Das Staatsangehörigendiskriminierungsverbot bei natürlichen Personen, in Lang/Schuch/Staringer (eds.) *Die Diskriminierungsverbote im Recht der Doppelbesteuerungsabkommen* (2006) p. 116; Lang, *Die Rechtsprechung des EuGH zu den direkten Steuern* (2007) pp. 25 et seq.; Eicker/Obser, *EuGH-Rechtsprechung Ertragssteuerrecht*[2] (2007) p. 44; Denys, The ECJ Case Law on Cross-Border Dividend Revisited, *ET* 2007, p. 221; Pons, The Denkavit Internationaal Case and Its Consequences: The Limit between Distortion and Discrimination?, *ET* 2007, p. 215.

[9] Both the ECJ and the AG mentioned the German rule contained in § 3c EStG, according to which "expenditure may not be deducted as constituting operating expenditure or costs of acquiring, securing and maintaining income", where it has "a direct economic link to tax-free income", From that rule one can infer that outside of the scope of Section 3c EStG expenditures are deductible. In my view this is relevant: If German rules had not allowed the deduction of expenditures at all, the freedoms would not require the deduction of currency losses either. However, one could have expected a more careful analysis of the legal situation in Germany, since under German rules not all expenditures are deductible.

different, the application of different rules is required. The complete denial of the loss deduction in the cross-border situation is not acceptable[10].

A further consequence of that convincing approach is that differences in the legal situation do not permit the legislator to provide for completely different treatment. The differences in treatment have to be proportionate in relation to the differences in the legal situations[11]. Advocate General Kokott has followed that approach in her Opinion in *Truck Center* by referring to an earlier Opinion delivered by Advocate General Maduro: "As Advocate General Poiares Maduro has rightly pointed out recently, however, '[f]or a finding of non-discrimination, it is not sufficient to point out that … citizens and foreign nationals are not in the same situation. It is also necessary to demonstrate that the difference in their respective situations is capable of justifying the difference in treatment. In other words, the difference in treatment must relate and be proportionate to the difference in their respective situations.'"[12] It is true, however, that this may lead to the result that arguments are considered at the level of comparability which had been considered at the level of proportionality in other cases. However, the alternative would be that in cases where the legal situation is not completely comparable, domestic rules could not be examined by the ECJ at all. Furthermore, the different levels of analysis in freedom cases are to a certain extent exchangeable, as has been seen in earlier cases where the Court already dealt with justifications at the level of comparability[13].

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[10] This case could be viewed as a different treatment of same situation as well: If one assumes that business expenses are deductible in Germany (which is not under all circumstances the case), the foreign currency loss could be seen as another business expense. If business expenses are seen as comparable situations, the different treatment of business expenses which are usually deductible but non-deductible in the case of a foreign currency loss requires a justification. However, applying different rules in different situation and identical rules in similar situations are two sides of the same coin. It is therefore not surprising that both approaches are to a certain extent exchangeable. For another example see Lang, *Die Rechtsprechung des EuGH zu den direkten Steuern* (2007) pp. 35 et seq.

[11] See an earlier discussion in Lang, *Die Rechtsprechung des EuGH zu den direkten Steuern* (2007) pp. 88 et seq.; for further deliberations on that issue, see Lyal, Non-discrimination and direct tax in Communtiy law, *EC Tax Review* 2003, pp. 68 et seq; Lang, Das EuGH-Urteil in der Rechtsache Schempp – Wächst der steuerpolitische Spielraum der Mitgliedsstaaten?, *SWI* 2005, pp. 412 et seq; Lang, Direct Taxation: Is the ECJ Heading in a New Direction?, *ET* 2006, p. 422; .

[12] Opinion of Advocate General Maduro, 3 April 2008, Case C-524/06, *Huber*, point 7; and Opinion of Advocate General Kokott, 18 September 2008, Case C-282/07, *Truck Center*, point 37.

[13] See Lang/Jettmar, Steuerrecht und Sozial(versicherungs)recht – Anmerkungen zum Schlussantrag in der Rs. Blanckaert – , *IWB* 2005, pp. 695 et seq. for an analysis of the Blanckaert case; Lang, Das EuGH-Urteil in der Rechtsache D. – Gerät der Motor der Steuerharmonisierung ins Stottern?, *SWI* 2005, pp. 365 et seq. for an

In *Truck Center*, however, the solution the ECJ came up with is not convincing[14]: Truck Center was a company incorporated and resident in Belgium. It was owned for 48 per cent by a company incorporated and resident in Luxemburg. Whereas withholding tax had to be levied on interest on a loan that was paid to the Luxemburg parent, no such withholding tax would have been levied if the parent were a resident of Belgium. In such a case corporation tax would be levied at the level of the parent company instead. The ECJ analyzed whether a resident and a non-resident taxpayer receiving interest were in a comparable situation. The Court offered three reasons why the two situations were not comparable[15]: "Firstly, when both the company paying the interest and the company receiving that interest are resident in Belgium, the position of the Belgian State is different to that in which it finds itself when a company resident in Belgium pays interest to a non-resident company, because, in the first case, the Belgian State acts in its capacity as the State of residence of the companies concerned, while, in the second case, it acts in its capacity as the State in which the interest originates." The ECJ refers to the basic differences between residents and non-residents. If these differences were decisive, then residents and non-residents would never be in a comparable situation[16]. "Secondly, the payment of interest by one resident company to another resident company and the payment of interest by a resident company to a non-resident company give rise to two distinct charges which rest on separate legal bases."[17] In short, the ECJ refers to the fact that in Truck Center's case a withholding tax has been charged whereas in the case of a payment of another Belgian corporation to its domestic parent no withholding tax would be levied but corporation tax would be levied at the level of the parent instead. This is a fair description of the facts of the case, but, however, not as such a reason why the situations are not comparable[18]. "Finally, those different taxation arrangements reflect the difference in the situations in which those companies find themselves with regard to recovery

analysis of the D. case, and Lang, Das EuGH-Urteil in der Rechtsache Schempp – Wächst der steuerpolitische Spielraum der Mitgliedsstaaten?, *SWI* 2005, pp. 412 et seq. for an analysis of the Schempp case in this respect.

[14] ECJ, 22 December 2008, Case C-282/07, *Truck Center*.

[15] ECJ, 22 December 2008, Case C-282/07, *Truck Center*, para. 42.

[16] CFE, Opinion Statement of the CFE ECJ Taskforce on the judgment in the case of Belgium SPF Finance V. Truck Center SA (Case C-282/07) Judgment of 22nd December 2008, MN 14 to 16.

[17] ECJ, 22 December 2008, Case C-282/07, *Truck Center*, para. 43.

[18] CFE, Opinion Statement of the CFE ECJ Taskforce on the judgment in the case of *Belgium SPF Finance V. Truck Center SA* (Case C-282/07) Judgment of 22nd December 2008, MN 17.

of the tax. […] While resident recipient companies are directly subject to the supervision of the Belgian tax authorities, which can ensure compulsory recovery of taxes that is not the case with regard to non-resident recipient companies inasmuch as, in their case, recovery of the tax requires the assistance of the tax authorities of the other Member State."[19] This, again, correctly describes basic differences between residents and non-residents. These arguments should either have been dealt with at the level of proportionality or, if they are already dealt with at the level of comparability, one would have expected to hear from the Court *to which extent* these differences permit a different treatment. Instead, the Court obviously took the position that once the legal situations are different, even if only to a small extent, the legislator is permitted to treat these situations completely differently. This approach is not convincing at all.

2. The *Schumacker* Exception: Factual Comparability

According to the settled case law of the ECJ, the legal situation is relevant in determining the comparability of two situations[20]. The Court already took that position in *Commission versus France* ("*Avoir Fiscal*") where it emphasized that "French tax law does not distinguish, for the purpose of determining the income liable to corporation tax, between companies having their registered office in France and branches and agencies situated in France of companies whose registered office is abroad. By virtue of Article 209 of the Code Général des Impots, both are liable to taxation on profits made in undertakings carried on in France, to the exclusion of profits which are made abroad or which France is entitled to tax under the terms of a double-taxation agreement. […] Since the rules at issue place companies whose registered office is in France and branches and agencies situated in France of companies whose registered office is abroad on the same footing for the purpose of taxing their profits, those rules, cannot, without giving rise to discrimination, treat them differently in regard to the grant of the advantage related to taxation, such as shareholders' tax credits. By treating the

[19] ECJ, 22 December 2008, Case C-282/07, *Truck Center*, paras. 47 et seq.

[20] ECJ, 28 January 1986, Case 270/83, *Commission / France* [1986] ECR I-273; ECJ 21 September 1999, Case C-307/97, *Saint Gobain ZN* [1999] ECR I-6161; ECJ, 29 April 1999, Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651; in contrast ECJ, 14 February 1995, Case C-279/93, *Schumacker* [1995] ECR I-225; Gutmann, The Marks & Spencer case: proposals for an alternative way of reasoning, *EC Tax Review* 2003, p. 155; Lang, Direct Taxation: Is the ECJ Heading in a New Direction?, *ET* 2006, p. 422; Lang, *Die Rechtsprechung des EuGH zum direkten Steuerrecht* (2007) pp. 39 et seq.

two forms of establishment in the same way for the purposes of taxing their profits, the French legislature has in fact admitted that there is no objective difference between their positions in regard to the detailed rules and conditions relating to that taxation which could justify different treatment."[21]

This case law had been confirmed recently[22]: In *Arens-Sikken* the ECJ held that "the situation of the heirs of the deceased concerned in the main proceedings is comparable to that of any heir whose inheritance includes an immovable property situated in the Netherlands and left by a person who was residing in that State at the time of death. […] The Netherlands legislation deems, in principle, both the heirs of resident persons and the heirs of persons who were non-resident at the time of death to be taxable persons for the purposes of collecting inheritance and/or transfer duties on immovable properties situated in the Netherlands. It is only in respect of the deduction of overendowment debts resulting from a testamentary parental partition inter vivos that the inheritances of residents and non-residents are treated differently. […] Where national legislation places the heirs of a person who, at the time of death, had the status of resident and those of a person who, at the time of death, had the status of non-resident on the same footing for the purposes of taxing an inherited immovable property which is situated in the Member State concerned, that legislation cannot, without giving rise to discrimination, treat those heirs differently in the taxation of that property so far as concerns the deductibility of charges secured on it. By treating the inheritances of those two categories of persons in the same way (except in relation to the deduction of debts) for the purposes of taxing their inheritance, the national legislature has in fact admitted that there is no objective difference between them in regard to the detailed rules and conditions relating to that taxation which could justify different treatment". Another recent example of ECJ case law requiring a legal comparison is its judgment in *Eckelkamp* where the Court used almost identical words[23].

