Diplomarbeit verfasst am

Institut für österreichisches und Internationales Steuerrecht

Freedom of Establishment (Art. 43 EC Treaty) and Freedom to Provide Services (Art. 49 EC Treaty) and Tax Law

Im Rahmen des
EUCOTAX-Wintercourse 1999/2000

'NON-DISCRIMINATION AND TAX LAW
(STRUCTURE AND COMPARISON OF THE VARIOUS NON-DISCRIMINATION CLAUSES)'

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WIRTSCHAFTSUNIVERSITÄT WIEN

DIPLOMARBEIT

Titel der Diplomarbeit:

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To My Parents And My Brother
Without Whom I Would Have Never Been Able
To Accomplish My Studies In General
And This Thesis In Particular.

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List of Abbreviations

AbgÄG	Abgabenänderungsgesetz
AdvGen	Advocate General
art.	article
BAO	Bundesabgabenordnung (Federal Fiscal Code)
BB	Betriebs-Berater
BIFD	Bulletin of International Fiscal Documentation
BMF	Bundesministerium für Finanzen (Ministry of Finance)
B-VG	Bundes-Verfassungsgesetz (Federal Constitutional Act)
DB	Der Betrieb
DTC	Double Taxation Convention
EC	European Community
ECSC	European Cole and Steel Community
ECJ	European Court of Justice
EC Treaty	The Treaty Establishing the European Community (in the Form of the Treaty of Amsterdam)
EEC	European Economic Union
ErbStG	Erbschafts- und Schenkungssteuergesetz (Inheritance Tax Act)
EStG	Einkommenssteuergesetz 1988 (Individual Income Tax Act)
et seq	and the following
EU	European Union
EU Treaty	The Treaty Establishing the European Union (in the Form of the Treaty of Amsterdam)
EuZW	Europäische Zeitschrift für Wirtschaftsrecht
EWS	Europäisches Wirtschafts- und Steuerrecht
FJ	Finanz-Journal
FPR	Fiscal Pension Reserve
FR	Finanzrundschau
GewSt	Gewerbesteuer (Trade Tax)
Hrsg.	Herausgeber (Editors)
IStR	Internationales Steuerrecht
IWB	Internationale Wirtschaftsbriefe

KStG	Körperschaftsteuergesetz 1988 (Corporate Income Tax Act)
LOB	limitation of Benefits
MFN	Most-Favoured-Nation Clause
OGH	Oberster Gerichtshof (Supreme Court)
ÖStZ	Österreichische Steuer-Zeitung
para.	paragraph
RdW	Recht der Wirtschaft
RIW	Recht der Internationalen Wirtschaft
SteuerreformG	Steuerreformgesetz (Tax Reform Act)
SWK	Steuer & Wirtschaftskartei
SWI	Steuer & Wirtschaft International (Tax and Business Review)
VfGH	Verfassungsgerichtshof (Supreme Constitutional Court)
VwGH	Verwaltungsgerichtshof (Supreme Administrative Court)
WBl	Wirtschaftsrechtliche Blätter
Z	Ziffer (number)

I. Introduction

After World War Two it was important to unite Europe and to make a new war in (western) Europe impossible. The European Cole and Steel Community (ECSC) was a first step to economic and political integration. It was followed by the European Economic Community (EEC) that evolved into the European Community (EC) and later in the European Union (EU).[1] The goal of this process is still not quite clear. No one knows if the EU will be one single state in the far future, or if it will retain a federation of sovereign countries.

One goal that has been accomplished for a long time is that the EU is a common market without borders or other obstacles for the free movement of goods, services and persons (natural and legal). To accomplish this (and other past and future) integration, there were two important competencies to grant to the EU:

- The competence to enact a partly harmonised framework for economic actions.
- The competence to ensure that the member states do not give preference to their own citizens over citizens of other member states.

That prohibition of discrimination of nationals of other member states is binding for the whole legislation and administration. Direct taxation is not mentioned in the EC Treaty. But it can also be used as an obstacle in the economic interaction between two countries. Thus, the national legislator has to take the prohibition of discrimination in direct tax matters into consideration, too.

A. *Effect of EC Law on Member States' Law*

The EC Treaty is a treaty under international law, but it is more. Since the EC has the competence to enact binding rules and to judge more or less independently of its member states, the EC is supranational. The EC Treaty and

[1] See Funk, *Einführung in das österreichische Verfassungsrecht*[9] (1996), p 102.

the EU Treaty are the 'constitution' of the EU; they are the primary law.[2] They are negotiated by the member states themselves. Primary EC law is directly applicable.[3] Other EC law is enacted by organs of the EU and is called secondary law. The primary law contains, among other things, the rules and competencies for enacting secondary law. For tax purposes, directives are the most common form of secondary law. They have to be transformed into member states' law. If directives are precise enough and member states fail to adopt them on time, or adopt them incorrectly, they are also directly applicable.[4] But direct applicability may only lead to advantages for the citizen because a member state may not profit from its negligence. Additionally it has to be said that it is not generally accepted by all legal commentators that all directives are direct applicable even if they are precise enough.

EC law overrules the national law of the member states.[5] The only member states' law that is not overruled by EC law, are the fundamental principles of the constitution,[6] but even that is not totally agreed upon in the literature. Those fundamental principles are common to most of the member states' constitutions and most authors believe that they have a priority higher than that of EC law. But as those principles are the only national rules that overrule EC law, even bilateral treaties have to obey the framework provided by EC law. This means treaties between two member states may possibly be examined by the European Court of Justice (ECJ) to decide if they infringe EC law. The same is valid for treaties between a member state and a third country that were concluded after the member state signed the EC Treaty.[7]

Because of its primacy, EC law even prevails over bilateral treaties and 'normal' national law.[8] The EC Treaty and directives that are detailed enough do

[2] See Funk, *Verfassungsrecht*[9], p 104; Griller, *Grundzüge des Rechts der Europäischen Union*[2] (1997), p 24.
[3] See Dautzenberg, 'Doppelbesteuerung und EG-Vertrag: Die Anrechnungsmethode als gemeinschaftsrechtlicher Mindeststandard?', Der Betrieb (DB) 1994, p 1543; Thömmes, 'Stand und Entwicklungstendenzen der EuGH-Rechtsprechung zu den direkten Steuern', in: Herzig/Günkel/Niemann (Hrsg.), Steuerberater-Jahrbuch 1998/99 (1999), p 175.
[4] ECJ Case C-6/90.
[5] See Lang, *Einführung in das Recht der Doppelbesteuerungsabkommen* (1997), p 31; Funk, *Verfassungsrecht*[9], p 12; Griller, *Europarecht*[2], p 26; Raschauer, 'Wirtschaftsverfassungsrecht und Gemeinschaftsrecht', in Raschauer (Hrsg.), *Grundriß des österreichischen Wirtschaftsrecht* (1998), p 25.
[6] Griller, *Europarecht*[2], p 66.
[7] See Lang, *DBA*, p 31.
[8] See Hinnekens, 'Compatibility of Bilateral Tax Treaties with European Community Law. The Rules', EC Tax Review 1994, p 160.

not even have to be transformed into national law. They grant a personal right without such a transformation.[9] This prevailing direct applicable EC law can be relied upon before national administrations and courts.[10] The prevailing and direct applicability of the EC Treaty, which is the 'constitution of the EC',[11] is not laid down in the EC Treaty but was introduced by the ECJ in several cases[12] to secure the uniformity and functionality of EC law. Citizens of the EU can only profit from ECJ decisions if a member state fails to adopt EC law on time, because only the citizen can, in contrast to the member state, request a preliminary ruling of the ECJ at a national court. This can lead to a direct application of more advantageous EC law if it is precise enough.[13]

Although EC law only prevails over infringing rules, but does not deviate from them, all legislation has to be interpreted in the light of EC law.[14] And as a consequence the national legislator is committed to adapt domestic law to EC law.[15] The ECJ stated that every member state is liable if it adapts domestic law to a directive too late, incorrectly, or maintains a rule that infringes the EC Treaty.[16] That means a liability of the legislator, which is unknown in Austrian law.[17]

B. Applicability to Tax Law

The primacy of EC law is also decisive for tax law.[18] For the freedom of establishment (art. 43 EC Treaty) this was confirmed by the ECJ in the *Avoir*

[9] See Doralt/Ruppe, *Grundriß des österreichischen Steuerrecht, Band II*[3] (1996), p 191.
[10] See Lechner, 'Harmonisierung des Steuerrechts in der EG – Rechtsgrundlagen, Entwicklung, gegenwärtiger Stand, Ausblick', in: Gassner/Lechner (Hrsg.), *Österreichisches Steuerrecht und europäische Integration* (1992), p 9.
[11] Vedder, 'Einwirkungen des Europarecht auf das innerstaatliche Recht und auf internatioale Verträge der Mitgliedstaaten: die Regelung der Doppelbesteueung', in Vogel (Hrsg.), *Europarecht und internationales Steuerrecht* (1994), p 2.
[12] ECJ Case 6/64; for prevailing over member states' constitutional law: ECJ Case 11/70.
[13] See Dautzenberg, 'Der Europäische Gerichtshof und die direkten Steuern', Betriebs-Berater (BB) 1992, p 2400.
[14] ECJ Cases C-106/89, C-19/90 & 20/90.
[15] See Jann, 'Die Auswirkungen des EU-Rechts auf Abkommensberechtigung von beschränkt Steuerpflichtigen', in: Gassner/Lang/Lechner (Hrsg.), *Doppelbesteueuerungsabkommen und EU-Recht – Auswirkungen auf die Abkommenpraxis* (1996), p 55.
[16] ECJ Case C-6/90 for directives; ECJ Case C-46 & 48/93 for EC Treaty.
[17] See Toifl, 'Die EU-Grundfreiheiten und die Diskriminierungsverbote der Doppelbesteuerungsabkommen', in Gassner/Lang/Lechner (Hrsg.), *Doppelbesteuerungsabkommen und EU-Recht – Auswirkungen auf die Abkommenspraxis* (1996), p 179; Raschauer, *Wirtschaftsrecht*, p 31.
[18] See Jann, *Auswirkungen*, p 54; Haunold/Tumpel/Widhalm, 'News aus der EU', Steuer & Wirtschaft International (SWI – Tax and Business Review) 1996, p 186; de Weerth, 'EG-Recht und direkte Steuern', Recht der Internationalen Wirtschaft (RIW) 1995, p 928; Birk, 'Besteuerungsgleichheit in der Europäischen

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Fiscal[19] case. The applicability of EC law to tax law means that every paragraph of every tax act can be examined for its compatibility to EC law. As already stated in I.A, bilateral treaties are not excluded from the scope of EC law either, but for Double Taxation Conventions (DTCs) the subject is a bit more difficult. DTCs do not force a state to tax. They only allow the state to tax certain income. Thus, a DTC cannot infringe EC law.[20] In those cases EC law is only infringed by the combination of several DTCs and the member states' laws. Therefore all the components of this combination have to be exercised with due respect to the EC Treaty.[21]

C. Missing Harmonisation in Direct Taxation Matters

Unlike indirect taxation – where legislation is nearly totally harmonised within the EC through secondary EC law – in direct taxation matters there is nearly no harmonisation.[22] There are probably two major reasons for this lack of harmonisation. The first reason is that the obstruction of the common market caused by direct taxes is not as obvious as it is for indirect taxes, where the different tax systems resulted in compensation payments when goods passed a border.[23] Probably the second reason why the member states defend their right to legislate direct tax laws with tooth and claws is that, as *Knobbe-Keuk*[24] reasons, 'the power to tax is the power to govern'. Since they already delegated their right to legislate indirect taxes, they are still less willing to give up their last and best hope to realise their social and economic goals through tax laws.[25]

But the absence of harmonisation and the fact that direct taxation is not mentioned in the text of the EC Treaty does not justify member states introducing

Union', in Lehner (Hrsg.), *Steuerrecht im Europäischen Binnenmarkt – Einfluß des EG-Rechts auf die nationalen Steuerrechtsordnungen* (1996), p 76.

[19] ECJ Case 270/83.

[20] See Lang, *DBA*, p 33; Lang/Schuch, *Doppelbesteuerungsabkommen Deutschland/Österreich* (1997), Vor 1, paras. 33 et seq.

[21] See Rainer, 'Doppelbesteuerungsabkommen und die EuGH-Rechtsprechung zu den direkten Steuern', Internationales Steuerrecht (IStR) 1995, p 476.

[22] See Eckhoff, 'Diskriminierung im Bereich der Besteuerung des Einkommens und des Vermögens', in Birk (Hrsg.), *Handbuch des Europäischen Steuer- und Abgabenrechts* (1995), p 463.

[23] See Eckhoff, *Diskriminierung*, pp 464 et seq.

[24] 'Die Einwirkung der Freizügigkeit und der Niederlassungsfreiheit auf die beschränkte Steuerpflicht', Europäische Zeitschrift für Wirtschaftsrecht (EuZW) 1991, p 650.

[25] See Thömmes, *EuGH-Rechtsprechung*, p 174.

discriminating rules in their tax law[26], because, as the ECJ ruled in the *Avoir Fiscal*[27] case, discrimination is not allowed in tax law, just like other areas of legislation that are not expressly mentioned in the EC Treaty.