However, the big exception to this case law has always been *Schumacker* and the judgments following that approach[24]. In these judgments the Court never required legal comparability

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[21] ECJ, 28 January 1986, Case 270/83, *Commission / France* [1986] ECR I-273, paras. 19 et seq.

[22] ECJ, 11 September 2008, Case C-43/07, *Arens-Sikken*, paras. 55 et seq.

[23] ECJ, 11 September 2008, Case C-11/07, *Eckelkamp*.

[24] ECJ, 14 February 1995, Case C-279/03, *Finanzamt Köln/Altstadt / Schumacker* [1995] ECR I-225; ECJ, 11 August 1995, Case C-80/94, *Wielockx / Inspecteur der directe belastingen* [1995] ECR I-2493; ECJ, 27 June 1996,

but focused on factual comparability instead[25]: The ECJ held the situation of a resident taxpayer and a non-resident taxpayer to be comparable if "the non-resident receives no significant income in the State of his residence and obtains the major part of his taxable income from an activity performed in the state of employment, with the result that the state of his residence is not in a position to grant him the benefits resulting from the taking into account of his personal and family circumstances. […] There is no objective difference of the situation of such a non-resident and a resident engaged in comparable employment, such as to justify different treatment as regards the taking into account for taxation purposes of the taxpayer's personal and family circumstances. […] In the case of a non-resident who receives the major part of his income and almost all his family income in a Member state other than his residence, discrimination arises from the fact that his personal and family circumstances are taken into account neither in the State of residence nor in the State of employment."[26]

The weaknesses of this approach are obvious, numerous and have been repeatedly mentioned[27]: The Court had to determine what "almost all of his income" means and it accepted a 90 % threshold, which has been correctly criticized as arbitrary. Moreover, the phrase "almost all of his income" makes only sense if there is a European-wide definition of income. However, such a definition does not exist. As a consequence, the Court's attempt to

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Case C-107/94, *Asscher / Staatssecretaris van Financiën* [1996] ECR I-3089; ECJ, 12 May 1998, Case C-336/96, *Gilly / Directeur des services fiscaux du Bas-Rhin* [1998] ECR I-2793; ECJ, 14 September 1999, Case C-391/97, *Gschwind* [1999] ECR I-5451; ECJ, 16 May 2000, Case C-87/99, *Zurstrassen* [2000] ECR I-3337; ECJ, 12 June 2003, Case C-234/01, *Gerritse* [2003] ECR I-5933; ECJ, 1 July 2004, Case C-169/03, *Wallentin* [2004] ECR I-6446; ECJ, 9 November 2006, Case C-520/04, *Turpeinen* [2006] ECR I-10685; ECJ, 17 July 2007, Case C-182/06, *Lakebrink and Peters-Lakebrink* [2007] ECR I-6705; ECJ, 16 October 2008, Case C-527/06, *Renneberg*; also Opinion of Advocate General Colomer, 26 October 2004, Case C376/03, *D.* [2005] I-5821; Opinion of Advocate General Léger, 1 March 2005, Case C-125/03, *Ritter-Coulais* [2006] ECR I-1711.

[25] See Cordewener/Dahlberg/Pistone/Reimer/Romano, The Tax Treatment of Foreign Losses: Ritter, M & S, and the Way Ahead (Part Two), ET 2004, pp. 225 and 230; Lang, Ist die Schumacker-Rechtsprechung am Ende?, *RIW* 2005, p. 344.

[26] ECJ, 14 February 1995, Case C-279/03, *Finanzamt Köln/Altstadt / Schumacker* [1995] ECR I-225, para. 36.

[27] Wattel, Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why Schumacker, Asscher, Gilly and Gschwind Do Not Suffice, *ET* 2000, pp. 210 et seq.; Avery-Jones, A Comment on "Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances", *ET* 2000, pp. 375 et seq.; Cordewener, *Europäische Grundfreiheiten und nationales Steuerrecht* (2002) pp. 493 et seq.; Mattson, Does the European Court of Justice Understand the Policy behind Tax Benefits Based on Personal and Family Circumstances?, *ET* 2003, p. 193; Lang, Wohin geht das Internationale Steuerrecht?, *IStR* 2005, p. 290; Lang, Ist die Schumacker-Rechtsprechung am Ende?, *RIW* 2005, pp. 337 et seq.

distinguish between *D.*[28] and *Wallentin*[29] by introducing a concept of income by "nature" failed completely[30]. Even if it were possible to apply the threshold uniformly, it is not satisfactory that non-resident taxpayers whose income is above that threshold are entitled to all benefits resident taxpayers get, while those non-resident taxpayers whose income is below the threshold would not get any of these benefits[31]. In addition, in a trilateral situation the *Schumacker* approach does not work[32]. Although the *Schumacker* case law intends to guarantee that personal and family circumstances are taken into account somewhere, this result cannot be achieved even in a bilateral situation, since neither state is obliged to take into account such circumstances at all[33]. Moreover, it is arbitrary, if not impossible, to distinguish between rules that are aimed at taking personal and family circumstances into account, and other rules[34]. In *Gerritse*, the Court, using this approach, even felt obliged to distinguish between different types of allowances[35]. Additionally, the *Schumacker* approach is limited to taxes. However, the area between tax law and social law is sometimes grey. Under some country's tax systems allowances may turn into transfer payments if the taxpayer has not earned a certain amount of income. While the Court usually does not have to distinguish between the different areas of the law when it applies the freedoms since the standards for the application of the freedoms are identical, the *Schumacker* case law forces the ECJ to determine whether a rule is still part of tax law or has to be treated already as a non-tax rule.

[28] ECJ, 14 September 2000, Case C-384/98, *D.* [2000] ECR I-6796.

[29] ECJ, 1 July 2004, Case C-169/03, *Wallentin* [2004] ECR I-6446.

[30] Lang, Die Neuregelung der beschränkten Steuerpflicht nach dem Abgabenänderungsgesetz 2004, *SWI* 2005, pp. 156 et seq.; Lang, Das EuGH-Urteil in der Rechtsache D. – Gerät der Motor der Steuerharmonisierung ins Stottern? *SWI* 2005, pp. 365 et seq.

[31] Wattel, Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why Schumacker, Asscher, Gilly and Gschwind Do Not Suffice, *ET* 2000, pp. 212 et seq.; similar Schnitger, Die Rechtsprechung des EuGH zur Berücksichtigung der persönlichen Verhältnisse, eine Sackgasse?, *IStR* 2002, p. 279; Kofler/Schindler, „Dancing with Mr D": The ECJ's Denial of Most-Favoured-Nation Treatment in the "D" case, *ET* 2005, pp. 536 et seq.

[32] Wattel, The Schumacker Legacy Introduction Taxing Non-Resident Employees: Coping with Schumacker, *ET* 1995, p. 351; Cordewener/Reimer, The Future of Most-Favoured-Nation Treatment in EC Tax Law – Did the ECJ Pull the Emergency Brake without Real Need? – Part 2, *ET* 2006, p. 302.

[33] See for instance Wattel, Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why Schumacker, Asscher, Gilly and Gschwind Do Not Suffice, *ET* 2000, pp. 214 et seq.

[34] Wattel, The Schumacker Legacy Introduction Taxing Non-Resident Employees: Coping with Schumacker, *ET* 1995, pp. 349 et seq.; Lang, Ist die Schumacker-Rechtsprechung am Ende?, *RIW* 2005, pp. 342 et seq.

[35] ECJ, 12 June 2003, Case C-234/01, *Gerritse* [2003] ECR I-5933.

The Court was faced with this problem in *Blanckaert*[36]. Wherever the Court draws the border line, the result will be arbitrary[37].

From this perspective it is highly surprising that the Court has neither explicitly given up nor at least silently stopped applying its *Schumacker* case law, but has even confirmed and extended that approach: Under the earlier *Schumacker* case law the ECJ required that the applicable rules had to be aimed at taking into account personal and family circumstances[38]. More recent judgments, however, no longer seem to require a link to the personal and family situation. In *Turpeinen* the Court had to deal with a disadvantageous treatment of non-resident pensioners whose pensions were taxed at a flat rate of 35 % while resident taxpayers could benefit from the progressive tax rate[39]. The ECJ applied its *Schumacker* case law and required (only) that non-resident taxpayers who receive almost all of their income in the state of source have to be treated like resident taxpayers. In *Turpeinen*, the ECJ referred only to personal and family circumstances insofar as Finnish tax legislation provided "that retirement pensions such as that paid to Ms Turpeinen are, in the case of resident taxpayers, taxed in the same way as any income deriving directly from an economic activity, on a progressive scale and with allowances to take into account the taxpayers' ability to pay tax and his personal and family circumstances"[40]. *Wielockx*, to which the Court had referred in its *Turpeinen* judgment, however, was about deductions from the taxable base that were denied to non-resident taxpayers[41]. Mr Wielockx at least could complain that these deductions were nowhere taken into account if he was not entitled to them in the state of employment where he received almost all of his income. If, however, the existence of a "progressive scale with allowances to take into account the taxpayers ability to pay tax and his personal and family circumstances" in the state of residence as such justifies the application of the *Schumacker* case law, that case law could be applied to nearly all income tax cases.

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[36] ECJ, 8 September 2005, Case C-512/03, *Blanckaert* [2005] ECR I-7685.

[37] Lang/Jettmar, Steuerrecht und Sozial(versicherungs)recht – Anmerkungen zum Schlussantrag in der Rs. Blanckaert -, *IWB* 2005, pp. 695 et seq.

[38] Lang, Ist die Schumacker-Rechtsprechung am Ende?, *RIW* 2005, pp. 337 et seq.

[39] ECJ, 9 November 2006, Case C-520/04, *Turpeinen* [2006] ECR I-10685.

[40] ECJ, 9 November 2006, Case C-520/04, *Turpeinen* [2006] ECR I-10685, para. 30.