Although ECJ decisions are normally binding for that specific case only, the decisions based on action by the EC commission are more general,[28] member states normally take decisions of the ECJ as a trigger for changing the law.[29] And as not only the plaintiff but also other member states change their law, the ECJ and the EC Treaty are, in the absence of secondary law, the motor of tax harmonisation in the EC.[30] And this change according to ECJ decisions is necessary as the court normally will make the same decision in similar cases and citizen can bring proceedings against member states that can result in the liability to pay the damages if the infringement was obvious, for example because of a similar decision.[31]

Because of the continuing integration the thought that harmonising direct taxation is not necessary turned out to be wrong. The reason for that is that different tax systems lead to incentives to invest in one or the other member state and that again distorts the common market.[32] Even tax systems that do not infringe the EC Treaty on their own may create distortions in combination with other tax systems, which do not infringe EC law, either. Thus, harmonisation is needed on those points at the very least.[33] But on other points the pressure of the

[26] See Hinnekens/Schelpe, 'Comments on Bachmann v. Belgium (C-204/90) and Commission v. Belgium (C-300/90)', EC Tax Review 1992, p 59; Eckhoff, *Diskriminierung*, p 469; Klein, 'Der Einfluß des Europarechts auf das deutsche Steuerrecht', in Lehner (Hrsg.), *Steuerrecht im Europäischen Binnenmarkt – Einfluß des EG-Rechts auf die nationalen Steuerrechtsordnungen* (1996), p 18.

[27] ECJ Case 270/83.

[28] But they are very rare at tax law. See Thömmes, *EuGH-Rechtsprechung*, p 176.

[29] See Thömmes, 'Tax Discrimination in Europe', Intertax 1993, p 614.

[30] See Dautzenberg, DB 1994, p 1542; Werndl, 'Die nationale (beschränkte) Steuerpflicht in Lichte der EG-Grundfreiheiten', Wirtschaftsrechtliche Blätter (WBl) 1995, p 228; Tumpel, *Harmonisierung der direkten Unternehmensbesteuerung in der EU* (1994), p 376; Eckhoff, Diskriminierung, p 467; Kaiser, 'Die „Wegzugssteuer" Verfassungsrechtliche und europarechtliche Beurteilung des § 6 Außensteuergesetz', BB 1991, p 2055; Thömmes, *EuGH-Rechtsprechung*, p 174; Saß, 'Einflüsse des Binnenmarktes auf die nationalen Steuerrechtsordnungen', in Lehner (Hrsg.), *Steuerrecht im Europäischen Binnenmarkt – Einfluß des EG-Rechts auf die nationalen Steuerrechtsordungen* (1996), p 35; Birk, *Besteuerungsgleichheit*, p 76; Lehner, 'Resümee', in Lehner (Hrsg.), *Steuerrecht im Europäischen Binnenmarkt – Einfluß des EG-Rechts auf die nationalen Steuerrechtsordnungen* (1996), p 264.

[31] See Thömmes, *EuGH-Rechtsprechung*, pp 177 et seq; v. Raad, 'The Impact of the EC Treaty's Fundamental Provisions on EU Member States' Taxation in Bordercrossing Situations – Current State of Affairs', EC Tax Review 1995, pp 191 et seq.

[32] See Eckhoff, *Diskriminierung*, p 466.

[33] See Herzig/Dautzenberg, 'Der EWG-Vertrag und die Doppelbesteuerungsabkommen – Rechtsfragen im Verhältnis zwischen Doppelbesteuerungsabkommen und den Diskriminierungsverboten des EWGV', DB

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fundamental freedoms is enough to harmonise the different rules in the member states.[34]

The only real harmonisation measures concerning direct taxes in substantive parts are the 'Merger'[35] and 'Parent-Subsidiary'[36] directives,[37] which are correctly implemented in Austrian Tax Law.[38] The Parent-Subsidiary Directive can be seen as a first step to a multilateral DTC within the EC because it regulates, which member state is allowed to tax dividends that flow form one member state into another.

Even where directives are correctly transformed into national law, the EC Treaty has to be obeyed, because special rules in member states' tax law can lead to discrimination.[39] So a correctly transformed directive does not prevent infringement of the EC Treaty.

The conclusion is that because of the missing of harmonisation measures, the EC Treaty and with it the discrimination prohibition and fundamental freedoms are growing in importance in tax law.[40]

D. Non-Discrimination

1. General Non-Discrimination Article (art. 12 EC Treaty)

Within the EC discrimination on grounds of nationality is forbidden by art. 12 EC Treaty. Art. 12 is the general rule, on which the four fundamental freedoms are

1992, pp 2519 et seq; Dautzenberg, 'Der Vertrag von Maastricht, das neue Grundrecht auf allgemeine Freizügigkeit und die beschränkte Steuerpflicht der natürlichen Personen', BB 1993, p 1563; Dautzenberg, DB 1994, p 1543.

[34] See Dautzenberg, BB 1992, p 2401.

[35] 90/434/EEC, OJ 1990 L 225/1.

[36] 90/435/EEC, OJ 1990 L 225/6.

[37] For further information see Tumpel, 'Die Bedeutung der abkommensrechtliche Ansässigkeit für die Mutter-Tochter-Richtlinie und die Fusionsrichtlinie', in Gassner/Lang/Lechner (Hrsg.), *Doppelbesteuerungsabkommen und EU-Recht – Auswirkungen auf die Abkommenspraxis* (1996); Tumpel, *Harmonisierung.*

[38] See Jann, 'The Implementation of EC Direct and Indirect Tax Directives in Austrian Tax Law', EC Tax Review 1995, p 142.

[39] See Berger, 'EU und Doppelbesteuerungsabkommen', SWI 1995, p 343; for further details, see III.M.

[40] See Eckhoff, *Diskriminierung*, pp 463, 468 et seq; Knobbe-Keuk, EuZW 1991, p 650; Knobbe-Keuk, 'Restrictions on the Fundamental Freedoms Enshrined in the EC Treaty by Discriminatory Tax Provisions – Ban and Justification', EC Tax Review 1994, p 76; Herzig/Dautzenberg, DB 1992, p 2519.

based.[41] The four fundamental freedoms relevant for direct taxation purposes are the freedom of movement for workers (art. 39 EC Treaty), the freedom of establishment (art. 43 EC Treaty), the freedom to provide services (art. 49 EC Treaty) and the free movement of capital (art. 56 EC Treaty). They are united in title III of the EC Treaty. The fundamental freedoms are 'legis specialis' and prevail over the general non-discrimination article.[42] But in the *Werner*[43] case the ECJ supported the doctrine that the fundamental freedoms are a more precise term of art. 12 and so art. 12 cannot be infringed if the fundamental freedoms are not.[44] That could have meant that all discrimination because of nationality is forbidden and not only the discrimination between home nationals and nationals of other member states. But in later decisions the ECJ did not come to a similar decision.[45] Like the fundamental freedoms, art. 12 is directly applicable.[46] In contrast to the fundamental freedoms, art. 12 is only applicable if the context is regulated in the EC Treaty.[47] But 'context' is interpreted very extensively by the ECJ.[48]

What then is an infringement of the EC Treaty? The first step is to ascertain if there is an unequal treatment because of nationality. A treatment is unequal if the facts of the case are similar but the treatment is different or if the facts are different but the treatment is equal. The second step is to determine if the discrimination is justified, or not. If it is an unjustified 'dissimilar treatment of comparable situations'[49], it is an infringement of the EC Treaty.[50] This is also applicable for tax

[41] See Griller, *Europarecht*^{2}, p 74.
[42] ECJ Case C-246/89 (para. 17); tax law decisions: Case C-118/96 (para. 35), Case C-311/97 (para. 20) ECJ Case C-55/98 (para. 16); see also Thömmes, 'Das EuGH-Urteil im Fall Werner – Keine Grundsatzentscheidung zur Diskriminierung beschränkt Steuerpflichtiger', Internationale Wirtschaftsbriefe (IWB) 1993, F 11, G 2, p 130; Eckhoff, *Diskriminierung*, p 472; Lang, 'Europarechtliche Aspekte der Besteuerung von Erbschaften', in Birk (Hrsg.), *Steuern auf Erbschaft und Vermögen* (1999), p 259; v. Raad, EC Tax Review 1995, p 193.
[43] ECJ C-112/91 (para. 20); ECJ Case C-330/91; conclusions Advocate General (AdvGen) (para. 63).
[44] Also in ECJ Case 90/76.
[45] See Cases in footnote 43.
[46] See Griller, *Europarecht*^{2}, p 76.
[47] See Zach, 'Auswirkungen der Diskriminierungsverbote (vorallem auf die direkten Steuern)', Gassner/Lechner (Hrsg.), *Österreichisches Steuerrecht und europäische Integration* (1992), p 111.
[48] for example: ECJ Case Rs 293/83.
[49] ECJ Case 14/59; ECJ Case 293/83.
[50] ECJ Case 106/83; See also Eckhoff, *Diskriminierung*, p 494; Wouters, 'The principle of non-discrimination in European Community law', EC Tax Review 1999, p 102; Kamphuis/Pötgens, 'Goodbye Mr Bachmann, Welcome Mr Wielockx', Bulletin of International Fiscal Documentation (BIFD) 1996, p 3.

law, as the ECJ has shown in the Cases *Avoir Fiscal*[51], *Wielockx*[52] and *Royal Bank of Scotland plc*[53].

Concluding it has to be said that art. 12 EC Treaty does not apply to tax discriminations, because one of the fundamental freedoms always prevails[54] and art. 12 is only applied if the fundamental freedoms cannot be applied.[55]

2. Fundamental Freedoms

For tax law purposes the four fundamental freedoms are significant. But for direct taxation, there is normally a different segmentation than for other purposes. The four fundamental freedoms primarily relevant for direct taxation are[56]:

- Freedom of Movement for Workers (art. 39 EC Treaty)
- Freedom of Establishment (art. 43 EC Treaty)
- Freedom to Provide Services (art. 49 EC Treaty)
- Free Movement of Capital (art. 56 EC Treaty)

This thesis will deal with the influence of the freedom of establishment and the freedom to provide services on tax law. But before concentrating on art. 43 and 49 and tax law (Chapter III), I want to discuss the concept of those two fundamental freedoms in general (Chapter II).

The free movement for workers and the freedom of establishment are both mainly an expression of the guarantee of free movement of persons. The reason for separating them in this discussions is that the free movement for workers can be much more easily introduced. The difference between the freedom of establishment and the freedom of movement for workers is that the realisation of the freedom of establishment needs certificates of ability in order to be

[51] ECJ Case 270/83, conclusion AdvGen (para. 10).
[52] ECJ Case C-80/94 (para. 17).
[53] ECJ Case C-311/97 (para. 26).
[54] See Eckhoff, *Diskriminierung*, p 473; Bachmann, 'Diskriminierungsverbote bei direkten Steuern im Regelungsbereich des EG-Vertrages', RIW 1994, p 850; Hinnekens, EC Tax Review 1994, p 149.
[55] See Schuch, 'Werden die Doppelbesteuerungsabkommen durch EU-Recht zu Meistbegünstigungsklauseln', in Gassner/Lang/Lechner (Hrsg.), *Doppelbesteuerungsabkommen und EU-Recht – Auswirkungen auf die Abkommenspraxis* (1996), p 120.

harmonised. That is not necessary for employees because it is the task of the employers to ascertain the qualification of the employees. Furthermore, the migration of workers is more easily controlled than compliance with the freedom of establishment.[57] The importance of the fundamental freedoms is that without the free movement of workers and capital and the freedom of establishment and to provide services a common market could have never been introduced. They are the tools to create an economically united area within the EU.[58] Additionally, the absence of discrimination, different laws and obstacles at borders lead to specialisation and purer competition and with it to further economic growth.

As there are different freedoms, a case may concern more than one freedom. In such a case the discrimination is not justified if one infringement is justified, but only one of the fundamental freedoms has to be infringed to make it a discrimination under the EC Treaty.[59]

[56] See Zach, *Auswirkungen*, p 112.
[57] See Randelzhofer, in Grabitz/Hilf, *Kommentar zur Europäischen Union* (1998), Art. 52, Vorbemerkung, paras. 8 et seq.
[58] See Randelzhofer, in Grabitz/Hilf, *EU*, Art. 52, Vorbemerkung, para. 4.
[59] ECJ Case C-118/96 (para. 35); see also Rainer, 'EuGH: Entscheidung – Freier Kapitalverkehr: Besteuerung der Prämien von Kapitallebensversicherungen', IStR 1998, p 301; Dautzenberg, 'Kommentar zu EuGH Rs. C-118/96', Finanzrundschau (FR) 1998, p 517; Saß, 'Abzugsverweigerung für Verluste einer inländischen Tochtergesellschaft wegen Beteiligung an weiteren Tochtergesellschaften in der EU', Europäisches Wirtschafts - und Steuerrecht (EWS) 1998, p 348.

II. Freedom of Establishment (Art. 43 EC Treaty) and Freedom to Provide Services (Art. 49 EC Treaty) – General Aspects

A. *Freedom of Establishment*

1. Legal Position

Art 43 EC Treaty:

Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.