[41] ECJ, 11 August 1995, Case C-80/94, *Wielockx / Inspecteur der directe belastingen* [1995] ECR I-2493, para. 20; ECJ, 9 November 2006, Case C-520/04, *Turpeinen* [2006] ECR I-10685, para. 28.

Therefore, it had to be expected that domestic courts would request from the ECJ guidance whether the *Schumacker* case law has to be applied on income taxpayers incurring losses from sources outside of the state where they receive almost all of their income. In *Ritter-Coulais* the Court had to deal with a couple who received all their employment income from sources in Germany, but who, however, were not permitted to deduct the foreign loss they incurred from the use of their French private dwelling from the German tax base[42]. For procedural reasons the ECJ did not deal with whether the deduction of the loss had to be allowed in Germany. The Court only dealt with whether the loss had to be deducted for the purpose of determining the tax rate in Germany. While the Advocate General had treated the couple as residents of France and non-residents in Germany who had received all their income outside of their state of residence and had therefore applied the *Schumacker* case law[43], the Court followed a slightly different approach[44]: The ECJ held "that individuals such as the appellants in the main proceedings, who worked in Germany whilst residing in their own home in another Member State, were not entitled, in the absence of positive income, to have income losses relating to the use of their home taken into account for the purposes of determining their income tax rate, in contrast with individuals working and residing in their own homes in Germany. […] Even though the national legislation is not specifically directed at non-residents, the latter are more likely to own a home outside Germany than resident citizens. […] It follows that the treatment of non-resident workers under the national legislation is less favourable than that afforded to workers who reside in Germany in their own homes." The Court concluded that Article 48 EC precludes "national legislation, such as that at issue in the main proceedings, which does not permit natural persons in receipt of income from employment in one Member State, and assessable to tax on their total income there, to have income losses relating to their own use of a private dwelling in another Member State taken into account for the purposes of determining the rate of taxation applicable to their income in the former state, whereas positive rental income relating to such a dwelling is taken into account." *Ritter-Coulais*, therefore, was finally not considered to be a case where resident and non-resident taxpayers were treated differently but where a resident taxpayer with foreign

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[42] ECJ, 21 Feburary 2006, Case C-152/03, *Ritter-Coulais* [2006] ECR I-1711.

[43] Opinion of Advocate General Léger, 1 March 2005, Case C-125/03, *Ritter-Coulais* [2006] ECR I-1711, points 84 et seq.

[44] ECJ, 21 Feburary 2006, Case C-152/03, *Ritter-Coulais* [2006] ECR I-1711, paras. 35 et seq.

losses was discriminated against compared to another resident taxpayer with domestic losses[45].

However, the ECJ considered *Lakebrink* as the appropriate case in which to develop its *Schumacker* case law further[46]. The couple resided in Germany, was employed in Luxemburg and received the major part of their income there, but incurred a loss from rental of immovable property in Germany. They requested that the loss should be taken into account for the determination of the tax rate. The Court held that "discrimination arises from the fact that the personal and family circumstances of a non-resident who receives the major part of his income and almost all his family income in a Member State other than that of his residence are taken into account neither in the State of residence nor in the State of employment (*Schumacker*, paragraph 38). […] the ground, recalled at paragraph 31 of the present judgment, on the basis of which the Court made its finding of discrimination in *Schumacker* concerns […] all the tax advantages connected with the non-resident's ability to pay tax which are not taken into account either in the State of residence or in the State of employment [...] since the ability to pay tax may indeed be regarded as forming part of the personal situation of the non-resident within the meaning of the judgment in *Schumacker*. […] Consequently, the refusal by a Member State's tax authorities to take into consideration negative rental income concerning a taxpayer's properties abroad constitutes discrimination prohibited by Article 39 EC."[47] After the ECJ's judgment in *Turpeinen*, it was not surprising that the Court extended its *Schumacker* case law to losses as well.

In *Renneberg*, which was about the tax base and not only the tax rate, the ECJ confirmed this approach once more[48]. Mr Renneberg was living in Belgium but received all his income from sources in the Netherlands, where he was employed and liable to unlimited taxation. He

[45] Ritter-Coulais is in this respect similar to Bachmann: In Bachmann the ECJ held that distinguishing between two Belgian residents, one of them paying insurance premiums to a foreign insurance company and therefore not being able to deduct them, whereas payments to a domestic insurance company are deductible, may mean that it is mainly residents of other EU Member States who will suffer since they typically have concluded insurance contracts with insurance companies in their Member States before they moved to Belgium (see ECJ, 28 January 1992, Case C-204/90, *Bachmann / Belgian State* [1992] ECR I-249; see further Lang, *Die Rechtsprechung des EuGH zu den direkten Steuern* (2007) p. 30.).

[46] ECJ, 17 July 2007, Case C-182/06, *Lakebrink and Peters-Lakebrink* [2007] ECR I-6705.

[47] ECJ, 17 July 2007, Case C-182/06, *Lakebrink and Peters-Lakebrink* [2007] ECR I-6705, paras. 31 et seq.

[48] ECJ, 16 October 2008, Case C-527/06, *Renneberg*.

suffered losses that had arisen from his Belgian home. Under the tax treaty between Belgium and the Netherlands, his state of residence was Belgium and profits from immovable property situated in Belgium could not be taxed in the Netherlands. However, under Netherlands domestic tax law losses from such sources were deductible if the taxpayer was not only liable to unlimited taxation in the Netherlands but also qualified as resident under the tax treaty. Since Mr Renneberg was not a Netherlands resident under the Netherlands-Belgium tax treaty he was not entitled to that deduction. The Court applied its *Schumacker* case law and required that the deductions have to be extended to those non-residents who receive all or almost all of their income in the Netherlands. The ECJ convincingly did not accept the balanced allocation of taxing rights as a justification[49]: The Netherlands had granted the foreign loss deduction to those resident taxpayers who were considered residents under the treaty without being obliged to do so under the treaty. If a country voluntarily grants benefits which it was not obliged to grant under EC law to its resident taxpayers, it has to extend those benefits to all other taxpayers who are in a comparable situation. In such a case that country may no longer refuse to do so by referring to the balanced allocation of taxing rights. If that Member State grants these benefits unilaterally in some circumstances, one may assume that it is not too concerned about preserving the balanced allocation of taxing rights.

It is interesting that the ECJ treated Mr Renneberg as a Belgian resident. For the Court it was obviously not relevant that he was liable to unlimited taxation in the Netherlands as well. That position seems to differ from the approach the Court followed in the *Ritter-Coulais* case: Under tax treaty law, Mr and Mrs Ritter-Coulais were only French residents; however, under German tax law they were German residents as well[50]. Contrary to *Renneberg*, the ECJ in *Ritter-Coulais* put emphasis on the unlimited tax liability of the couple under German law and required for *all* taxpayers subject to unlimited tax liability in Germany that losses incurred from foreign dwellings should be deductible. The exclusion of foreign dwellings might have more likely hurt those taxpayers subject to unlimited taxation in Germany who reside outside Germany[51]. The approach of the ECJ in *Renneberg* is to a certain extent narrower, and to a

[49] Different opinion Kemmeren, The Netherlands I: The Renneberg, X Holding and Commission v. the Netherlands Cases, in Lang/Pistone/Schuch/Staringer, *ECJ – recent developments in direct taxation 2008* (2008) pp. 284 et seq.; see also Englisch, Grundfreiheitsbeschränkung zwecks Wahrung der Aufteilung der Besteuerungsbefugnis, *SWI* 2007, pp. 399 et seq.

[50] ECJ, 21 Feburary 2006, Case C-152/03, *Ritter-Coulais* [2006] ECR I-1711.

[51] Meussen, The Ritter-Coulais Case – A Wrong Decision in Principle by the ECJ, *ET* 2006, pp. 335 et seq.

certain extent broader than its *Ritter-Coulais* judgment: It is narrower since only those Belgian residents are entitled to the loss deduction in the Netherlands who receive all or almost all of their income from Netherlands sources. It is broader since not only taxpayers who are subject to unlimited tax liability in the Netherlands benefit but other taxpayers as well if they earn all or almost all of their income in the Netherlands. Therefore, if the ECJ had applied the same reasoning as in *Ritter-Coulais*, Mr Renneberg would have been able to deduct his losses on his Belgian home even if he had received only part of his income from Netherlands sources.

It is doubtful whether the fact that *Renneberg* was about the tax base while *Ritter-Coulais* (merely) dealt with the tax rate justifies a different approach. The answer to this question depends on whether one assumes that a tax treaty which prohibits the taxation of certain foreign profits has any impact on the treatment of foreign losses. This issue will be discussed below when justifications are more closely analyzed. However, as far as the comparison is concerned, the comparator should not have been different in *Ritter-Coulais* and in *Renneberg*. In my view, the tensions between the two judgments demonstrate that a careful search for a legal comparison, on the one hand, and the *Schumacker* case law, on the other hand, do not fit together and that that the Court should overturn *Schumacker*.

3. Comparing Two Cross Border Situations

The traditional approach to determining comparability is to focus on the different treatment of residents and non-residents, on the one hand, and of residents who have domestic and foreign income or property, on the other hand. For a long time the Court has, however, applied other approaches as well: Different cross-border situations have in many cases been found comparable. This goes back to old judgments like *Schumacker* where, in another part of its reasoning, the Court found it worth mentioning that under the Netherlands-Germany tax treaty Mr Schumacker would have been entitled to benefits he was denied due to his status as Belgian resident. The *D.* judgment is one of the leading cases in this respect[52]: Although the Court could not find Mr D., a German resident, to be in a comparable situation to a Belgian resident, who would have been entitled to the beneficial treatment requested by Mr D. from

[52] ECJ, 5 June 2005, Case C-376/03, *D.* [2005] ECR I-5821, paras. 28 et seq.; see Kofler/Schindler, “Dancing with Mr D”: The ECJ’s Denial of Most-Favoured-Nation Treatment in the “D” case, *ET* 2005, pp. 531 et seq.; Cordewener/Reimer, The Future of Most-Favoured-Nation Treatment in EC Tax Law – Did the ECJ Pull the Emergency Brake without real Need? – Part 2, *ET* 2006, pp. 291 et seq.

the Netherlands, it indirectly confirmed that different non-residents may be in a comparable situation. The only reason why the Court did not hold that German and Belgian residents were in a comparable situation was that their different treatment was due to a tax treaty. Thus, one may assume that in other situations where the different treatment is the result of the application of domestic law the Court is willing to compare different cross-border situations[53]. This has been confirmed by the ECJ repeatedly: In *CLT UFA* the situation of a subsidiary with a parent in another Member State was comparable to the situation of a permanent establishment with a head office in the other Member State[54]. In *Cadbury Schweppes* a UK corporation with a subsidiary in a low tax jurisdiction was not only held comparable with a UK corporation with a domestic subsidiary but also with UK corporations with subsidiaries in other Member States where no beneficial tax regime is applicable[55]. In *Denkavit Internationaal* parent companies receiving dividends paid by resident subsidiaries were held "as regards taxation in France of those dividends, in a comparable situation, whether they receive those dividends as resident parent companies or as non-resident parent companies which have a fixed place of business in France, or as non-resident parent companies which do not have a fixed place in France"[56]. In *Amurta* the Court made reference to the domestic system in the source state under which not only dividends distributed to domestic companies were exempt from withholding tax but also dividends paid to companies having a permanent establishment there, which owns the shares in the company making the distribution[57].

[53] See Weber/Spierts, The "D Case": Most-Favoured-Nation Treatment and Compensation of Legal Costs before the European Court of Justice, *ET* 2004, p. 67; Lang, Das EuGH-Urteil in der Rechtssache D. Gerät der Motor der Steuerharmonisierung ins Stottern?, *SWI* 2005, pp. 367 et seq.; Kofler/Schindler, "Dancing with Mr D": The ECJ's Denial of Most-Favoured-Nation Treatment in the "D" case, *ET* 2005, p. 531; Cordewener/Reimer, The Future of Most-Favoured-Nation Treatment in EC Tax Law – Did the ECJ Pull the Emergency Brake without real Need? – Part 2, *ET* 2006, pp. 293 et seq.

[54] ECJ, 23 February 2006, Case C-253/03, *CLT-UFA* [2006] ECR I-1831, para. 30.

[55] ECJ, 12 September 2006, Case C-196/04, *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, para. 44.

[56] ECJ, 14 December 2006, Case C-170/05, *Denkavit Internationaal and Denkavit France* [2006] ECR I-11949, para. 36.

[57] ECJ, 8 November 2007, Case C-379/05, *Amurta* [2007] ECR I-9569, para. 51.

Columbus Container, however, led to a lot of speculation[58]. Contrary to the Opinion of the Advocate General[59], the ECJ did not follow the approach it already had taken in *Cadbury Schweppes* when comparing two cross-border situations, namely resident taxpayers receiving income from a low tax jurisdiction within the EU compared to resident taxpayers receiving income from other Member States[60]. The ECJ has not provided any reasoning why it deviated from both its own approach in *Cadbury Schweppes* and the Opinion of the Advocate General in *Columbus Container*. However, those who assumed that the Court has completely given up comparing two different cross-border situations were refuted by the Court's judgment in the *A.* case where the Grand Chamber of the Court, no more than two weeks after its First Chamber had decided *Columbus Container*, held that Swedish residents receiving dividends from EU and EEA countries and Swedish residents receiving dividends from third countries like Switzerland are in a comparable situation[61].

Orange European Smallcap is an even more recent judgment where the Grand Chamber of the Court confirmed this line of reasoning[62]: A shareholder investing through the intermediary of a fiscal investment enterprise gets a tax benefit in the Netherlands insofar as the investment enterprise receives dividends from corporations located in countries with which the Netherlands has concluded tax treaties. Therefore, the Netherlands legislation distinguishes between two different situations[63]: "[…] where a fiscal investment enterprise receives dividends from Member States with which the Kingdom of the Netherlands has concluded a convention providing for shareholders who are natural persons to be entitled to credit the tax which those Member States have deducted from the dividends to the income tax for which those shareholders are liable in the Netherlands, the situation of that enterprise is different from that in which it finds itself when receiving dividends from Member States with which

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[58] See e.g. Gstöttner, Rs Columbus Container – Absage an die "Outbound-Meistbegünstigung"?, *taxlex* 2008, pp. 288 et seq.

[59] Opinion of Advocate General Mengozzi, 29 March 2007, Case C-298/05, *Columbus Container Services* [2007] ECR I-10451, point 67.

[60] See ECJ, 12 September 2006, Case C-196/04, *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, para. 44 and ECJ, 6 December 2007, Case C-298/05, *Columbus Container Service* [2007] ECR I 10451, para. 39.

[61] ECJ, 18 December 2007, Case C-101/05, *A.* [2007] ECR I-11531, paras. 41-42.

[62] ECJ, 20 May 2008, Case C-194/06, *Orange European Smallcap Fund*, para. 105.

[63] ECJ, 20 May 2008, Case C-194/06, *Orange European Smallcap Fund*, para. 61.

the Kingdom of the Netherlands has not concluded such a convention, as there is no such entitlement in respect of those dividends." The ECJ referred to its judgment in *D.*; however, the Court acknowledged that the case is different since "the payment of the concession granted in Article 28(1)(b) of the Law on corporation tax, in conjunction with Article 6 of the Royal Decree, results, not from the automatic application of such a bilateral tax convention, but from the unilateral decision of the Kingdom of the Netherlands to extend the benefit of such conventions to fiscal investment enterprises."[64] The Court gives reasons why the two different situations are not comparable[65]: "[…] by granting the concession, the Netherlands legislation at issue in the main proceedings seeks to make dividends received by a shareholder investing directly subject as far as possible to the same treatment for tax purposes as those received by a shareholder investing through the intermediary of a fiscal investment enterprise, so as to prevent investments abroad by such an enterprise from being regarded as less appealing than direct investments. […] However, under such legislation, where a fiscal investment enterprise receives dividends from Member States, with which the Kingdom of the Netherlands has concluded a convention providing for shareholders who are natural persons to be entitled to credit the tax which those Member States have deducted from the dividends to the income tax for which those shareholders are liable in the Netherlands, the situation of that enterprise is different from that in which it finds itself when receiving dividends from Member States, with which the Kingdom of the Netherlands has not concluded such a convention, as there is no such entitlement in respect of those dividends. […] In fact, it is only as regards investments in the Member States with which the Kingdom of the Netherlands has concluded such a bilateral tax convention that, without the concession granted by the legislation at issue in the main proceedings, the decision to invest through the intermediary of a fiscal investment enterprise runs the risk of being less advantageous to a shareholder who is a natural person than direct investment. […] By contrast, as regards the Member States with which the Kingdom of the Netherlands has not concluded such a convention, the decision, by a natural person, to invest through the intermediary of such an enterprise does not involve the risk of losing a benefit which he could have enjoyed if he had chosen to invest directly in those Member States. Accordingly, that situation is not objectively comparable to the situation in which the Kingdom of the Netherlands has concluded such a tax convention. […] It follows that, in the case of legislation such as that at issue in the main proceedings, pursuant

[64] ECJ, 20 May 2008, Case C-194/06, *Orange European Smallcap Fund*, para. 54.

[65] ECJ, 20 May 2008, Case C-194/06, *Orange European Smallcap Fund*, para. 60.

to which – in order to make the tax treatment of direct investments and of those made through the intermediary of investment enterprises the same, as far as possible – a Member State has decided to grant those enterprises a concession in respect of tax deducted at source on dividends from Member States vis-à-vis which it has undertaken, under the terms of bilateral agreements, to allow natural persons to credit those deductions to the income tax for which they are liable under national law, Articles 56 EC and 58 EC do not preclude that Member State from withholding that concession in respect of dividends from other Member States with which it has not concluded bilateral agreements containing such provisions, as these are not objectively comparable situations." There is only a need for such a careful and lengthy reasoning if unilateral rules granting benefits for income from sources in certain countries in other circumstances than the special situation described in the decision run the risk of being incompatible with the freedoms. Thus, in *Orange European Smallcap* the ECJ implicitly confirmed that the situation of taxpayers who receive income from different Member States may be viewed as comparable.

The judgment on the *Belgian care insurance scheme*, decided by the Grand Chamber of the Court as well, fits within this case law[66]: Under provincial legislation in Belgium employed and self-employed workers performing their activities in the Dutch-speaking and the bilingual region of Belgium could only benefit from a care insurance scheme if they either resided in one of the two regions or in another Member State, but not if they resided in the French-speaking region of Belgium. Although the ECJ, contrary to the position taken by the Advocate General[67], refused to apply the freedoms in merely internal situations, the freedoms were not completely inapplicable[68]: "[…] the legislation at issue in the main proceedings may also exclude from the care insurance scheme employed or self-employed workers falling within the ambit of Community law, that is to say, both nationals of Member States other than the Kingdom of Belgium working in the Dutch-speaking region or in the bilingual region of Brussels-Capital but who live in another part of the national territory, and Belgian nationals in the same situation who have made use of their right to freedom of movement." The Court

[66] ECJ, 1 April 2008, Case C-212/06, *Gouvernement de la Communauté française and Gouvernement wallon*.

[67] Opinion of Advocate General Sharpston, 28 June 2007, Case C-212/06, *Gouvernement de la Communauté française and gouvernement wallon*, point 101.

[68] ECJ, 1 April 2008, Case C-212/06, *Gouvernement de la Communauté française and Gouvernement wallon*, para. 41.

made an interesting statement[69]: "Migrant workers, pursuing or contemplating the pursuit of employment or self-employment in one of those two regions, might be dissuaded from making use of their freedom of movement and from leaving their Member State of origin to stay in Belgium, by reason of the fact that moving to certain parts of Belgium would cause them to lose the opportunity of eligibility for the benefits which they might otherwise have claimed. In other words, the fact that employed or self-employed workers find themselves in a situation in which they suffer either the loss of eligibility care insurance or a limitation of the place to which they transfer their residence is, at the very least, capable of impeding the exercise of the rights conferred by Articles 39 EC and 43 EC." In essence, the Court compared workers who leave their Member State of origin and perform their activities in the Dutch-speaking or in the bilingual region of Belgium and reside in one of the two regions, with other workers who leave their Member State of origin and perform their activities in one of these two regions, but who reside in the French-speaking region of Belgium. Thus, the ECJ accepted two different cross-border situations as comparable.