2. General Remarks

Since the end of the transitional period on 1.1.1970, art. 43 and art. 49 are directly applicable, no matter whether the executing directives have been transformed, or if there is a general program that has been transformed the right way.[1] The EC Treaty was changed by the treaty of Amsterdam[2]. The freedom of

[1] ECJ Case 2/74; for the freedom to provide services: ECJ Case 33/74; see also Randelzhofer, in Grabitz/Hilf, *EU*, Art. 52, Vorbemerkung, para. 25; Dautzenberg, DB 1994, p 1543; Knobbe-Keuk, EuZW 1991, p 650; Geiger, *Kommentar zu dem Vertrag zur Gründung der Europäischen Gemeinschaft*[2] (1995), Art. 52, para. 3; Eberhartinger, 'Konvergenz und Neustrukturierung der Grundfreiheiten', EWS 1997, pp 43 & 49.

establishment was basically only affected by a change in the numbering. The only change in the text was an adjustment to the end of the transitional period that ended on 1.1.1970. Because of this, the whole former art. 53 (standstill) became obsolete and was dropped from the EC Treaty. The EC Treaty is primarily binding for the member states, legal persons by public law (for example: professional bodies[3]) and the community itself,[4] but the member state can never justify its opinion with the EC Treaty if there is contradictory national law.

What does 'freedom of establishment' mean? Art. 43 provides the unrestricted right of establishment for natural persons, their agencies, branches, or subsidiaries for self-employed or managing purposes within the EU. The same rights are granted for corporations under art. 48.[5] For art. 43 to be applicable the establishment must be permanent and the establishment must be set up to make profits.[6] The difference from art. 49 is mainly that a permanent establishment leads to the application of art. 43, whereas a temporary presence leads to the application of art. 49.[7] The difference from art. 39 is simply that employees fall under art. 39, while self-employed persons can appeal to art. 43. The distinction is based on whether there is subordination or not and not on the classification under national law.[8] But as the freedom of establishment and the freedom of movement for workers are based on the same principles,[9] this distinction is of no great importance.

The consequence of the direct applicability of the prevailing EC Treaty is that the non-discrimination principle on the freedom of establishment has to be applied by the authorities (as well as the courts[10]) to themselves and from the first instance on.[11] But in reality it is up to the taxpayer and his consultant to appeal to prevailing fundamental freedoms.[12] Nevertheless, this opportunity makes the freedom of

[2] OJ 1997 C 340/1.
[3] ECJ Case 71/76; Wouters, EC Tax Review 1999, p 101.
[4] See Schuch, *Meistbegünstigung*, p 106.
[5] See Dautzenberg, BB 1992, pp 2401 et seq; Fischer/Köck, *Europarecht einschließlich des Rechtes supranationaler Organisationen*[2] (1995), p 508; for more details see Randelzhofer, in Grabitz/Hilf, *EU*, Art. 52, paras. 1 et seq.
[6] See Eckhoff, *Diskriminierung*, p 480.
[7] See Fischer/Köck, *Europarecht*[2], p 508.
[8] ECJ Case C-107/94 (para. 25).
[9] p.ex.: ECJ Case C-107/94 (para. 29).
[10] See Thömmes, *EuGH-Rechtsprechung*, p 175.
[11] See Toifl, *Grundfreiheiten*, p 178.
[12] See Birk, *Besteuerungsgleichheit*, p 74.

establishment especially one of the most important rules of EC law for direct taxation matters.[13]

Last but not least, it has to be said that a potential discrimination is enough to be an infringement.[14] And already the result that exercise of a cross-border activity is less attractive that the domestic activity is a possible infringement of the EC Treaty.[15]

3. Personal Scope

Art. 48 EC Treaty:

Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.

'Companies or firms' means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.

All natural persons who are nationals of a member state fall under the personal scope of the freedom of establishment.[16] Every national of a member state has the right to pursue activities as a self-employed person, but for the right to establish branches, agencies, or subsidiaries the person has to be resident within the EU.[17] Art. 48 EC Treaty extends the scope to companies and firms that were formed in accordance with the law of a Member State and have their registered office, central administration or principal place of business within the Community. 'Companies or firms means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.'[18] Companies that have no legal capacity also fall under art. 48, as long as they have

[13] See Lang, *Erbschaften*, p 257.
[14] See Dautzenberg, BB 1992, p 2404.
[15] Settled case law since ECJ Case C-55/94; ECJ Case C-118/96 (para. 23); ECJ Case C-212/97 (para. 34).
[16] See Geiger, *EG*[2], Art. 52, para. 7.
[17] See Fischer/Köck, *Europarecht*[2], p 507.
[18] Art. 48 EC Treaty.

economic purposes.[19] The requirement 'profit-making' has to be interpreted in a broad sense,[20] because only if profit-making is interpreted as following economic purposes, can legal persons by public law, which are listed in art. 48, fulfil this requirement.[21] The law under which the company was formed constitutes the nationality for those corporations.[22] This fact means that the EC Treaty does not follow the control theory, which applies the legal system of the majority of the shareholders.[23] As the control theory is not applied, corporations that are controlled from third states, but are established in and run from within the EU, are also entitled to rely on the fundamental freedoms.[24] There are two additional theories about which legal system has to be applied to corporations. Continental Europe mostly follows the residence theory, which applies the legal system of the state of residence.[25] The result is that with migration the company loses its identity.[26] The other theory is the incorporation theory. It applies the legal system of the state of incorporation. It is more liberal, because migration is possible while keeping the company's identity.[27] The incorporation theory is the one that is more in accordance with the goal of the EC Treaty. But the ECJ decided in the *Daily Mail*[28] case that an agreement between the member states is necessary for the application of the incorporation theory, which has not been ratified yet.[29] But this decision has been put into perspective by the decision in the *Centros* case.[30]

To be characterised as an establishment, there should be a genuine link to the economy of the member state where the establishment is created. But this genuine link must not be the nationality of the shareholders.[31] This rule should

[19] See Randelzhofer, in Grabitz/Hilf, *EU*, Art. 58, para. 3; Geiger, *EG*[2], Art. 58, para. 2.
[20] For example ECJ Case 23/74, ECJ Case 13/76; Hahn, *Die Vereinbarkeit von Normen des deutschen internationalen Steuerrechts mit EG-Recht* (1999), p 67.
[21] See Randelzhofer, in Grabitz/Hilf, *EU*, Art. 58, para. 7.
[22] ECJ Case C-307/97 (para. 35); see also Schuch, *Meistbegünstigung*, p 107.
[23] See Randelzhofer, in Grabitz/Hilf, *EU*, Art. 58, para. 8.
[24] See Randelzhofer, in Grabitz/Hilf, *EU*, Art. 58, para. 12.
[25] In Austria: § 10 IPRG.
[26] See Randelzhofer, in Grabitz/Hilf, *EU*, Art. 58, para. 9; Eicker, 'Centros: Aus für die Sitztheorie?', IWB 1999, F 11, G 3, p 234; for further details and the combination with the IPRG see Bauer/Quantschnigg, *Kommentar zum Körperschaftsteuergesetz 1988 mit Erläuterungen und einschlägigen Vorschriften* (1989), § 9, paras. 20 et seq; different opinion, see Eilers/Wienands, 'Neue steuerliche und gesellschaftsrechtliche Aspekte der Doppelansässigkeit von Kapitalgesellschaften nach der EuGH-Entscheidung vom 9.3. 1999', IStR 1999.
[27] See Randelzhofer, in Grabitz/Hilf, *EU*, Art. 58, para. 10.
[28] Case 81/87; for further details, see III.D.2.
[29] See also Zehetner, 'Niederlassungsfreiheit und Sitztheorie', Ecolex 1999, p 773
[30] For further details, see III.D.4.
[31] See Fischer/Köck, *Europarecht*[2], p 507.

exclude firms that merely have an accommodation address within the EU from the favourable provisions of the EC Treaty, but the ECJ declined this requirement in the *Segers*[32] case and stated that only the requirements have to be met that are listed in art. 48. As the EC Treaty only refers to nationality,[33] but not to the residence, which is common as a link in tax law, nationals of third states, who only have their residence within the EU, are not covered by the favourable provisions of the EC Treaty.[34]

4. Substantive Scope

a) Legal Position

The substantive scope is defined in such a way that everyone (natural and legal persons) who falls under the personal scope and wants to establish an agency, branch, or subsidiary within another member state to manage undertakings or pursue activities as self-employed person, falls under the freedom of establishment.[35] What kind of self-employed activity it is, is of no concern.[36]

The difference between subsidiaries, branches and agencies is that a subsidiary is a legal independent entity that is controlled by the foreign parent, but is established according to the rules of the host country.[37] Branches and agencies, on the other hand, are a part of the foreign firm, so they are only a permanent establishment.[38] Subsidiaries are far less of a problem with respect to discrimination, because, since they are a firm of the host country, they are treated as a domestic firm. Thus, normally there is no discrimination. However, the freedom of establishment not only applies to persons who want to cross a border into another member state, but also to employees who want to become self-employed.[39] This is basically also seen in the *Werner*[40] case.

[32] ECJ Case 79/85.
[33] See Randelzhofer, in Grabitz/Hilf, *EU*, Art. 52 para. 20.
[34] See Jann, *Auswirkungen*, p 56; Eckhoff, *Diskriminierung*, p 481; Schuch, *Meistbegünstigung*, p 107.
[35] See Fischer/Köck, *Europarecht*[2], p 507.
[36] See Geiger, *EG*[2], Art. 52, para. 5.
[37] See Randelzhofer, in Grabitz/Hilf, *EU*, Art. 58, para. 19.
[38] See Randelzhofer, in Grabitz/Hilf, *EU*, Art. 58, para. 20.
[39] See Randelzhofer, in Grabitz/Hilf, EU, para. 23.
[40] ECJ Case C-112/91; for further information see II.A.4.b).

b) Werner

(1) Facts

Mr. Werner, a German national, who was educated[41] and who had always worked in Germany, had been resident in the Netherlands for more then twenty years when he changed his employment status from employee to self-employed. Because of this, he fell outside the scope of the rule for employees of the DTC between the Netherlands and Germany that granted the right of unlimited taxation to the state of activity. From that point in time on, the DTC granted the state of residence – the Netherlands – the right to tax Mr. Werner unlimited and in the state of activity – Germany – Mr. Werner was only subject to limited tax liability. But, as nearly all his income originated in Germany, he could not get the relief resulting from the unlimited tax liability in the Netherlands. Mr. Werner saw this additional taxation as an obstacle to self-employment in Germany and, thus, as an infringement of the freedom of establishment.

(2) Decision of the ECJ

Normally such facts are a clear discrimination. But in this case Mr. Werner had no economic link[42] to another member state and because of that he could not appeal to any rights granted by the EC Treaty.[43] For that reason there was no comparability to a non-resident originating from another member state.[44] Since these were the facts, the EC Treaty and with it the fundamental freedoms are not applicable[45] and the discrimination was no infringement.[46] Of course, this is not true if there is a link to another member state (for example: nationality). Thus, in such a case this decision is not relevant.[47]

[41] Education is an economic link: ECJ Case 115/78.
[42] Residence is no economic link: ECJ Case C-112/91, conclusions AdvGen (paras. 13, 19 et seq, 30); ECJ Case C-112/91, paras. 13 et seq; see also Bachmann, RIW 1994, p 856.
[43] ECJ Case C-112/91, conclusions AdvGen (paras. 25 et seq).
[44] ECJ Case C-112/91, conclusions AdvGen (paras. 44 et seq).
[45] ECJ Case C-112/91, conclusions AdvGen (para. 44).
[46] ECJ Case C-112/91 (para. 17).
[47] See Knobbe-Keuk, 'Das Urteil des EuGH im Falle Werner zur Besteuerung der Grenzgänger – ärgerlich, aber nicht das letzte Wort', DStR 1993, p 425, 426.

The conclusion that can be drawn from this case, for the applicability of the EC Treaty, is that a compensation of a disadvantage with another advantage is not allowed.[48]

(3) Effect of the Change in EC Law

Since free movement is now guaranteed by the EC Treaty (since the Residence Directive[49] and the Maastricht Treaty) in art. 18 even if there are no economic reasons and because the ECJ is now more willing to see an infringement, the decision might be different today.[50] Thus, it is unlikely that similar cases will be rejected on grounds of admissibility in the future.[51]

(4) Effects on Austrian Law

Discrimination of home nationals is allowed[52] as long as the national has not acquired any rights under the EC Treaty[53] in another member state, because then he is comparable to a foreigner from another EU country. *Knobbe-Keuk*[54] and *Thömmes*[55] even think that Mr Werner, who had his residence in the Netherlands for 20 years, should be comparable to a citizen of the Netherlands because he had his private interest in the Netherlands. That was not dealt with in the decision. Furthermore *Eberhartinger*[56] argues that as the common market shall establish an area without inner borders, it is not consistent to apply the fundamental freedoms depending on which side of a border the person was born. Additionally, a discrimination of home nationals (reverse discrimination) will normally violate Austrian constitutional law.