It is obvious that not all cross-border situations are automatically comparable to each other. Neither are domestic and cross-border situations always comparable. Comparability depends on the legal situation of the case. However, in the meantime one may assume that it is settled case law that, *depending on the legal situation at stake*, cross-border situations may be considered comparable to domestic situations as well as to other cross-border situations[70]. Although after *Columbus Container*, due to the lack of reasoning, it was not clear whether the Court had just not found the two cross-border situations to be comparable in that case or whether the Court intended to refrain from comparing two different cross-border situations in general, more recent ECJ case law confirms that the Court has not given up comparing one cross-border situation with another[71].

[69] ECJ, 1 April 2008, Case C-212/06, *Gouvernement de la Communauté française and Gouvernement wallon*, para. 48.

[70] Lang, ECJ case law on cross-border dividend taxation – recent developments, *EC Tax Review* 2008, pp. 73 et seq.

[71] See Schmidtmann, Zur vertikalen und horizontalen Vergleichspaarbildung des EuGH aus ökonomischer Sicht, *IW* 2008, p. 1101, who supports horizontal comparison from an internal market point of view.

III. Justifications and Proportionality

1. Which and How many Justifications?

Looking at the recent case law regarding justifications, one has to acknowledge that the case law of the ECJ is furthering a continual state of development. On the one hand, the Court is willing to accept new grounds of justification: E.g. in *Jäger* the ECJ did not want to rule out that "objectives connected with the carrying on of the activities of agricultural and forestry holdings and preservation of jobs in the latter in cases of inheritance may in themselves, in certain circumstances and under certain conditions, be in the public interest and capable of justifying restrictions on the free movement of capital"[72]. This requires distinguishing these objectives from more general objectives mentioned in cases like *Verkooijen*[73]: The UK Government had submitted that a legislative provision "may be objectively justified by the intention to promote the economy of the country by encouraging investment by individuals in companies with their seat in the Netherlands."[74] The Court was quick to respond that "it need merely be pointed out that, according to settled case-law, aims of a purely economic nature cannot constitute an overriding reason in the general interest justifying a restriction of a fundamental freedom guaranteed by the Treaty"[75]. An alternative reading of the statement in *Jäger* is that from now on the Court may consider accepting justifications of a mere economic nature, which it had rejected in its earlier case law.

In the case of the *Belgium care insurance scheme* the ECJ confirmed its settled case law according to which constitutional requirements cannot justify a different treatment of comparable situations[76]: The Flemish Government had referred exclusively to the requirements inherent in the division of powers within the Belgian federal structure and, particularly, to the fact that the Flemish Community could exercise no competence in relation to care insurance in respect of persons residing in the territory of other linguistic communities

[72] ECJ, 17 January 2008, Case C-256/06, *Jäger* [2008] ECR I-123, para. 50.

[73] ECJ, 6 June 2000, Case C-35/98, *Verkooijen* [2000] I-4071, para. 46.

[74] ECJ, 6 June 2000, Case C-35/98, *Verkooijen* [2000] I-4071, para. 47.

[75] ECJ, 6 June 2000, Case C-35/98, *Verkooijen* [2000] I-4071, para. 48.

[76] ECJ, 1 April 2008, Case C-212/06, *Gouvernement de la Communauté française and Gouvernement wallon*, para. 58.

of Belgium[77]. This line of argument was rejected by the Court[78]: "[…] the Court has consistently held that a Member State cannot plead provisions, practices or situations prevailing in its domestic legal order, including those resulting from the constitutional organisation of that State, to justify the failure to observe obligations arising under Community law." Although the Court is correct in referring to its settled case law, this approach is, however, limited to the scope of the freedoms. In the area of state aid, the Court has taken a different route: In order to determine regional selectivity the ECJ has followed the suggestion of the late Advocate General Geelhoed of developing criteria under which regions may be considered autonomous[79]. If these requirements are met, beneficial measures which are limited to a certain region are not considered to be selective. In its case law on the limitation of the temporal effects of its judgments, the ECJ applies a less elaborate approach but focuses as well on local entities in order to determine how severe the economic consequences of its judgments would be[80]. E.g. in *EKW* the Court held that "calling in question legal relations which have exhausted their effects in the past […] would retroactively cast into confusion the system whereby Austrian municipalities are financed."[81] Contrary to its approach on regional selectivity, it was not the situation of the *individual* municipality that was relevant, but the whole "system whereby Austrian municipalities are financed". This approach, however, differs from the position taken by the Court in the area of the freedoms, since in *EKW* it made a difference that it was not the federal government of Austria but the municipalities which benefitted from that tax[82]. A different approach is followed in the area of procedural law when the Court requires equivalent treatment of recoveries under Community law and domestic law: The Court only takes into account rules that had been introduced by

[77] ECJ, 1 April 2008, Case C-212/06, *Gouvernement de la Communauté française and Gouvernement wallon*, para. 57.

[78] ECJ, 1 April 2008, Case C-212/06, *Gouvernement de la Communauté française and Gouvernement wallon*, para. 58.

[79] Opinion of Advocate General Geelhoed, 20 October 2005, Case C-88/03, *Portuguese Republic / Commission of the European Communities* [2006] ECR I-7115, point 54.

[80] Lang, Die Beschränkung der zeitlichen Wirkung von EuGH-Urteilen im Lichte des Urteils Meilicke, *IStR* 2007, p. 235; see also ECJ, 6 March 2007, Case C-292/04, *Meilicke* [2007] ECR I-1835.

[81] ECJ, 9 March 2000, Case C-437/97, *EKW and Wein & Co.* [2000] ECR I-1157, para. 59.

[82] Lang, Die Beschränkung der zeitlichen Wirkung von EuGH-Urteilen im Lichte des Urteils Meilicke, *IStR* 2007, p. 238; Lang, Limitation of the Temporal Effects of Judgments of the ECJ, *Intertax* 2007, p. 238.

the same legislator[83]. Thus, legislation on recovery of community charges introduced by a region may be considered to be in accordance with the equivalency requirement, even if domestic recoveries are treated more favorably by a rule introduced by another level of government for charges levied by that level, as long as there is no rule introduced by the same provincial legislator that is more beneficial for domestic recoveries. One cannot exclude that there are convincing reasons why the ECJ applies different standards in different areas of Community law. However, it could at least be expected that the Court would provide reasons for the different approaches.

Recently, the Court had to come back to its *Marks & Spencer* judgment where it had dealt with the protection of a balanced allocation of the power to impose taxes between the various Member States concerned, the danger that losses would be used twice and the risk of tax avoidance as possible justifications and had concluded that these justifications, "taken together", were acceptable[84]. Authors have been speculating since whether from *Marks & Spencer* one has to draw the conclusion that each justification alone is insufficient to accept different treatment, and whether justifications that have been rejected in the past individually, could be relevant again and could, if "taken together", get accepted by the Court[85].

Advocate General Poiares Maduro gave his interpretation of this requirement in his Opinion in *Rewe*[86]. He suggested that the criterion of a balanced allocation of taxing powers between the Member States cannot stand alone. This criterion cannot be separated from the other two criteria, i.e. the danger of the double utilization of losses and the risk of tax avoidance. From this, he concluded that only these two criteria must be examined[87]. This was, in the author's

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[83] ECJ, 2 Oktober 2003, Case c-147/01, Weber's Wine World and others [2003] ECR I-11365; see Lang, Die landesabgabenrechtlichen Rückzahlungssperren im Lichte des Getränkesteuer-Urteils des EuGH vom 2. 10. 2003, C-147/01 Teil 1, *ÖStZ* 2003, pp. 464 et seq.

[84] ECJ, 19 September 2006, Case C-356/04, *Lidl Belgium* [2006] ECR I-8501, paras. 38-43.

[85] Lang, Direct Taxation: Is the ECJ Heading in a New Direction?, *ET* 2006, pp. 426 et seq., Lang, The Marks & Spencer Case – The Open Issues Following the ECJ's Final Word, *ET* 2006, pp. *59* et seq.; Douma/Naumburg, Marks & Spencer: Are National Tax Systems Éclairé?, *ET* 2006, p. 433; Kessler/Eicke, Gedanken zur grenzüberschreitenden Verlustnutzung nach Lidl Belgium, *IStR* 2008, p. 583; Kube, Grenzüberschreitende Verlustverrechnung und die Zuordnung von Verantwortung, *IStR* 2008, pp. 307 et seq.; Petutschnig/Six, EuGH Urteil Lidl Belgium – Neues zur grenzüberschreitenden Verlustverrechnung, *SWI* 2008, p. 370.

[86] Opinion of Advocate General Poiares Maduro, 31 May 2006, Case C-347/04, *Rewe Zentralfinanz.*

[87] Opinion of Advocate General Poiares Maduro, 31 May 2006, Case C-347/04, *Rewe Zentralfinanz,* point 34.

view, a very elegant attempt to dispose of the balanced allocation of the power to impose taxes between the Member States as a possible justification[88]. Specifically, if the other two criteria are considered exclusively, it is unnecessary to deal with the question of whether or not the power to impose taxes is allocated in a balanced way. The ECJ in *Rewe*, however, approvingly referred to the Opinion of its Advocate General, but seemed to have left it open whether it would go as far[89]: "As the Advocate General stated at point 32 of his Opinion, it is necessary to define the scope to be accorded to the legitimate requirement of the balanced allocation of the power to impose taxes between the Member States. In particular, it must be noted that such a justification was accepted by the Court in the judgment in Marks & Spencer only in conjunction with two other grounds, based on the taking into account of tax losses twice and on tax avoidance (see, to that effect, Marks & Spencer, paragraphs 43 and 51)."

In her Opinion in *OY AA* Advocate General Kokott dealt with the three justifications mentioned in *Marks & Spencer* as well and emphasized that they should be seen together: "The formulation cited above already makes it clear that all three elements are closely linked to one another and cannot be viewed in isolation. In this connection preserving the allocation of the power to impose taxes is at the heart of these elements. […] The second element of justification recognised in *Marks & Spencer*, namely preventing the danger that losses are used twice, is closely connected to the allocation of the power to impose taxes. […] The allocation of power to impose taxes on the basis of elements of territoriality (an undertaking's residence or source of income within the territory) serves to confer on a State a primary right to tax certain income. This, taken together with the rules to prevent double taxation, creates an international system of tax competence. […] The risk of tax avoidance as the third element of justification is also closely linked to the other two elements of justification. One might regard intra-group transfers to companies resident in Member States in which such payments are not taxable in itself as tax avoidance. To that extent this justification may be considered together with the second justification."