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[48] See Toifl, *Die Wegzugsbesteuerung § 31 Abs 2 Z 3 EStG* (1996), p 157.
[49] Directive 73/148/EEC.
[50] See Wiedow, 'Steuerharmonisierung bei den direkten Steuern: Stand, Perspektiven, Auswirkungen auf Doppelbesteuerungsabkommen', in: Vogel (Hrsg.), *Europarecht und Internationales Steuerrecht* (1994), p 55; Jacobs (Hrsg.), *Internationale Unternehmensbesteuerung*[4] *(1999)*, p 188; Rainer, 'GA Léger gegen Steuersatzdiskriminierung', IStR 1996, p 130; Thömmes, *EuGH-Rechtsprechung*, p 182; other opinion: Klein, *Steuerrecht*, p 21; Thömmes, 'Verbote der Diskriminierung von Steuerausländern', in Lehner (Hrsg.), *Steuerrecht im Europäischen Binnenmarkt – Einfluß des EG-Rechts auf die nationalen Steuerrechtsordnungen* (1996), *p* 88; Heydt, contribution to the discussion, in Thömmes, *Diskriminierung*, p 114.
[51] See Daniels, 'The freedom of establishment: some comments on the *ICI* decision', EC Tax Review 1999, p 41.
[52] See Wouters, EC Tax Review 1999, p 105; Wiedow, *Steuerharmonisierung*, p 55.
[53] ECJ Case C-18/95; see also Knobbe-Keuk, DStR 1993, p 426, Knobbe-Keuk, EuZW 1991, p 651.
[54] DStR 1993, p 427.
[55] IWB 1993, F 11, G 2, p 131; contribution to the discussion, in Thömmes, *Diskriminierung*, p 107.
[56] EWS 1997, pp 50 et seq.

c) Conclusions

Thus, a very important restriction to be protected by the principle of freedom of establishment is that the situation has to have a cross-border link. Otherwise the EC Treaty is not applicable and an reverse discrimination of a home national occurs that is not prohibited by the EC Treaty. But in the case that a home national has a link to EC the EC Treaty also protects home nationals against discrimination by their home country. [57]

5. Exceptions

Art. 45 EC Treaty:

The provisions of this Chapter shall not apply, so far as any given Member State is concerned, to activities which in that State are connected, even occasionally, with the exercise of official authority.

The Council may, acting by a qualified majority on a proposal from the Commission, rule that the provisions of this Chapter shall not apply to certain activities.

Art. 45 EC Treaty provides the exception to the freedom of establishment. In art. 45 activities are excluded from the scope of the freedom of establishment that are connected with official authority.[58] That connection is also a reason for an exception if it only occurs occasionally. If the part of an activity that is connected to official authority is separable, only the part that is linked, is excepted.[59] The member states are allowed to define what is connected to official authority on their own but they may not exclude more than is necessary,[60] because otherwise this would not be in accordance with the object and purpose of the EC Treaty.[61] However, it has to be said that this article is not really relevant for tax discrimination, as taxation is not useful in reserving to home nationals those activities that need the loyalty of home nationals.

[57] ECJ Case C-251/98 (para. 36); see also Eckhoff, *Diskriminierung*, pp 485 & 487; Knobbe-Keuk, 'Niederlassungsfreiheit: Diskriminierungs- oder Beschränkungsverbot?', DB 1990, p 2577; Jann, *Auswirkungen*, p 58; Fischer/Köck, *Europarecht*^{2}, p 513.
[58] ECJ Case C-42/92.
[59] See Geiger, *EG*^{2}, Art. 55, para. 4; Randelzhofer, in Grabitz/Hilf, *EU*, Art. 55, para. 4.
[60] See Geiger, *EG*^{2}, Art. 55, paras. 3 et seq.
[61] See Randelzhofer, in Grabitz/Hilf, *EU*, Art. 55, para. 8.

6. Overt – Covert Discrimination

Overt discrimination is discrimination based on nationality. Covert discrimination is discrimination as a result of another feature that is not nationality itself, but an attribute that nearly only affects foreigners and that, because of this, in fact leads to the same effect as a discrimination because of nationality.[62] Only the effect of the rule is decisive and not the intention of the legislator.[63] Covert discrimination is not mentioned in the EC Treaty. But regulation 1612/68 introduced covert discrimination as an infringement of the freedom of movement for workers[64] and has been extrapolated by the ECJ to the other fundamental freedoms,[65] because otherwise it would be up to member states to introduce covert discriminations to undermine the EC Treaty. As nearly no tax law makes a link to nationality (the Erbschafts- und Schenkungssteuergesetz [ErbStG – Inheritance Tax Act] is the only exception in Austria), overt discrimination has literally no importance in direct taxation.[66] But it is common in the European tax systems to differentiate because of residence. However, as most people who are resident abroad are nationals of other (member) states, this discrimination is a latent infringement of the EC Treaty.[67] DTCs also differentiate on the basis of the state of residence. And in that cases this is a possible discrimination, too.[68]

A tricky issue concerning the distinction between overt and covert discrimination is whether the discrimination of corporations because of their residence (according to the residence theory the state of residence nearly always coincides with the state of incorporation[69]) is a direct discrimination.[70] This would

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[62] for example: ECJ Case 152/73 (para. 11); ECJ Case 330/91 (para. 14); see also Griller, *Europarecht*^{2}, p 76; Geiger, *EG*^{2}, Art. 52, para. 14; Tumpel, *Harmonisierung*, p 380; Knobbe-Keuk, EC Tax Review 1994, p 77; Eckhoff, *Diskiriminierung*, pp 490 et seq; Zach, *Auswirkungen*, p 110; Thömmes, 'Steuerrecht', in Lenz (Hrsg.), *EG-Handbuch Recht im Binnenmarkt* (1991), p 515; Bachmann, RIW 1994, p 850; Wouters, EC Tax Review 1999, p 103; Thömmes, *Diskriminierung*, p 83; Lehner, *Resümee*, p 259; Offermanns, 'Tax Treaties in Conflict with EC Treaety: The Incompatibility of Anti-abuse Provisions and EC Law (Conference 13 March 1993, Fiscal Institute of Tilburg)', EC Tax Review 1995, p 98; Anido/Carrero, 'Accounting, the permanent establishment and EC law: the Futura-Singer Participations case', EC Tax Review 1999, p 26.

[63] See Lang, *Erbschaften*, p 259.

[64] See Toifl, 'Neue EuGH-Rechtsprechung zur Diskriminierung beschränkt Steuerpflichtiger', SWI 1995, p 425; Werndl, WBl 1995, p 230.

[65] ECJ Case C-266/95 (para. 33); ECJ Case C-350/96 (para. 27).

[66] See v. Raad, EC Tax Review 1995, p 194.

[67] ECJ Case C-279/93 (para. 28); ECJ Case C-350/96 (para. 29); see also Jann, *Auswirkungen*, p 57; Eckhoff, *Diskiriminierung*, p 492; Jacobs, *Unternehmensbesteuerung*^{4}, p 189; Dautzenberg, BB 1992, p 2403; Toifl, *Wegzugsbesteuerung*, p 155; Klein, *Steuerrecht*, p 18.

[68] For more details see III.O; see also Toifl, *Grundfreiheiten*, p 153.

[69] See II.A.3.

be the only 'regular' direct discrimination in direct taxation. The question is obvious, because the ECJ has stated that the law under which the company was formed is the nationality of corporations.[71] That coincidence between state of residence and state of incorporation and the fact that the state of incorporation is an equivalent to nationality leads to the conclusion that discrimination on the basis of residence is a direct discrimination of corporations. That would have the consequence that only the justification listed in the EC Treaty would be a possible justification. The problem is that they are normally no useful justification for tax law reasons.[72] But as the ECJ at least examines other justifications, I conclude that the ECJ does not see discrimination on the basis of residence of corporations as an overt discrimination.

7. Discrimination – Restriction

In the beginning of the EC the fundamental freedoms were mere prohibitions of discrimination between nationals of the home country and non-nationals. As time went by it was clear that covert discrimination is also discrimination according to EC law. And as more and more cases were decided, the ECJ further defined and adapted what it thought was an infringement. Many authors think that some time ago the ECJ started to interpret the fundamental freedoms not only as a prohibition of discrimination, but also as a prohibition of restriction.[73] The reason for that is that they think that some decisions of the ECJ cannot be explained by the prohibition of discrimination. Therefore they argue that the ECJ interpreted the fundamental freedoms as a prohibition of restriction, too. The difference between a discrimination and a restriction is that at discriminations a person with a link to the EC – for example a foreigner – is discriminated against – treated differently – a person without a link to the EC – in that example a home national – whereas at a restriction both persons are treated the same way but that treatment inhibit the person with the link to the EC to execute a fundamental freedom. A general investigation of this question would be too wide and not useful for this thesis. I am thus limiting the examination to cases where tax law was involved. The question is

[70] See Wouters, EC Tax Review 1999, p 104.
[71] ECJ Case C-307/97 (para.35); see also Schuch, *Meistbegünstigung*, p 107.
[72] See II.A.8.a).

was there really such a big change in the decisions that a different terminology is justified, or was it just the application of the old principle to new facts that had not previously been submitted to the ECJ previously?

At first sight, there are quite good arguments for both opinions. There was a change in the decisions and in the explanations. But I think that this change was the result of the fact that the facts of the cases that were submitted changed. The certainty that fundamental freedoms can also be applied in tax law only came with the decision in the *Avoir Fiscal*[74] case in 1986. From that date on tax experts began to check rules on the compatibility with the EC Treaty. But it again took some years until these activities resulted in a significant increase of the number of submissions to the ECJ. But already the second direct tax case, *Daily Mail*[75], concerned a company that was incorporated by the law of the member state, which discriminated against it or restricted its activities. As the *Werner*[76] case showed, the EC Treaty is only applicable in tax law if there is a link to another member state. And the necessary comparison which is fundamental to be able to show a discrimination is obvious.[77] The comparison has to be made between a person subject to unlimited tax liability with a link to another member state and one without a link. Two cases to compare are so vital to a discrimination because without two items to compare it cannot be shown that there is an unjustified (un)equal treatment.

The ECJ has not expressly made this comparison. But this is not reason enough to think that it has changed its definition of the scope of the fundamental freedoms because it needs a comparable, 'ideal', rule for a transfer of residence. And that is a movement of the company within the UK. So there is a comparison between a case, where the transfer of residence is within the EU (link to the EC) and a case, where the residence is changed to a place within the UK (domestic case).[78] Thus, the only difference with the *Avoir Fiscal* case is that the comparison

[73] For example: Thömmes, *EuGH-Rechtsprechung*, p 174; Kaiser, BB 1991, p 2057;Knobbe-Keuk, DB 1990, pp 2573 et seq; Dautzenberg, BB 1992, p 2401 only sees in the freedom to provide services a prohibition of restriction; Hahn, *Internationales Steuerrechts*, p 66.
[74] ECJ Case 270/83; for further details, see III.N.2.
[75] ECJ Case 81/87; for further details, see III.D.2.
[76] ECJ Case 112/91; for further details, see II.A.4.b).
[77] See Lang, *Erbschaften*, p 260; Dautzenberg, contribution to the discussion, in Thömmes, *Diskriminierung*, p 112.
[78] See Toifl, *Grndfreiheiten*, p 162.

is one between two nationals of the home country (*Daily Mail*) in contrast to a comparison between a national of the home country and a foreigner (*Avoir Fiscal*). And this difference has to be made because of the facts. Thus, I think that this still can be subsumed under discrimination and does not have to be a restriction.[79] Because of this, the move away from the home country, which is the requirement for the freedom of establishment,[80] is basically also protected by the prohibition of discrimination.

The other cases that are often listed as examples for the fact that fundamental freedoms are interpreted as a prohibition of restriction by the ECJ can be similarly explained as a prohibition of discrimination. The explanation of the *Biehl*[81] case is that a change of residence within the EU is treated discriminatory compared to a change within Luxembourg and that nationals of other member states are much more likely to move to another member state than Luxembourgian nationals.[82] As *Lang*[83] has shown, in the *ICI*[84] case the comparison has been made between a holding which only holds shares of UK companies and one that also holds shares of companies of other member states.[85] And in the *Futura-Singer*[86] case the comparison has been made between a Luxembourgian firm with a branch in Luxembourg and a foreign firm with a branch in Luxembourg.[87] The Luxembourgian branch of the Luxembourgian firm does not have to keep own books. Thus, the obligation of the branch of the foreign firm is a discrimination.[88]

Consequently, since in all those cases a comparison between a domestic case and a case with a link to the EC has been (or can be) drawn, the normal scheme of discrimination can always be applied.[89] The only difference is that the discrimination is not against a national of another member state, but a discrimination against a case with a link to another member state. And that, is in

[79] See Eberhartinger, EWS 1997, p 47.
[80] See Toifl, *Wegzugsbesteuerung*, p 161.
[81] ECJ Case 175/88.
[82] See Lang, *Erbschaften*, p 261.
[83] *Erbschaften*, p 262.
[84] ECJ Case C-264/96; for further details, see III.L.4.
[85] Different opinion, see Rainer, 'Anmerkung zu EuGH Rs. C-264/96, *ICI*', IStR 1998, p 471.
[86] ECJ Case C-250/95; for further details, see III.J.4.
[87] ECJ Case C-250/95, conclusions of the AdvGen (para. 50); Anido/Carrero, EC Tax Review 1999, p 31.
[88] Different Opinion: Anido/Carrero, EC Tax Review 1999, pp 24, 27 et seq.
[89] See Lang, *Erbschaften*, p 262; different opinion: Offermanns, EC Tax Review 1995, p 98.

my opinion, still a discrimination, not a restriction.[90] Thus, at least for tax purposes it is not clear that the fundamental freedoms are prohibitions of restriction. But, as the term 'discrimination' was adapted as new cases were submitted to the ECJ, it is possible that in the future the ECJ will have to decide if freedom of establishment also prohibits restriction in the field of direct taxation. But until now this decision has not been given and the link between art. 12 EC Treaty and the fundamental freedoms supports the opinion that the freedom of establishment and the freedom to provide services are only prohibitions of discrimination[91]. Furthermore, every tax is an obstacle to economic activities. So every taxation of cases with a link to the EC could be seen as a restriction. But on the other hand, the member states need the tax revenue and, thus, taxation is justified by public interest ('ordre public' reservation – see II.A.8.a)) as long as it is not discriminatorily applied. An additional argument for the statement that the fundamental freedoms are still prohibitions of discrimination in direct taxation is that the member states decided against further integration of tax matters because they kept the principle of unanimity at tax law.[92] Thus, *Hahn*[93] argues that the ECJ does not apply the concept 'restriction' to direct tax matters. In compensation, it enlarged the concept of covert discrimination.[94]

8. Justification

a) From the EC Treaty

Art 46 EC Treaty:

1. The provisions of this Chapter and measures taken in pursuance thereof shall not prejudice the applicability of provisions laid down by law, regulation or administrative action providing for special treatment for foreign nationals on grounds of public policy, public security or public health.

[90] Different opinion: Jacobs, *Unternehmensbesteuerung*[4], p 191.
[91] See Lang, *Erbschaften*, p 259.
[92] Art. 95 (2) EGV.
[93] *Internationales Steuerrecht*, p 102.
[94] See Hahn, *Internationales Steuerrecht*, p 106.

2. The Council shall, acting in accordance with the procedure referred to in Article 251, issue directives for the coordination of the abovementioned provisions.

Art. 46 EC Treaty allows discrimination only because of public policy, public security and public health reasons.[95] This is called the 'ordre public' reservation.[96] But these exceptions do not have any relevance for tax law,[97] since terrorists for example are not taxed higher if they are foreigners, but they are, if possible, prevented from entering Austria. These are the only justifications for overt discrimination. But in practice the distinction as to which justification is possible is not applied very strictly.[98]

b) Other Justifications

For covert discrimination (and restriction, if the ECJ is seen as interpreting the freedom of establishment as a prohibition of restriction[99]), there are also imperative requirements of general interest, a possible justification[100] if there is no rule possible that is less discriminatory.[101] Thus, the ECJ has introduced in its newer case law the principle of proportionality that is already common for examination of national restrictions of fundamental rights.[102]

As direct tax rules are normally covert discrimination, if they are discriminatory at all, the threshold for overruling the EC Treaty is lower than in other areas.[103] Thus, the question is what such imperative requirements of general interest are. The ECJ is very restrictive in applying such an imperative requirement of general interest.[104] On the other hand, it is not really stringent in its examination scheme[105] and has no strict boundry between justification and the point, where it decides, whether the two cases compared in order to find a discrimination are

[95] See Hahn, 'Das ICI-Urteil des EuGH und die Hinzurechnungsbesteuerung gemäß §§ 7 ff. AStG', IStR 1999, p 610.
[96] See Geiger, *EG*[2], Art. 56, para. 1.
[97] See Jann, *Auswirkungen*, p 66.
[98] See Offermanns, EC Tax Review 1995, p 98.
[99] See II.A.7.
[100] ECJ Case 120/78.
[101] See Knobbe- Keuk, DB 1990, p 2577; Offermanns, EC Tax Review 1995, p 98.
[102] See Fischer/Köck, *Europarecht*[2], p 513; Lang, *Erbschaften*, p 260; Knobbe-Keuk, EC Tax Review 1994, p 78.
[103] See Hinnekens, EC Tax Review 1994, p 150.
[104] See Thömmes, *Diskriminierung*, p 96.

comparable. Thus, sometimes it sees justification not as justification, but as a reason why two cases are not comparable.[106]

Until now most of the justifications that governments proposed were rejected by the ECJ. The most important of these are the lack of harmonisation, the offsetting of advantages, administrative difficulties in obtaining information regarding non-resident taxpayers, DTCs, general risk of tax avoidance, discretionary administrative relief, a different tax framework abroad, the need for reciprocal treatment of the own nationals by another member state and the drop in tax revenue.[107] But anti-abuse measures are a possible justification that is not rejected by the ECJ. But here the principle of proportionality has to be taken into consideration.[108] Another justification that was introduced by the ECJ itself in the *Bachmann* case[109] was the 'coherence principle'. In later cases the ECJ further developed the 'coherence principle'. This evolution will be discussed now.

(1) Bachmann

In the joined cases *Bachmann* and *Commission / Belgian State*[110], the ECJ introduced the 'coherence principle'. It did not see a discrimination in a forbidden deduction of expenses. The reason for that decision was that that treatment was the consequence of a future exclusion of taxation of the forthcoming return and the later taxation could not be secured. Additionally the coherence of the tax system could not be attained through less discriminatory measures. The ECJ decided that that violation of the EC Treaty was justified because of a coherence of the tax system. Thus, a coherence was given if compensation of the advantage and the disadvantage was inevitable in one matching rule, because then it is no forbidden compensation of advantages.[111] Additionally the rule has to correspond to the principle of proportionality.[112] With this decision the ECJ granted the member

[105] For further details, see III.A.
[106] See Lang, *Erbschaften*, p 260.
[107] See v. Raad, EC Tax Review 1995, pp 199 et seq; Dautzenberg, BB 1992, p 2404; Jacobs, *Unternehmensbesteuerung*[4], p 191.
[108] See Offermanns, EC Tax Review 1995, p 99.
[109] ECJ Case C-204/90.
[110] ECJ Cases C-204/90 & C-300/90 respectively; for further details, see III.G.2.
[111] See Dautzenberg, BB 1992, p 2403; Saß, EWS 1998, p 348.
[112] See Toifl, *Grundfreiheiten*, p 175; Hinnekens/Schelpe, EC Tax Review 1992, p 61; Thömmes, *Diskriminierung*, p 97.

states the choice of the tax system and accepted discrimination if it is the least possible discrimination to maintain the coherence of the tax system.[113]

The criticism was that the ECJ has not gone far enough. It excluded the consequences of DTCs. Thus, the decision ignored the fact that there would have been no coherence, if the effects of DTCs which are also part of the national tax system,[114] would have been included.[115]

(2) Schumacker

In the *Schumacker*[116] case, the 'coherence principle' was brought up in connection with the right to tax the worldwide income of a person and the consideration of his personal circumstances.[117] But the ECJ stated that the principle of equal treatment prevails and so the personal circumstances have to be considered by the state of activity if the person earns (nearly) all his income in the state of activity.[118] Already in this decision the fundamental freedoms prevail over the 'coherence principle'.[119]

(3) Wielockx

The next case where the 'coherence principle' was of concern was the *Wielockx*[120] case.

(a) Facts

A Belgian who was resident in Belgium, but had an establishment in the Netherlands, was denied deduction for payments to a fiscal pension reserve (FPR). As the money stays – in contrast to a pension-insurance – in the firm, it is

[113] See Dautzenberg, BB 1992, p 2404.
[114] See III.O.1.
[115] See Thömmes, 'Das EuGH-Urteil in der Rechtsache Wielockx – Abschied vom Rechtfertigungsgrund „steuerliche Kohärenz"?', IWB 1996, F 11, G 2, p 227; Hinnekens/Schlelpe, EC Tax Review 1992, p 61; Knobbe-Keuk; EC Tax Review 1994, pp 80 et seq; Jacobs, *Unternehmensbesteuerung*[4], p 182; Toifl, *Wegzugsbesteuerung*, p 159; *Auswirkungen*, pp 74 et seq; Thömmes, *Diskriminierung*, p 97.
[116] ECJ Case C-279/93.
[117] See Klein, *Steuerrecht*, p 20.
[118] See Lang, 'Die Bindung der Doppelbesteuerungsabkommen an die Grundfreiheiten des EU-Rechts', in Gassner/Lang/Lechner (Hrsg.), *Doppelbesteuerungsabkommen und EU-Recht – Auswirkungen auf die Abkommenspraxis* (1996), p 39.
[119] See Jann, *Auswirkungen*, p 76; Thömmes, *Diskriminierung*, p 98.
[120] ECJ Case C-80/94.

an advantage for the business,[121] although the FPR is caused by private circumstances.[122]

(b) Decision of the ECJ

The government of the Netherlands argued that the same facts were the same as in the *Bachmann*[123] case, because the pension could not be taxed after Mr. Wielockx returned to Belgium after his retirement. This was therefore a typical application of the 'coherence principle'.

As the OECD Model DTC[124] and the similar DTC Belgian / Netherlands[125] grants the state of residence the right to tax, the ECJ set the possible coherence at a higher level[126] and also took, following the criticism after the *Bachmann* decision,[127] the DTC into account.[128] Since the Netherlands does not have the right to tax pensions of a non-resident because of the DTC, the ECJ sees no justification in the coherence principle.[129]

The reference[130] to the *Schumacker*[131] case shows that the freedom of establishment follows the same principles as the freedom of movement for workers.[132] This is also expressed in the *Asscher*[133] decision. If a person subject to limited tax liability earns nearly all his income in the host country that member state has to take the personal circumstances of the taxpayer into account. Because of this, of Mr. Wielockx's treatment was an infringement of the freedom of establishment.[134]

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[121] ECJ Case C-80/94, conclusions of the AdvGen (paras. 45 et seq).
[122] See Kamphuis/Pötgens, BIFD 1996, p 3.
[123] ECJ Case C-204/90; for further details see III.G.2.
[124] Art. 18.
[125] Art. 18.
[126] ECJ Case C-80/94, conclusions of the AdvGen (paras. 52 et seq).
[127] See II.A.8.b)(1).
[128] See Jann, *Auswirkungen*, p 76.
[129] ECJ Case C-80/94 (paras. 24 et seq); see also Thömmes, 'ECJ to Further define 'Coherence Principle' in Direct Tax Matters', Intertax 1995, p 536; Thömmes, Diskriminierung, p 99.
[130] ECJ Case C-80/94 (paras. 16 et seq).
[131] ECJ Case C-279/93.
[132] See de Weerth, RIW 1995, p 928; Rainer, IStR 1996, p 130; Kamphuis/Pötgens, BIFD 1996, p 4.
[133] ECJ Case C-107/94; for further details see III.J.3; Jacobs, *Unternehmensbesteuerung*[4], p 187.
[134] ECJ Case C-80/94 (para. 27); see also Wouters, EC Tax Review 1999, p 105.

(c) Effects on the 'Coherence Principle'

One consequence for the 'coherence principle' is that to be a possible coherence the interdependence between deductibility and taxation has to be on the level of the same tax subject.[135] The other consequence is that for applying the 'coherence principle', the argumentation may not be restricted to the normal national law any longer, but has to take the international web of DTCs in account, too.[136] With this development of the term 'coherence', the ECJ followed the criticism in the literature after its decision on the *Bachmann*[137] case. It abandoned most of the possible applications of the 'coherence principle',[138] as even the combination of plain national law with DTC rules does not lead to a coherence.[139] *Thömmes*[140] and *de Weerth*[141] even think that the 'coherence principle' is a formula without content, because every member state that concludes DTCs offers the 'coherence principle' as a possible justification. On the other hand, if there is no DTC, there is no duty to relinquish the right of taxation. And there is thus no justification, either. From that point of view, it is quite improbable that the 'coherence principle' will ever be a justification again. Another argument – why there cannot be coherence, when the member states have not concluded a DTC– is that DTCs comply with the goal of the EC Treaty and dilatoriness cannot be a justification.[142]

(4) Svensson-Gustavsson

In the Svensson-Gustavsson[143] case the 'coherence principle' was mentioned once again.

[135] See Thömmes, 'European Court of Justice follows Advocate General in the Wielockx Case', Intertax 1995, p 602.
[136] See Rainer, IStR 1995, p 475; Kanphuis/Pötgens, BIFD 1996, p 5 & 7; Saß, 'EuGH zu Art. 52 EG-Vertrag – Verpflichtung zur Gleichbehandlung – Besteuerung des Einkommens von Gebietsfremden', DB 1995; p 2150; Lang, *DBA und Grundfreiheiten*, p 40.
[137] ECJ Case C-204/90; for further details, see III.G.2.
[138] See Toifl, *Wegzugsbesteuerung*, p 160.
[139] See Jann, *Auswirkungen*, p 77.
[140] IWB 1996, F 11, G 2, p 228; *EuGH-Rechtsprechung*, p 182; *Diskriminierung*, pp 99 et seq.
[141] RIW 1995, p 930.
[142] See Lang, *DBA und Grundfreiheiten*, p 41.
[143] ECJ Case C-484/93.

(a) Facts

The Svensson-Gustavsson couple, who were born in Sweden and lived in Luxembourg, took a loan for improving their flat at a Belgian bank. But the promotion of such loans was limited to loans by a Luxembourg bank.