In the judgment in *Oy AA* the Court held that the balanced allocation of the power to tax may be jeopardized and could be undermined if the scope of the Finnish group contribution system

[88] Lang, Direct Taxation: Is the ECJ Heading in a New Direction?, *ET* 2006, p. 427.

[89] ECJ, 29 March 2007, Case C-347/04, *Rewe Zentralfinanz* [2007] ECR I-2647, para. 41.

would have to be extended[90]. The Finnish system was able to prevent practices which are designed only to avoid the tax normally due in the Member State of the subsidiary on its profits. Concerning, however, the risk that losses might be utilized twice, the ECJ pointed out that the Finnish system of intra-group financial transfers did not concern the deductibility of losses[91]. Although only two of the three grounds of justifications were accepted, the Court viewed this as sufficient, without providing further reasoning[92]: "Having regard to the combination of those two factors, concerning the need to safeguard the balanced allocation of the power to tax between the Member States and the need to prevent tax avoidance, this Court therefore finds that a system, such as that at issue in the main proceedings, which grants a subsidiary the right to deduct a financial transfer in favour of its parent from its taxable income only where the parent and the subsidiary both have their principal establishment in the same Member State, pursues legitimate objectives compatible with the Treaty and justified by overriding reasons in the public interest, and is appropriate to ensuring the attainment of those objectives. "

In *Lidl Belgium* the Court returned to its *Marks & Spencer* judgment[93]: "The national court asks, however, whether the justifications set out in paragraphs 44 to 50 of the judgment in *Marks & Spencer*, which also include the need to prevent the risk of tax avoidance, must be understood as being cumulative or whether the existence of only one of those factors is sufficient for the tax regime at issue in the main proceedings to be treated, in principle, as being justified. […], bearing in mind the wide variety of situations in which a Member State may put forward such reasons, it cannot be necessary for all the justifications referred to in paragraph 51 of the *Marks & Spencer* judgment to be present in order for national tax rules which restrict the freedom of establishment laid down in Article 43 EC to be capable, in principle, of being justified. […] Thus, in the judgment in *Oy AA*, the Court acknowledged in particular that the national tax legislation at issue could, in principle, be justified on the basis of two of the three justifications referred to in paragraph 51 of the judgment in *Marks & Spencer*, namely the need to safeguard the allocation of the power to tax between the Member States and the need to prevent tax avoidance, taken together (see *Oy AA*, paragraph 60). […]

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[90] ECJ, 18 July 2007, Case C-231/05, *Oy AA* [2007] ECR I-6373, para. 56.

[91] ECJ, 18 July 2007, Case C-231/05, *Oy AA* [2007] ECR I-6373, para. 65.

[92] ECJ, 18 July 2007, Case C-231/05, *Oy AA* [2007] ECR I-6373, para. 60.

[93] ECJ, 19 September 2006, Case C-356/04, *Lidl Belgium* [2006] ECR I-8501, para. 38.

Likewise, the tax regime at issue in the main proceedings can, in principle, be justified in the light of two of the factors referred to in paragraph 51 of the judgment in *Marks & Spencer*, namely the need to safeguard the allocation of the power to tax between the Member States and the need to prevent the danger that the same losses will be taken into account twice." Whether focusing on two justifications instead of three is more convincing is doubtful[94]. Neither of the justifications is very clear and they leave room for interpretation, as can be seen by taking a closer look at *Lidl Belgium*.

2. Symmetry

In *Lidl Belgium* one of the key words was "symmetry"[95]: The Court "pointed out that the Member State in which the registered office of the company to which the permanent establishment belongs is situated would, in the absence of a double taxation convention, have the right to tax the profits generated by such an entity. Consequently, the objective of preserving the allocation of the power to impose taxes between the two Member States concerned, which is reflected in the provisions of the Convention, is capable of justifying the tax regime at issue in the main proceedings, since it safeguards symmetry between the right to tax profits and the right to deduct losses."

The underlying assumption of the Court, however, is questionable: It is highly controversial whether tax treaty provisions that exempt certain parts of the income are applicable to losses as well. Case law seems to diverge. Whereas German courts take the position that the application of a tax treaty prevents the taxpayer from deducting a loss incurred on an exempt source of income[96], courts in Austria and Luxemburg arrived at the opposite result[97]. In any case, a tax treaty does not prevent legislation from granting deduction of losses, even if the profits are exempt[98].

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[94] See Seiler/Axer, Die EuGH-Entscheidung im Fall "Lidl Belgium" als (Zwischen-) Schritt auf dem Weg zur Abstimmung von nationaler Steuerhoheit und europäischem Recht, *IStR* 2008, p. 841.

[95] ECJ, 19 September 2006, Case C-356/04, *Lidl Belgium* [2006] ECR I-8501, para. 33.

[96] BFH, 11 March 2008, - I R 116/04 NV.

[97] VwGH 25 September 2001, 99/14/0217; Luxemburg Cour Administrative 10 August 2005, no. 17 820.

[98] See the former German rule in Section 2a EStG.

Referring to the symmetry between the right to tax profits and the right to deduct losses is definitely a more recent development and cannot be traced back to some of the older case law. *Wielockx*, inter alia, would have been decided differently if the Court had applied this approach[99]. In *Wielockx* the ECJ did not accept as a justification for refusing to non-resident taxpayers the right to reduce their tax base by setting up a pension reserve the fact that according to the tax treaty the pension would not be taxed either. The Court held that "[f]iscal cohesion has not therefore established in relation to one and the same person by a strict correlation between the deductibility of contributions and the taxation of pensions but is shifted to another level, that of reciprocity of the rules applicable in the Contracting states. […] 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."[100] In other words, the Member State cannot claim that its tax treatment is coherent if it has waived the right to tax under a tax treaty. If the Court had applied that approach in *Lidl Belgium*, the deductibility of the loss could not have been denied just because Germany has waived its right to tax foreign profits under a tax treaty.

In *Wielockx* the relevant ground of justification was fiscal cohesion[101]. The same justification had been accepted in *KR Wannsee* where the Court developed symmetry arguments as well[102]: The Court "noted that the reintegration of losses provided for by the German tax system at issue in the main proceedings cannot be dissociated from their having earlier been taken into account. That reintegration, in the case of a company with a permanent establishment in another State in relation to which that company's State of residence has no power of taxation, as the referring court indicates, reflects a logical symmetry. There was thus a direct, personal and material link between the two elements of the tax mechanism at issue in the main proceedings, the said reintegration being the logical complement of the deduction previously granted. […] It must be concluded that the restriction which follows from the reintegration thus provided for is justified by the need to guarantee the coherence of the German tax system."

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[99] ECJ, 11 August 1995, Case C-80/94, *Wielockx / Inspecteur der directe belastingen* [1995] ECR I-2493, para. 25.

[100] ECJ, 11 August 1995, Case C-80/94, *Wielockx / Inspecteur der directe belastingen* [1995] ECR I-2493, para. 24.

[101] ECJ, 11 August 1995, Case C-80/94, *Wielockx / Inspecteur der directe belastingen* [1995] ECR I-2493, para. 25.

[102] ECJ, 23 October 2008, Case C-157/07, *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt*, para. 42.

It is worth mentioning that the key argument both in *Lidl Belgium* and in *KR Wannsee,* symmetry, is identical, although the Court applied different grounds of justifications[103]: In *KR Wannsee* fiscal cohesion was dealt with[104], whereas *Lidl Belgium* was about the prevention of the double utilization of losses and the balanced allocation of taxing powers[105]. The justifications seem to become exchangeable. Two grounds of justifications, taken "together" as one of the legacies of the *Marks & Spencer* reasoning, can be replaced by the somehow magical concept of "fiscal cohesion". However, it is, at least, difficult to bring both judgments in line with each other, as far as the utilization of the foreign losses is concerned. In *Lidl Belgium* the ECJ referred to *Marks & Spencer,* where it had held "that a measure which restricts the freedom of establishment goes beyond what is necessary to attain the objectives pursued where a non-resident subsidiary has exhausted the possibilities for having the losses incurred in the Member State where it is situated taken into account for the accounting period concerned and also for previous accounting periods and where there is no possibility for that subsidiary's losses to be taken into account in that State for future periods. […] In paragraph 56 of that judgment, the Court also stated that where, in one Member State, the resident parent company demonstrates to the national tax authorities that those conditions are fulfilled, it is contrary to Article 43 EC to preclude the possibility for the parent company to deduct from its taxable profits in that Member State the losses incurred by its non-resident subsidiary."[106] The ECJ continued by pointing out "that Luxembourg tax legislation provides for the possibility of deducting a taxpayer's losses in future tax years for the purposes of calculating the tax base. […] As was confirmed at the hearing before the Court, Lidl Belgium has in fact benefited from such an offsetting of the losses incurred by its permanent establishment in 1999 in a subsequent tax year, namely 2003, in which that entity generated profits."[107] Thus, it remains unclear whether the mere existence of loss carry forward rules is sufficient, irrespective whether they are applicable in the actual case, or whether it has to be ensured that

[103] For a critical analysis of the symmetry argument see also Englisch, Grundfreiheitsbeschränkungen zwecks Wahrung der Aufteilung der Besteuerungsbefugnis, *SWI* 2007, pp. 402 et seq; Englisch, Anmerkung, *IStR* 2008, p. 404 et seq.

[104] ECJ, 23 October 2008, Case C-157/07, *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt,* para. 42.

[105] ECJ, 19 September 2006, Case C-356/04, *Lidl Belgium* [2006] ECR I-8501, para. 42.

[106] ECJ, 19 September 2006, Case C-356/04, *Lidl Belgium* [2006] ECR I-8501, para. 42.ECJ, 19 September 2006, Case C-356/04, Lidl Belgium [2006] ECR I-8501, para. 48.

[107] ECJ, 19 September 2006, Case C-356/04, Lidl Belgium [2006] ECR I-8501, paras. 49-50.

the taxpayer actually benefitted from these rules, in order to relieve the state of residence from its subsidiary obligation to utilize the loss. In *KR Wannsee*, however, the Court did not see it as a responsibility of the state of residence to allow deduction of the foreign loss although the other contracting state did not make that possible either. The Court held that it was the responsibility of the state of the permanent establishment to allow the loss to be utilized[108]. One might speculate why the Court did not take that position in *Lidl Belgium* as well. Under that position, the ECJ would not have had to worry whether Luxemburg provides for a loss carry forward, since Germany would not have any responsibility for taking into account the loss incurred in Luxemburg.