(b) Decision of the ECJ

The justification proposed by the Luxembourgian government for this discrimination was that this sponsoring leaded to higher profits of Luxembourg banks, which again leads to higher tax revenue. Only the coherence of this higher tax revenue made the generous sponsoring possible.[144] The ECJ stated that such sponsoring is a distortion of competition and, because of that, an infringement of art. 49.[145] Coherence was not present, because the connection was not close enough.[146]

(c) Effects on the 'Coherence Principle'

Coherence is only possible if advantages and disadvantages have a personal and substantive connection. But, as already mentioned it is very improbable that coherence will serve as a justification in a future case.[147]

Thömmes[148] thinks that the ECJ buried the 'coherence principle' in the *Futura-Singer* case[149] forever and instead applies the principle of proportionality. Since that decision, the ECJ or the AdvGen has often discussed the 'coherence principle', mostly because the government tried in vain to justify the discrimination with it, but it has never again been acknowledged as justification. The concept has not been changed since the *Svensson-Gustavsson* decision.

[144] ECJ Case C-484/93 (para. 13).
[145] ECJ Case C-484/93 (paras. 10 et seq).
[146] ECJ Case C-484/93 (para. 18).
[147] See II.A.8.b)(3)(c).
[148] 'Besteuerung der Einkünfte einer ausländischen Zweigniederlassung', IWB 1997, F 11a, p 196.
[149] ECJ Case C-250/95.

B. Difference between Freedom of Establishment and Freedom to Provide Services

1. Legal Position

Art 49 EC Treaty:

Within the framework of the provisions set out below, restrictions on freedom to provide services within the Community shall be prohibited in respect of nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended.

The Council may, acting by a qualified majority on a proposal from the Commission, extend the provisions of the Chapter to nationals of a third country who provide services and who are established within the Community.

2. General Remarks

The reason why the freedom of establishment and freedom to provide services are combined in this thesis is that they are very similar, hard to differentiate exactly and most statements are true for both of them.[150] Because of this, I will only describe the differences here, to prevent repeating what has already been said in II.A. As the difference with the freedom of establishment is so small, art. 55 EC Treaty only refers to art. 45-48 and does not itself define exemptions, justification and the application for companies. Also, the changes of the Treaty of Amsterdam are similar to the changes in the freedom of establishment. That means that at the freedom to provide services art. 49 and 52 were adopted to and the former art. 62 was dropped as a result of the end of the transitional period.

[150] See Lang, *Erbschaften*, p 257; Randelzhofer, in: Grabitz/Hilf, *EU*, Art. 59, para. 5.

The freedom to provide services is a residual rule for those economic activities that cannot be subsumed under any other fundamental freedom. Hence, the other fundamental freedoms prevail.[151]

Cross-border services may not be discriminated against in relation to services within a member state.[152] There are 4 types of cross-border services possible:

- The supplier of the service travels into the country of the customer to provide the service.[153] (active service)
- The customer travels into the country of the supplier to get the service.[154] (passive service)
- The supplier only sends the result of the service to the customer in the other member state.[155] (correspondence service)
- Customer and supplier travel into another member state to carry out the service there.[156] (foreign country referring service) In this case both may come from the same member state!

As the freedom to provide services is a residual rule – for all activities that have an economic purpose but cannot be subsumed under any other fundamental freedom – an extensive interpretation has to be used. For that reason the ECJ introduced passive and foreign country referring services as protected by the EC Treaty in the cases *Luisi and Carbone*[157] and *Commission / France*[158], respectively. In the EC Treaty only type number one is expressly mentioned.

Because services are, in contrast to establishments, only temporary, requirements that in fact require an establishment or a residence, are forbidden,

[151] See Geiger, *EG*[2], Art. 60, para. 1; Randelzhofer, in Grabitz/Hilf, *EU*, Art. 59, para. 4, Art. 60, paras. 1 et seq; Fischer/Köck, *Europarecht*[2], p 509; Zach, *Auswirkungen*, p 112.
[152] See Dautzenberg, BB 1992, p 2401; Geiger, *EG*[2], Art. 59, para. 1; Randelzhofer, in: Grabitz/Hilf, *EU*, Art. 59, para. 1; for the discussion of whether the freedom to provide service is a prohibition of discrimination or restriction see II.A.7.
[153] See Geiger, *EG*[2], Art. 60, para. 6; Fischer/Köck, *Europarecht*[2], p 509.
[154] See Geiger, *EG*[2], Art. 60, para. 7.
[155] See Geiger, *EG*[2], Art. 60, para. 8.
[156] See Randelzhofer, in: Grabitz/Hilf, *EU*, Art. 60, para. 4.
[157] ECJ Cases 286/82 & 26/83; ECJ Case C-224/97 (para. 11).
[158] ECJ Case C-154/89.

since that would lead to an deterioration of the freedom to provide services.[159] Additionally, requirements that have to be met in the home country of the supplier have to be taken into account in the requirements of the other member state and the remaining requirements have to be justified by an urgent public interest.[160]

3. Comparison with the Other Fundamental Freedoms

The similarity of active service and an establishment is obvious. Here, the difference from the freedom of establishment is that for the application of the freedom to provide services no permanent establishment is needed. The freedom to provide services is applied if there is only a temporary activity in the host country.[161] The differentiation between these two fundamental freedoms declines in importance as differences in the decisions decrease.[162] If the activity of a firm is nearly totally performed in another member state, without having a permanent establishment there, the rules of the freedom of establishment are applied to prevent an evasion of special statutes of the profession.[163]

Correspondence service is comparable to the free movement of goods.[164] Here, the goal of the freedom to provide services is to enhance the trade with intangible goods. For the differentiation to the free movement of goods it is important which aspect – good or service aspect – predominates.[165] As to the difference to the freedom of movement for workers it has to be said that the supplier has to be self-employed;[166] otherwise, the case is subsumed under the freedom of movement for workers.

[159] ECJ Case 205/84 (para. 52); see also Randelzhofer, in Grabitz/Hilf, *EU*, Art. 59, para. 3; Thömmes, *Steuerrecht*, p 523; Knobbe-Keuk, DB 1990, p 2573.
[160] See Randelzhofer, in Grabitz/Hilf, *EU*, Art. 60, para. 22; Fischer/Köck, *Europarecht*[2], p 515.
[161] ECJ Case 196/87; see also Geiger, *EG*[2], Art. 59, para. 1; Randelzhofer, in: Grabitz/Hilf, *EU*, Art. 60, para. 3; Fischer/Köck, *Europarecht*[2], p 509; Zach, *Auswirkungen*, p 111.
[162] Eberhartinger, EWS 1997, p 48.
[163] ECJ Case 33/74; see also Geiger, *EG*[2], Art. 60, para. 2.
[164] See Geiger, *EG*[2], Art. 59, para. 1.
[165] See Randelzhofer, in: Grabitz/Hilf, *EU*, Art. 60, paras. 6 et seq.
[166] See Geiger, *EG*[2], Art. 60, para. 3.

4. Personal Scope

a) Legal Position

To be protected by the freedom to provide services the provider has to be resident in and a national of a member state of the EC and the customer has to be resident within the EU[167]. A proposal of the commission to enlarge the scope of the freedom to provide services to nationals of third countries[168] who are resident within the EU has not been passed by the council yet. As in accordance with art. 55, art. 45-48 are also applied for the freedom to provide services; companies are also protected by the freedom to provide services by art. 48.[169]

The guarantees of the freedom to provide services are also in force in relation to nationals of the home country if there is a link to the EC.[170] Otherwise, the provision of freedom to provide services, especially of passive services, would not be complete.

b) Eurowings

(1) Facts

Leasing expenditure was deductible only if the lessor was subject to Gewerbesteuer (GewSt – trade tax), which was only possible if the lessor was resident in Germany. If the lessor did not fall under the GewSt, the lessee could only deduct half of the expenditure. Thus, half of the expenditure was deemed to be profit.[171] This is unusually high. Additionally, a German lessor could reside in a municipality where the tax rate was nearly 0, because the rate was fixed by each municipality.[172] Thus, this market was nearly excluded from the common market.[173]

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[167] See Roth, in Dauses (Hrsg.), *Handbuch des EU-Wirtschaftsrechts* (1999), E.I, paras. 113 et seq.
[168] OJ 1999 C 67 L 225/1, p 17.
[169] See Geiger, *EG*[2], Art. 59, para. 3; Randelzhofer, in Grabitz/Hilf, *EU*, Art. 59, paras. 17 & 23; for further details, see II.A.3.
[170] See Randelzhofer, in Grabitz/Hilf, *EU*, Art. 59, para. 21; See Roth, in Dauses, *EU-Wirtschaftsrecht*, E.I, para. 113.
[171] ECJ Case C-294/97 (para. 8).
[172] ECJ Case C-294/97 (paras. 12 & 38); see also Kaefer/Tillmann, 'Gemeinschaftswidrigkeit gewerbesteuerlicher Hinzurechnungsvorschriften', IWB 1999, F 11a, p 396.
[173] Kaefer/Tillmann, IWB 1999, F 11a, p 396.

It is also important that also the lessee, as indirectly affected by the discrimination of the lessor, may request at national courts a preliminary ruling of the ECJ.[174]

(2) Decision of the ECJ

As no foreign lessor was able to fulfil the requirement in question, but most German ones did, this was a covert discrimination.[175] The German government tried to justify the discrimination by the fact that in all cases the lessor or lessee was taxed and hence there was coherence because the lessor would pass the tax burden on to the lessee.[176] But the ECJ did not apply the coherence principle as justification.[177]

Because of this rule a distortion of the common market had occurred, because lessees would prefer German lessors since only in that case was the expenditure deductible.[178] Thus, this was a kind of penalty tax for leasing from a foreign lessor. That was why the German market for leasing has been nearly separated until today.[179] The fact that the lessee was subject to a low tax level was not a justification either.[180] Any other interpretation would lead to tax compensations upon cross-border activities and this is not compatible with the common market.[181] This standpoint can already be seen, according to *Meilicke*[182] in the *Avoir Fiscal*[183] case, and in the report on the hearing in the *Schumacker* case.[184] Thus, there was no justification at hand in that case. Additionally, in this

[174] ECJ Case C-294/97 (para. 34); settled case law since 286/82; see also Kaefer/Tillmann, 'Vereinbarkeit gewerbesteuerlicher Hinzurechnungsvorschriften mit europäischen Gemeinschaftsrecht', IWB 1997, F 11a, p 238; Eberhartinger, EWS 1997, p 51.
[175] ECJ Case C-294/97 (paras. 35 et seq & 40); ECJ Case C-311/97 (paras. 24 et seq); different opinion: Kischel, 'Nochmals: Vereinbarkeit der Hinzurechnungsvorschriften des Gewerbesteuergesetzes mit dem EG-Recht', IWB 1997, F 11a, p 241.
[176] See Kischel, IWB 1997, F 11a, p 242.
[177] ECJ Case C-294/97 (para. 41); see also Jänisch, 'Anmerkung zu BFH: Entscheidung – AdV wegen eventl. europarechtswidriger Hinzurechnung nach GewStG', IStR 1997, p 208; Rainer, 'Vereinbarkeit gewerbesteuerlicher Hinzurechnungsvorschriften mit europäischem Gemeinschaftsrecht?', IStR 1997, p 527; Saß, EWS 1998, p 348.
[178] ECJ Case C-294/97 (para. 37); see also Jacobs, *Unternehmensbesteuerung*[4], p 218; Kaefer/Tillmann, IWB 1997, F 11a, p 238.
[179] See Kaefer/Tillmann, 'Anmerkung zu Rs. C-294/97', IWB 1999, F 11a, p 327.
[180] ECJ Case C-294/97 (paras. 43 et seq); see also Jacobs, *Unternehmensbesteuerung*[4], p 219.
[181] ECJ Case C-294/97 (para. 46); Kaefer/Tillmann, IWB 1997, F 11a p 239.
[182] 'Diskriminierung beschränkt steuerpflichtiger EG-Ausländer und Niederlassungsfreiheit (Art. 52, 58 EWG-Vertrag)', RIW 1989, p 642.
[183] ECJ Case 81/87.
[184] ECJ Case C-279/93; see Rädler, 'Bericht – EuGH: Mündliche Verhandlung im Fall Schumacker – Ehegattensplitting bei beschränkt steuerpflichtigen Grenzgängern', FR 1994, p 705.

specific case there even was a possible solution at hand that was less discriminatory, like an exclusion of all lessors of the liability to trade tax and as a compensation the duty of all lessees to tax half of the leasing expenditure.[185] Thus, the ECJ ruled in favour of Eurowings.

c) Effects of the Decision in the Sala[186] Case

Every citizen of the EU is protected by the fundamental freedoms if he legally stays in another member state. This means the freedom to provide services is also to be applied if a citizen travels to another member state to use a service.[187] For tourists this has already been guaranteed before[188] and now it is also granted through art. 18 EC Treaty, on EU citizenship.

d) Conclusions

The freedom to provide services is always applied when there is a link to the EC. Under specific circumstances the supplier and the customer may even be nationals of the same member state.

The customer can also request a preliminary ruling of the ECJ, under art. 234 EC Treaty, at a national court if he is only affected indirectly by the discrimination of the supplier.

5. Exceptions

Art. 51 EC Treaty:

1. Freedom to provide services in the field of transport shall be governed by the provisions of the Title relating to transport.

2. The liberalisation of banking and insurance services connected with movements of capital shall be effected in step with the liberalisation of movement of capital.

[185] ECJ Case C-294/97, conclusions AdvGen (paras. 61 et seq).
[186] ECJ Case C-85/96.
[187] See Toifl, SWI 1999, p 156.
[188] ECJ Cases 286/82 and 26/83.

Art. 51 EC Treaty contains additional exceptions of the freedom to provide services that are not relevant for the freedom of establishment. The provisions of the title relating to transport of the EC Treaty also governs services in the field of transportation.[189] When banking services are liberalised, the liberalisation of the free movement of capital has to be taken into account.[190]

[189] Art. 51 (1) EC Treaty.
[190] Art. 51 (2) EC Treaty.

III. Influence on Austrian Tax Law

Before giving a list of rules that are more or less obviously critical in the light of the freedom of establishment and the freedom to provide services, I will begin with an introduction into the examination scheme of the ECJ. As the legal system the ECJ creates, is based on case law, nobody can foresee a future decision. Thus, we depend on educated guesses as to what that decisions will look like. Sometimes, it is quite clear how a hypothetical case will end. Sometimes, it is not obvious. But with regard to all the educated guesses that will come in this chapter, it has to be borne in mind that the outcome is not totally sure until the ECJ has decided in a real case.

A. Examination Scheme of the ECJ

The ECJ normally follows the same examination scheme in determining if there is discrimination. At first, it agrees on what the content of the rule in question is. The ECJ does not restrict itself to one section or article, but decides what paragraphs form one matching rule.[1] Because of this, the coherence in the *Bachmann*[2] case was due to one matching rule and not a compensation of advantages that is prohibited by the ECJ.[3] In the next step, it examines if the EC Treaty is applicable and which articles are relevant in the case in question.[4] After that, the ECJ checks if the member state treats two equal cases unequally, or two unequal cases equally. The next step is to examine if an established discrimination can be justified or not.[5] In the end the 'principle of proportionality' has to be examined because a violation of the EC Treaty can only be justified if the infringement is proportionate and unavoidable and the measure is designed to guarantee the accomplishment of its aim.[6]

[1] See Dautzenberg, BB 1992, p 2403; Dautzenberg, contribution to the discussion, in: Thömmes, *Diskriminierung*, p 110; Schuch, *Meistbegünstigung*, p 105.
[2] ECJ Case C-204/90; for further details, see III.G.2.
[3] See II.A.8.b)(1).
[4] See ECJ Case C-112/91, where the EC Treaty was not applicable; for further details, see II.A.4.b).
[5] ECJ Case C-212/97 (para. 34); see also Schuch, *Meistbegünstigung*, p 105.
[6] ECJ Case C-212/97 (para. 34); see also Anido/Carrero, EC Tax Review 1999, pp 27 & 32; Eberhartinger, EWS 1997, p 48.

This scheme is an 'ideal' and the ECJ is not bound to it. Thus, the ECJ does not always follow the scheme strictly. Sometimes some steps are skipped because they are obvious, or not relevant to the ECJ. When following the scheme, the ECJ is sometimes not stringent in differentiating between deciding if the cases are equal and if there is a justification. Of course, an exact distinction is hard to make because if the cases are not totally equal, the different treatment is justified and if there is no difference, there can be no grounds for a justification. But it would be desirable if the ECJ always showed what is a feature that differentiates two cases and what is a possible justification.

B. § 1 (4) EStG in the Form of the EU-AbgÄG 1996 and § 34 EStG

After the *Schumacker*[7] decision, which is also relevant for self-employed persons as was shown in the *Wielockx* and *Asscher* cases[8], § 1 (4) EStG was inserted into the EStG to prevent a corresponding decision in an Austrian case. An EU citizen can opt for being subject to unlimited tax liability if he earns more than 90 per cent of his worldwide income in Austria, or if he earns less than ATS 96.000,- (approximately € 6977,-) abroad.[9]

The difficulty of § 34 EStG is also a part of the problem of § 1(4) EStG. § 34 regulates the deductibility of exceptional expenses. They are only deductible if the taxpayer is subject to unlimited tax liability[10] or if he opts for the application of § 1 (4) EStG. Exceptional expenses are a part of the circumstances of the taxpayer's life which has to be taken primarily into account by the state of residence but have to be taken into account in the state of activity if the state of residence cannot consider them.[11] Thus, the lack of a deduction of that expenditure would be an infringement of the fundamental freedoms.[12] But the possibility to opt for an assessment as taxpayer subject to unlimited tax liability basically eliminates that infringement.

[7] ECJ Case C-279/93.
[8] ECJ Case C-80/94 (paras. 16 & 18) and ECJ Case C-107/94 (para. 42), respectively.
[9] For further details on subject to limited tax liability, see III.J.
[10] See Doralt/Ruppe, *Grundriß des österreichischen Steuerrechts, Band I*[6] (1997), p 259.
[11] ECJ Case C-279/93; Jacobs, *Unternehmensbesteuerung*[4], p 184; Werndl, WBl 1995, p 229; Thömmes, Intertax 1995, p 602.
[12] See Tumpel, *Harmonisierung*, pp 383 et seq.

But this rules does not seem to be enough to prevent future ECJ rulings. There are still cases possible – for example, a person that earns half of his income in Austria, the other half in member state A, but resides in member state B – where this is not enough to encompass the meaning of the *Schumacker* case.[13] *Pülzl*[14] reasons that it was confirmed in the *Asscher*[15] case that the limited tax liability of EU citizens can hardly be justified[16] and that, as a consequence, the requirement that 90 per cent of the income has to originate in Austria, has to be abolished.[17] This general statement has to be put into perspective of the *Gschwind*[18] case, because there the ECJ confirmed the system of limited tax liability if the state of residence has enough income to tax to take the personal circumstances into account.[19] *Stapperfend*[20] even believes that the ECJ abandoned the claim of strict equal treatment of residents and non-residents. But I cannot agree with him because the ECJ has always stated that the personal circumstances only have to be taken into account in the state of activity if the state of residence does not have enough income left to take them into account. And as roughly 50 per cent of the family income – which is relevant because the splitting tariff concerns the family situation – are taxed in the state of residence that is not the case.

Thus, at least the strict 90 per cent requirement should be abolished. The minimum solution should be to consider personal circumstances if the state of residence is not able to and if the taxpayer's highest part of income originates in Austria. Other possible solutions would be to open the possibility of assessment as a taxpayer subject to unlimited tax liability to all EU citizens, or to grant the deductible amounts and the tax progression that takes into account the personal situation, corresponding to the part of income that originates in Austria. As

[13] See also Göttsche, 'Anmerkung zu EuGH Rs. C-391/97 (Gschwind)', DStR 1999, p 1613.
[14] 'Neuer Absatz 4 im § 1 EStG nicht ausreichend', Recht der Wirtschaft (RdW) 1996, p 606.
[15] ECJ Case C-107/94; for futher details, see III.J.3.
[16] See also Urlesberger, 'Die Folgen des Schumacker-Urteils – zur Begriffsbestimmung des Gleichbehandlungsgrundsatzes nach Art. 48 und 52 EG-V, WBl 1996, pp 347 et seq.
[17] See also Kaefer, 'Anmerkung zu EuGH Rs. C-391/97', IStR 1997, p 758; Kaefer/Toifl, 'Verweigerung des Splittingtarifs für verheiratete Grenzpendler mit EG-Recht vereinbar?', IWB 1999, F 11a, p 343; Stapperfend, 'Anmerkung zu BFH XI R 45/97', FR 1998, p 61; different opinion, see Haunold/Tumpel/Widhalm, 'News aus der EU', SWI 1999, p 462; Thömmes, 'Vereinbarkeit der Verweigerung des Splittingtarifs für verheiratete Grenzpendler mit europäischem Gemeinschaftsrecht', IWB 1998, F 11a, p 248.
[18] ECJ Case C-391/97.
[19] ECJ Case C-391/97 (paras. 16 and 28 et seq).
[20] 'Anmerkung zu EUGH Rs. C-391/97 (Gschwind)', FR 1999, p 1079.

Werndl[21] claims that the tax administration has to survey the personal circumstances in all cases to determine whether § 1 (4) EStG can be applied or not, it should only be a smaller step to opening the assessment of a taxpayer subject to unlimited tax liability, because all information has to be at hand already.

A different problem resulting from § 1 (4) EStG is that persons that are subject to unlimited tax liability because of § 1 (2) EStG – persons who spend more than 6 months in Austria, or have their residence in Austria – may deduct the household tax credit (§ 33 (4) EStG) only if his/her spouse is subject to unlimited tax liability in Austria. That requirement is, however, not relevant for persons who opt for § 1 (4). Thus, this is a discrimination of residents that is, as shown in the *Werner* case[22], no infringement of the EC Treaty. Nevertheless, it can also be a discrimination of one non-resident EU citizen against another one. The comparison can be made between a national of another member state – or even an Austrian who has acquired rights according to the EC Treaty – who provides services in Austria and spends more than 6 months in Austria and another national of another member state who provides services in Austria but spends less than 6 months in Austria. Both derive nearly all their income in Austria. The first person is subject to unlimited tax liability because of § 1 (2) EStG and the second opts for an assessment according to § 1 (4) EStG. The spouses of both are only subject to limited tax liability in Austria. Thus, only the second one may deduct the household tax credit. But the only difference between the two is that the second one spends fewer days in Austria. Therefore, this should be a discrimination. The same argument is true if the discriminated person is an Austrian national who has acquired rights under the EC Treaty. But it is uncertain that the ECJ would see an infringement of the EC Treaty in that rule because it has never before made a comparison between two non-residents. According to case law, comparison is possible for two taxpayers subject to limited tax liability[23] but it has not been made clear yet if such a comparison was possible between two taxpayers subject to unlimited tax liability and only one of them has a link to the EC. Thus, it is more than questionable if the ECJ would see an infringement in that rule. It more likely

[21] Wbl 1995, p 231.
[22] ECJ Case C-112/90; for further details, see II.A.4.b).
[23] See III.O.4.

that the VfGH (Verfassungsgerichtshof – Supreme Constitutional Court) would see an infringement of the Austrian constitution.

C. Deductible Donations Are Restricted to Austrian Institutions in Accordance with § 4 (4) Z 5 and 6 EStG

In Austria donations are basically not deductible from income. § 4 (4) Z 5 and 6 enumerate exceptions to that rule: For example, donations to special Austrian scientific and cultural institutions. That is of course a disadvantage for institutions of other member states. But as the enumerated institutions do not have any economic purpose, other institutions that may claim to be entitled to this rule must not have economic purposes either. Thus, they are not protected by the fundamental freedoms.[24] But there is another discrimination possible. Permanent establishments and foreign companies that do business in Austria without a permanent establishment may be discriminated against Austrian corporations. It is quite possible that every corporation concentrates donations in its home country because the concentration of all donations at one beneficiary may lead to a higher benefit than spreading the donations across several institutions in every state of activity. Additionally the management of a corporation will probably have closer relations to institutions of the home country. Furthermore the corporation simply may be used to donating to institutions of the home country since the time the corporation only operated in that one member state. Moreover it is quite reasonable that corporations concentrate on donating to institutions in their home country because institutions of other member states are less well known to the managers. Last but not least the management is probably especially interested to have a good image in the home country and that may be reached by concentrating donations in the home country. Thus, it can be argued that it is typical to concentrate all donations in the home country. Therefore this rule is a disadvantage for foreign corporations that donate to institutions in their home country in relation to Austrian corporations that donate in Austria. The *Futura-Singer* case[25] showed that even such a rule that does not differentiate between residents and non-residents but has disadvantages for non-residents may be a

[24] See II.A.3.

discrimination. Additionally the *Baxter* decision[26] explicitly showed that in cases in which it is typical to concentrate expenses to the home country it is prohibited to restrict the deductibility to expenses that occurred in the host country. Thus, it should be possible to deduct donations if they are made to (scientific) institutions in the state of residence if those institutions are similar to those enumerated in § 4 (4) Z 5 and 6. On the other hand, that restriction could be justified by the 'ordre public' reservation because it is in the interest of the member state to support its own science and culture, especially since those institutions are maintained by the member state. Thus, it is improbable that the ECJ would see an infringement of the EC Treaty in this rule.

D. Obligation to Tax Reserves at Emigration in Accordance with §§ 6 Z 6 and 31 (2) Z 2 EStG

1. Legal Position

§ 6 Z 6 obligates every taxpayer who moves assets from his establishment in Austria to another establishment abroad to tax the reserves, that is, the difference between the book value and the real value that would be earned if that asset was sold. § 31 (2) Z 2 determines the same for shares even if they are held privately and provided the share exceeds 10 per cent of the corporation's capital. Those two sections are dealt with together because the problems at hand are nearly the same.[27]

2. Daily Mail

a) Facts

The legal position for corporations in Great Britain is quite similar. But corporations can move from Great Britain to another member state without being liquidated because Britain follows the incorporation theory,[28] but the movement of

[25] ECJ Case C-250/95; for further details, see III.J.4.
[26] ECJ Case C-254/97; for further details, see III.J.6.
[27] See Tumpel, *Harmonisierung*, p 391.
[28] See II.A.3.

the corporation requires the consent of the tax administration which leads to the duty to tax the reserves.