The reasoning of the ECJ in *KR Wannsee* is questionable: The starting point of the reasoning of the Court is that, "in the absence of any unifying or harmonising Community measures, Member States retain the power to define the criteria for taxing income and wealth with a view to eliminating double taxation, by means of conventions if necessary […]. […] That competence also implies that a Member State cannot be required to take account, for the purposes of applying its tax law, of the possible negative results arising from particularities of legislation of another Member State applicable to a permanent establishment situated in the territory of the said State which belongs to a company with a registered office in the first State […] The Court has held that freedom of establishment cannot be understood as meaning that a Member State is required to draw up its tax rules on the basis of those in another Member State in order to ensure, in all circumstances, taxation which removes any disparities arising from national tax rules, given that the decisions made by a company as to the establishment of commercial structures abroad may be to the company's advantage or not, according to circumstances (*Deutsche Shell*, paragraph 43). […] Even supposing that the combined effect of taxation in the State where the principal company of the permanent establishment concerned is situated and tax due in the State where that establishment is situated might lead to a restriction of the freedom of establishment, such a restriction is imputable only to the latter of those States."[109] However, the reasoning in *Lidl Belgium* demonstrates that such a

[108] ECJ, 23 October 2008, Case C-157/07, *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt*, paras. 50 et seq.

[109] ECJ, 23 October 2008, Case C-157/07, *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt*, paras. 48 et seq.

restriction is not necessarily "imputable only to the latter State"[110]. Even if the state of residence is not obliged to ensure, "in all circumstances", taxation that removes disparities, there are, as can be inferred from *Lidl Belgium*, obviously some circumstances in which the state of residence is responsible. The question remains which rules of the permanent establishment state do *not* have to be considered as "peculiarities of legislation" of that state[111], and thus, have to be taken into account by the state of residence.

The main problem of the ECJ's approach is that the Court is trying to develop criteria under which under certain conditions a Member State is responsible for taking into account losses. The ECJ tries use the tax treaty rules for that purpose; however, tax treaties neither ensure that a loss can be utilized once nor prevent the risk of double utilization of a loss. In these judgments the ECJ ignores, contrary to its – in this respect – convincing approach in judgments like *Columbus Container* or *Amurta*, that the interpretation of tax treaties is not within the Court's competence. The ECJ would go far beyond what is its settled case law so far if it were to really require the country to which the loss is "imputable" to grant a deduction to non-residents, *irrespective* of whether the legislation of that country grants it to comparable residents. It is contradictory that the Court, on the one hand, tries to ensure that a loss has to be taken into account only in one country, whereas, on the other hand, it accepts, that, outside of the scope of a tax treaty, its case law makes it possible that debts may be deducted twice from the (inheritance) tax base, as was the case in *Eckelkamp*[112].

In my view, the approaches taken in *Eckelkamp* and in *Block* are more promising[113]: The Court should limit its analysis exclusively to the legislation of one Member State in each individual case and should refrain from taking into account the legal situation in the other Member State. Since tax systems are not harmonized yet, the Court cannot avoid results that lead either to double taxation or to non-taxation, or translated to losses, to a situation where losses cannot be deducted anywhere or where they are deducted twice. Among other reasons, the fact that no common rules exist on how a loss has to be determined should prevent the

[110] See Thömmes, Nachversteuerung zuvor zum Abzug zugelassener Betriebsstättenverluste verstößt nicht gegen die Niederlassungsfreiheit, *IWB* 2008, pp. 1115 et seq.

[111] ECJ, 19 September 2006, Case C-356/04, *Lidl Belgium* [2006] ECR I-8501, para. 54.

[112] ECJ, 11 September 2008, Case C-11/07, *Eckelkamp,* para. 65 et seq.

[113] ECJ, 11 September 2008, Case C-11/07, *Eckelkamp*, para. 68 et seq; ECJ, 12 February 2009, Case C-67/08, *Block*, para. 31 et seq.

ECJ from attempting to establish a system in which every "loss" is utilized once, but not more often or not less, throughout the EU. The ECJ cannot replace the Community legislator, but can only make sure that each single Member State complies with its obligations under Community law. If the results are, from a policy point of view, not satisfactory, since neither double taxation nor non-taxation is in the long run ideal, either the Community legislator or the Member States may step in and take action. The more it becomes visible that the interaction of tax systems which are, individually, perfectly consistent, creates both tax planning opportunities and burdens, the more pressure the Community legislator may feel.

3. Proportionate and disproportionate measures

The proportionality test has not played an important role in the case law of the ECJ in the area of direct taxation for a long time. However, since the ECJ has recently been more willing to accept justifications for different treatment, it has had to deal more often with the question whether a certain domestic measure is proportionate in regard to the justification.

Even in the "old days" the Court frequently had to answer the question whether different treatment can be justified because of the need for fiscal supervision. The ECJ had dealt with that issue at the level of proportionality[114]: "As regards effective fiscal supervision, the Commission has rightly referred to Council Directive 77/799/EEC of 19 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), which can be invoked by a Member State in order to check whether payments have been made in another Member State, or to obtain all necessary information, where those payments and that information must be taken into account in determining the correct amount of income taxes (see *Bachmann*, cited above, paragraph 18, and Case C-55/98 *Vestergaard* [1999] ECR I-7641, paragraphs 26 and 28). Member States are free to resort to these arrangements when it appears appropriate to them to do so." However, more recently the Court put more emphasis on the obligation of the taxpayer to contribute to the procedure. E.g.in *Jäger*, the Court held that regarding practical difficulties "it should be noted that, while it may indeed prove difficult for national authorities to apply the assessment procedure provided for in Paragraphs 140 to 144 of the BewG to agricultural land and forestry situated in another Member State, that difficulty cannot justify a categorical refusal to grant the tax advantage in question since the taxpayers concerned could be asked themselves to

[114] ECJ, 4 March 2004, Case C-334/02, *Commission / France* [2004] ECR I-2229, para. 31.

supply the authorities with the data which they consider necessary to ensure application of that procedure in such a way that it is adapted to holdings in other Member States."[115]

A related question concerned the compatibility of withholding taxes which are exclusively levied on income of non-residents if the directive on the mutual assistance on the recovery of debt-claims is applicable. In *Scorpio* the Court explicitly left that question open since the case concerned a period in which the directive had not been in force for direct taxes[116]. In *Truck Center* Advocate General Kokott had to deal with that issue as well[117]. Although in the tax years at issue Belgium was likewise unable to rely on the directive to facilitate the recovery of taxes in another Member State, even then there was, however, the Benelux Convention signed in Brussels on 5 September 1952 on mutual administrative assistance in the recovery of tax claims:[118] "It should therefore be considered whether charging the withholding tax in the hands of the Luxembourg recipient of the interest payment – calling if need be on the administrative assistance of the Luxembourg tax authorities – might not be a less intrusive measure than deducting tax at source. […] Despite the possibility of administrative assistance, however, it is by no means necessarily the case that collecting tax from the foreign parent company to which the interest is due in fact constitutes a less severe means than collection at source within the country from the subsidiary company. If the foreign recipient were the tax debtor of the withholding tax, it would have to make a tax declaration to the tax authorities of the Member State of the source of the income, despite not being resident there. The authorities of that State would have to register that company as a taxable person and supervise the making of the tax declaration and the payment of the tax. In a case of enforcement they would also have to turn to the authorities of the State of residence of the recipient of interest, by means of administrative assistance. Altogether, this form of tax collection would probably give rise to substantially greater expense for the tax authorities, and for the group of companies, than taxation at source in the hands of the subsidiary company, which is liable to taxation within the country in any event. Especially in the case of one-off or small tax claims, the additional expense would be out of proportion to the administrative burden of deducting tax at source, as the Commission too suggests. […] Those considerations show that creating a

[115] ECJ, 17 January 2008, Case C-256/06, *Jäger* [2008] ECR I-123, para. 54.

[116] ECJ, 3 October 2006, Case C-290/04, *FKP Scorpio Konzertproduktionen* [2006] ECR I-946.

[117] Opinion of Advocate General Kokott, 18 September 2008, Case C-282/07, *Truck Center,* points 40-41.

[118] Opinion of Advocate General Kokott, 18 September 2008, Case C-282/07, *Truck Center,* points 42 et seq.

proportionate procedure for collecting taxes requires a complex assessment which the national legislature has to undertake when it exercises its competence to regulate direct taxation. […] In a situation such as the present the legislature's margin of discretion […] is in any event not obviously exceeded if the Member State introduces a withholding tax, even though it could rely on bilateral arrangements for administrative assistance for the enforcement of taxes abroad."

It is interesting that Advocate General Kokott took into account whether a less restrictive measure would give rise to substantially greater expense *both* for the tax authority and the taxpayer. In the older case law the burden for the tax authorities has not been taken into account. As far as the additional expenses of the taxpayers are concerned, it would also have been possible to leave it to the taxpayer to calculate and decide which measure is less burdensome and expensive, by allowing him *to opt* for the withholding tax. However, the Court had already followed a similar approach in the *N.* case where it accepted a rule requiring assessment at the time of emigration since this rule relieves the taxpayer from keeping all the documents in the future[119], without considering that it could have been possible as well to leave it to the taxpayer whether he prefers to be assessed at the time of the emigration, or at the time of the alienation, in case he is willing to keep all the records. In its judgment in *Truck Center* the ECJ was not concerned about the proportionality of the measure. It already dealt with the directive at the level of comparability[120]: "While resident recipient companies are directly subject to the supervision of the Belgian tax authorities, which can ensure compulsory recovery of taxes, that is not the case with regard to non-resident recipient companies inasmuch as, in their case, recovery of the tax requires the assistance of the tax authorities of the other Member State." Thus, the Court regarded the situations of non-resident and resident taxpayers as not comparable because requiring the assistance of the tax authorities of the other Member State is not equivalent to directly supervising taxpayers. Although it is surprising that the Court dealt with this issue at the level of comparability, one can conclude that the ECJ would not require the application of the directive at the level of proportionality, either. One may speculate whether it makes a difference if assistance may be required under a directive, whose application can be enforced by initiating infringement procedures and taking legal action at the level of the ECJ, or a mere

[119] ECJ, 7 September 2006, Case C-470/04, *N.* [2006] ECR I-7409, para. 50.

[120] ECJ, 22 December 2008, Case C-282/07, *Truck Center,* para. 48.

treaty under international public law, as was the case in *Truck Center*. The application of such a treaty by the government of the other contracting state can hardly be enforced by the contracting state which is requesting the other state to cooperate. However, case law on the relevance of the mutual assistance directive on exchange of information indicates that the ECJ is not inclined to distinguish between directives and treaties under international public law for that purpose[121].

Both in *Truck Center* and in *Lidl Belgium* the issue was raised whether a cash-flow disadvantage was proportionate[122]. In her Opinion in *Lidl Belgium* Advocate General Sharpston politely criticized the Court for its *Marks & Spencer* judgment, which she regarded was not in line with its older case law according cash-flow advantages[123]: "The Court is well aware of the significance of cash flow to undertakings. It has repeatedly held that the exclusion of a cash-flow advantage in a cross-border situation where it is available in an equivalent domestic situation is a restriction on the freedom of establishment. [...] Indeed it made this very point forcefully in *Marks & Spencer*. There, it explained in terms that, by speeding up the relief of the losses of the loss-making companies by allowing them to be set off immediately against the profits of other group companies, the group loss relief at issue conferred a cash advantage on the group. The exclusion of such an advantage in respect of the losses incurred by a subsidiary established in another Member State was such as to hinder the exercise by that parent company of its freedom of establishment by deterring it from setting up subsidiaries in other Member States. Thus, it constituted a restriction on freedom of establishment. […] That statement was made in the (analytically prior) context of whether the inability to deduct cross-border losses was a restriction contrary to Article 43. It seems anomalous that, having clearly accepted the potential significance of the denial of a cash-flow advantage and categorised it (correctly) as a prima facie infringement of Article 43 EC, the Court did not also examine expressly whether, where the restriction was prima facie justified, the denial of a cash-flow advantage which was an unavoidable consequence was

[121] ECJ, 18 December 2007, Case C-101/05, *A.* [2007] ECR I-11531, para. 54.

[122] ECJ, 19 September 2006, Case C-356/04, *Lidl Belgium* [2006] ECR I-8501; ECJ, 22 December 2008, Case C-282/07, *Truck Center*, paras. 48 et seq.

[123] Opinion of Advocate General Sharpston, 14 February 2008, Case C-414/06, *Lidl Belgium*, points 28 et seq.

disproportionate." Although she suggested that the ECJ should not accept the cash-flow disadvantage, the Court, without any explanation, did not follow her approach[124].

In *Truck Center* Advocate General Kokott revisited that issue[125]: "Finally, whether a possible cash-flow disadvantage, threatened in the Commission's view because the withholding tax is payable immediately, is relevant at all appears doubtful in the light of the recent case-law of the Court. Thus in its recent judgment in *Lidl Belgium* […] the Court did not even mention this issue, although Advocate General Sharpston had reached a different conclusion from the Court's precisely because of the cash-flow disadvantage. […] If cash-flow effects were now no longer relevant, that would however be a rejection of the earlier case-law, to which Advocate General Sharpston had expressly referred. […] In my view, a cash-flow disadvantage can indeed be of importance in assessing the proportionality of a national provision. In the present case, however, it is doubtful whether such a disadvantage actually occurs to an appreciable extent. The Belgian Government pointed out at the hearing that undertakings resident in the country, whose income from interest flows into the general basis of assessment to corporation tax, have to make regular advance payments of tax in the current tax year. In practice, therefore, the withholding tax deducted probably falls due only slightly earlier than the advance payments of corporation tax for the equivalent income from interest of domestic recipients. In any case, slight cash-flow disadvantages that nevertheless occur are compensated by the administrative simplification that can be achieved by deducting tax at source." The last-mentioned assumptions are questionable. It is doubtful whether the levy of a withholding tax compared to regular advance payments really leads just to a "slight" cash-flow disadvantage in all possible cases. Her additional assumption that "there are scarcely likely to be significant operating expenses in connection with loan transactions between associated undertakings" may have had relevance for the factual situation in the case referred, but, according to practical experience, cannot be supported for intra-group financing arrangements in general. However, since the Court arrived at its solution at the level of comparability, it did not go into these issues at all.

On the one hand, the Court seems to have lowered the standards and increased the room for Member States to treat residents and non-residents differently. Had the Court already taken

[124] For a critical analysis see also Watrin/Wittkowski/Lindscheid, EuGH: Keine Sofortverrechnung ausländischer Betriebsstättenverluste, *IStR* 2008, pp 637 et seq.

[125] Opinion of Advocate General Kokott, 18 September 2008, Case C-282/07, *Truck Center*, points 48 et seq.

this position in its earlier case law, *Höchst and Metallgesellschaft* would have been decided in favor of the tax authorities as well[126]. At least cash-flow disadvantages seem to no longer be of concern to the Court. However, in this context as well one can see how difficult it is to see whether there is a trend. In the case of the *Belgian care insurance scheme* the ECJ held that "as regards the Flemish Government's argument that that legislation could in any case have only a marginal effect on freedom of movement, in view of the limited nature of the amount of benefits in question and the number of persons concerned, it need merely be observed that, according to the Court's case-law, the articles of the Treaty relating to the free movement of goods, persons, services and capital are fundamental Community provisions and any restriction, even minor, of that freedom is prohibited […]."[127] Since even "minor" restrictions have to be taken into account, one would assume that cash-flow disadvantages should be considered all the more.

IV. Conclusions

It is difficult to see whether there are certain trends in the most recent case law of the ECJ in the area of direct taxation. On the one hand, the Court is no longer so rigid in accepting justifications for different treatment. As far as proportionality is concerned the Court does not seem to require the Member States to impose only the least restrictive measure. The Court has recently been more generous to the Member States compared to the "old days". On the other hand, the Court implicitly or explicitly accepts that the comparator for a cross-border situation may not only be a domestic situation but another cross-border situation as well. To this extent the Court has taken a route that will probably not be appreciated by governments of the Member States for whom in this respect it becomes more difficult to defend their rules. Hence, it is difficult to see a trend which leads in one direction only.

As has been illustrated, more frequently the judgments contradict each other in one way or the other, or at least there are more tensions in the case law of the ECJ to point out. In order to achieve more consistency, I submit the following proposals on the way in which the Court should change its case law:

[126] ECJ, 8 March 2001, Case C-397/98, *Metallgesellschaft and others* [1995] ECR I-1727.

[127] ECJ, 1 April 2008, Case C-212/06, *Gouvernement de la Communauté française and Gouvernement wallon*, para. 52.

1. The ECJ should overturn its *Schumacker* case law: It is not convincing that the Court looks at the factual situation in order to determine whether situations are comparable. Instead, the ECJ should follow its usual case law in these cases as well, according to which comparability depends on the legal situation alone.
2. The ECJ should be consistent in requesting equal treatment for comparable situations and different treatment for different situations. The latter case law should be developed further, in order to avoid giving the wrong impression that a mere restriction-based approach is needed for direct taxes.
3. The ECJ should continue to compare one cross border situation with another cross border situation, as it is settled case law already, with *Columbus Container* as an exception. Within an internal market justifications are required both for the different treatment of cross-border situations compared to domestic situations and for the different treatment of cross-border situations compared to other cross-border situations.
4. The ECJ should be consistent in taking into account the legal situation *in one Member State only* when deciding whether a Member State has not complied with the freedoms ("per country approach"). An "overall approach" makes it difficult to determine responsibility for infringements of the freedoms[128]. As long as there is no harmonized European tax system, double taxation and double non-taxation may occur. Such a "per country approach" may increase the sensitivity of the Member States to the fact that the Court cannot replace the legislator and that there is a need for harmonization, which has to be created by the legislator[129].
5. The ECJ should give up its case law distinguishing between measures implemented by tax treaties and by mere domestic provisions. An approach which distinguishes on the basis of the legal instrument is not convincing. Both the *D.* judgment as well as the more recent case law that is searching for the balance of the allocation of powers to tax under tax treaties should be overturned.

[128] See Kemmeren, The Internal Market Approach Should Prevail over the Single Country Approach, in Hinnekens/Hinnekens (eds.) *A Vision of Taxes within and outside the European Borders* (2008) pp. 557 et seq. who is a strong supporter of the „overall approach".

[129] For a third approach which has not been followed by the ECJ yet see Mason, Made in America for European Tax: The Internal Consistency Test, *Boston College Law Review* 2008, pp. 1277 et seq.

6. The ECJ should avoid combining different grounds of justification. The approach that was first introduced in *Marks & Spencer* and revised, but not abolished, in *Oy AA* and *Lidl Belgium* should be overturned.
7. The ECJ should refrain from introducing new grounds of justification that lead to uncertainty. Cohesion and balanced allocation of taxing powers seem to be exchangeable and lead to a large amount of uncertainty[130]. Instead, the Court should develop accepted justifications further.
8. The ECJ should request that Member States that treat comparable situations differently and which can come up with acceptable justifications should apply the least restrictive measure.
9. The ECJ should reconcile its approaches on the relevance of the separation of competences between the central level and the provincial level. In the area of the freedoms the Court applies a strict approach whereas its approach in its case law on the limitation of the temporal effects of its judgments, on equivalence of procedural measures and on state aids is different.
10. The ECJ should make it explicit whenever it changes its case law.

However, one should also be aware of the fact that tensions like those which have been illustrated are not completely avoidable: The more cases that have to be decided by the ECJ the higher the risk and probability of such contradictions and tensions. This is true for every other court as well. The record of the ECJ does not seem worse compared to other courts in this respect. However, this should not prevent the Court from taking the opportunity to reconsider its judgments and to benefit from the fact that throughout Europe academics and practitioners are dealing with ECJ case law and reflecting on it.

[130] See Wattel, Fiscal Cohesion, Fiscal Territoriality and Preservation of the (Balanced) Allocation of Taxing Power: What is the Difference?, in Weber (ed.) *The Influence of European Law on Direct Taxation – Recent and Future Developments* (2008) pp. 154 et seq.