In the *Daily Mail*[29] case a holding wanted to move its residence to the Netherlands to sell shares there and use the revenue to buy its own shares back. The selling of the shares would be tax-free because only the capital gains being generated after the movement to the Netherlands were subject to tax.[30] After that, a subsidiary should have been established in Great Britain to guarantee advantages that only shareholders get if the corporation is established in Great Britain. Daily Mail appealed because it thought that the prohibition of the movement because of tax reasons was a violation of EC law.

b) Decision of the ECJ

As the corporate law is not uniform in the EC,[31] prohibition of a cross-border movement of a corporation is allowed. Thus, a prohibition because of tax law is also possible if it is possible to liquidate the company and found it in another member state.[32] Otherwise, the member states that allow the movement are put at a disadvantage.[33] Thus, the member states have a right to demand the settlement of the taxpayer's tax position.[34] The treatment of Daily Mail was not an infringement of the EC Treaty.

Most authors think that the decision was right[35] but many argue that the ECJ was not right in taking corporate law into account.[36] But I think that that consideration of the corporate law is an examination for a justification. And that examination was what was demanded by *Toifl*[37] in this case. Since there are different corporate laws in the EC that have very different consequences for tax law on the issue of a cross-border movement of a corporation, it is justified to discriminate against cross-border movement if there is no other possibility to

[29] ECJ Case 81/87.
[30] ECJ Case 81/87, conclusions AdvGen (para. 3); see also Knobbe-Keuk, EC Tax Review 1994, p 81.
[31] ECJ Case 81/87 (para. 14).
[32] ECJ Case 81/87 (para. 17).
[33] See Knobbe-Keuk, EC Tax Review 1994, p 83.
[34] ECJ Case 81/87, conclusions AdvGen (para. 13).
[35] See Toifl, *Wegzugsbesteuerung*, pp 156 et seq.
[36] See for example Knobbe-Keuk, DB 1990, p 2579; Knobbe-Keuk, EuZW 1991, p 651; Saß, 'Zum Einfluß der Rechtsprechung des EuGH auf die beschränkte Einkommen- und Körperschaftsteuerpflicht', DB 1992, 859; Kaiser, BB 1991, pp 2057 et seq.

ensure the settlement of the taxpayer's tax position.[38] *Jacobs*[39] reasons that in this specific case lack of harmonisation is a justification because the problem of movement for corporations cannot be solved on the base of the EC Treaty. But as this harmonisation – an agreement was negotiated long ago, but has never been ratified[40] – is unlikely, the problem cannot be solved by the ECJ[41] and, thus, discrimination – also in tax law – is still possible.

Since that problem does not exist for natural persons other justifications have to be found. But the *Daily Mail* case shows that basically the settlement of the tax position could be a possible justification.[42]

c) Criticism

The most important criticism after this case law is that the ECJ 'ruling does not correspond with the questions of the referring court'[43], because the argument that it is possible to liquidate the corporation and found it in another member state may protect the secondary right of establishment of the shareholders, but not the freedom of establishment for the corporation itself that is granted by art. 48 EC Treaty. And liquidating and refunding a corporation is always possible. Therefore, no EC Treaty is needed.[44] Furthermore, the taxes upon liquidating the corporation that were the reason for this preliminary ruling are normally prohibitively high.[45] With this decision the ECJ has thrown away a chance to favour the incorporation theory which is beneficial to integration but which is opposed in continental Europe.[46]

Although the legal situation has not changed since the decision in the *Daily Mail* case, it is not sure that the decision would be the same today. The ECJ allows fewer reasons as justification and, thus, judges a rule as infringement more

[37] *Wegzugsbesteuerung*, p 163.
[38] Different opinion: Knobbe-Keuk, DB 1990, p 2579.
[39] *Unternehmensbesteuerung*[4], p 180.
[40] See Grabitz/Hilf, *EU*, Art. 58, para. 18.
[41] For the effect of the decision of the ECJ in the Case C-212/97 see III.D.4.
[42] ECJ Case 81/87 (para. 13).
[43] Knobbe-Keuk, EC Tax Review 1994, p 82.
[44] See Sandrock/Austmann, 'Das Internationale Gesellschaftsrecht nach der Daily Mail Entscheidung des Europäischen Gerichtshofs: Quo vadis?', RIW 1989, p 250.
[45] See Sandrock/Austmann, RIW 1989, p 250; Grabitz/Hilf, *EU*, Art. 58, para. 17.
[46] See Sandrock/Austmann, RIW 1989, p 249.

easily.[47] On the other hand, the majority of the member states follow the residence theory and there is no trend to change to the incorporation theory. Nor has an agreement been ratified. Then again, the ECJ does not really care if most member states have a specific rule implemented in their legal system when it examines a possible infringement of EC law.[48] My opinion is that this problem cannot be solved by the ECJ on the basis of the EC Treaty because a conclusion that has to be drawn is that since the EU respects the differences between the member states and the choice between residence and incorporation theory is a primary political task,[49] the ECJ is unable to solve the conflict between residence and incorporation theory based on the EC Treaty.

3. Discrimination?

The decision in the *Daily Mail* case shows that basically the discrimination of own nationals is forbidden if there is a link to the EC[50] because then the home national is comparable to a national of another member state.[51] That is also a logical consequence of the freedom of establishment within the EC[52] because movement out of the home state is the prerequisite for establishment in another member state[53] and discrimination can originate in the home state, too,[54] as the *Daily Mail* case shows. But in that case the discrimination was justified. A taxation on transfer of the residence out of a country is always a possible conflict with the EC Treaty. *Kaiser*[55] even reasons that such taxation is always an infringement of EC law. But I think this statement is too general. As the *Daily Mail* case shows, there are possible justifications but in some cases less discriminatory rules are possible.

Art. 18 EC Treaty grants free movement to its citizens with Union citizenship. But that only affects natural persons, so it has no impact on a case like the *Daily*

[47] For example: ECJ Case C-212/97; for further details, see III.D.4.
[48] For example, see ECJ 270/83; for further details, see III.N.2.
[49] See Eckhoff, *Diskriminierung*, p 471.
[50] ECJ Case 81/87 (para. 16); see also Toifl, *Wegzugsbesteuerung*, p 157; Kaiser, BB 1991, p 2057; Wouters, EC Tax Review 1999, p 105; Saß, DB 1992, p 859; Achatz, 'Die steuerlichen Auswirkungen des EWR-Abkommens', SWI 1993, p 25; Toifl, *Wegzugsbesteuerung*, p 161.
[51] See Knobbe-Keuk, DB 1990, p 2576.
[52] See Knobbe-Keuk, DB 1990, pp 2575 & 2577.
[53] See Kaiser, BB 1991, pp 2057 et seq; Tumpel, 'Wegzugsbesteuerung für Beteiligungen im Sinne des § 31 EStG', SWI 1992, p 73.
[54] See Knobbe-Keuk, DB 1990, p 2574.

Mail case. Additionally, it will not influence the scope and the effect of the fundamental freedoms. Thus, it is even questionable if it grants rights in a similar case, where the taxpayer is a natural person.[56]

In Austria the situation is different from the one in Great Britain. Austrian corporate law itself prohibits a cross-border movement of a corporation.[57] The only possibility of a move without losing the identity would be to move the effective residence into a state that follows the incorporation theory, but even that is not accepted by the all legal commentators.[58] Additionally, Austrian tax law does not prohibit the movement, it only demands a settlement of the taxpayer's tax position. But, of course, this is a differentiation with regard to a move within Austria.[59] It is a fact that the taxation on the transfer of the residence is discrimination because it only occurs on a cross-border transfer. It is a disadvantage because money is required to pay taxes on deemed profits that have not been earned yet;[60] on the other hand, upon a move within Austria the reserves remain taxable in Austria. Thus, *Jacobs*[61] and *Lechner*[62] argue that such taxation is at least critical in the light of the EC Treaty. *Achatz*[63] even characterizes §§ 6 Z 6 and 31 (2) Z 2 as an EC law infringement. *Kaiser*[64] reasons that taxation on transfer of the residence is incompatible with the idea of a common market because that means the abolishment of all differences between transactions within a member state and within the EC. But this is rash because discrimination can be justified for several reasons.[65] And the cases *Daily Mail*[66] and *Bachmann*[67] show a possible justification because in both cases the ECJ characterises the claim to tax as a legitimate demand. And, thus, measures are taken to assure that claim are legitimate, too.[68] Especially in the *Daily Mail* case the AdvGen suggested that measures to guarantee the settlement of the taxpayer's tax position are

[55] BB 1991, p 2059.
[56] See Dautzenberg, BB 1993, p 1564; Hahn, *Internationales Steuerrechts*, pp 78 et seq.
[57] For the German legal position see Grabitz/Hilf, *EU*, Art. 58, para. 17.
[58] See Bauer/Quantschnigg, *KStG*, § 9, para. 23.2.
[59] See Zach, *Auswirkungen*, p 122; Toifl, *Grundfreiheiten*, p 162.
[60] See Tumpel, SWI 1992, p 73.
[61] *Unternehmensbesteuerung*[4], p 220.
[62] *Harmonisierung*, p 12.
[63] SWI 1993, p 26.
[64] BB 1991, p 2054.
[65] See II.A.8.
[66] ECJ Case 81/87; for further details, see III.D.2.
[67] ECJ Case C-204/90; for further details, see III.G.2.
[68] Knobbe-Keuk, EC Tax Review 1994, pp 81 & 83 et seq.

appropriate[69] and the ECJ followed this. But that kind of taxation can only be justified if the state's right to tax is endangered. The rules of §§ 6 Z 6 and 31 (2) Z 2 normally comply with this requirement as § 6 Z 6 requires the movement of the assets to another state. This normally coincides with Austria losing its right to tax and § 31 (2) Z 2 even expressly requires actions that lead to a loss of Austria's right to tax. But nevertheless there are possible regulations that would cause fewer problems for the taxpayer.[70] Those alternatives are to defer the tax payment until the asset is sold and, thus, the profit is realised;[71] or to set off the tax payment against the savings because of higher depreciation in the other member state.[72] But, on the other hand, this brings up the problem of recovering the tax if the taxpayer is resident in another member state. Thus, the discrimination is probably justified.[73]

Two other justifications that could be referred to were the fact that the abolishment of the taxation would lead to less revenue and the fact that there is a coherence in Austrian tax law because the real value is taken as book value upon moving assets to an Austrian establishment.[74] But those two justifications probably would not be enough to justify a discrimination before the ECJ. However, the abolishment of taxation of capital gains on a transfer of residence would probably lead to the result that those capital gains are tax free, since in the new state of residence normally the capital gains are only taxable that occur after the transfer of residence. Thus, this rule could be justified by a coherence on a European Union level.[75] On the other hand, the ECJ showed in the *Avoir Fiscal*[76] decision that the fact that a rule is common to all European tax systems does not prevent it from being an infringement of the EC Treaty. Additionally, the ECJ restricted the application of the 'coherence principle' as justification[77] and, additionally, that regulation is not common to all tax systems. Therefore, it is not reasonable that

[69] ECJ Case 81/87, conclusions AdvGen (para. 13).
[70] See Thömmes, IWB 1997, F 11a, p 196.
[71] See Jacobs, *Unternehmensbesteuerung*, p 216; Thömmes, *EuGH-Rechtsprechung*, p 184.
[72] See Saß, 'Steuerharmonisierung in der EG – Perspektiven für eine Harmonisierung der Körperschaftsteuer und der Gewinnermittlung', DB 1993, p 122.
[73] See Toifl, *Wegzugsbesteuerung*, p 163; different opinion, see Kaiser, BB 1991, p 2059 who does not examine a possible justification.
[74] § 6 Z 6 EStG.
[75] See Kamphuis/Pötgens, BIFD 1996, p 6, for a coherence on European Union level at the taxation of payments for insurance.
[76] ECJ Case 270/83 for the system of restricted liability to taxation.
[77] See II.A.8.b).

coherence on the EU level is a useful justification. But the fact that the abolishment of this rule would mean that the capital gains could be ultimately tax free could lead to the question whether the domestic case is comparable to the cross-border case. But, as already discussed in III.A, the ECJ is not very stringent in this distinction.

Thus, the only useful justification before the ECJ is that this taxation is Austria's only chance to assure that the tax position is settled. But that is only possible if Austria definitively loses its possibility to tax. Thus, assets that stay in a permanent establishment in Austria may not be taxed if the DTC allows Austria to tax the capital gains. As this requirement is normally met by §§ 6 Z 6 and 31 (2) Z 2 EStG, I do not see an infringement in those rules. But some authors even do not think that it is enough to fulfil those requirements. They think that a rule like §§ 6 Z 6 or 31 (2) Z 2 EStG does not comply to the principle of proportionality because it would be less infringing to defer the tax payment until the asset is sold. Another possibility would be to claim a payment that corresponds to the tax that is saved in the new country of residence because the depreciation is higher as a result that the depreciation is calculated from the real value at the time of the movement of residence. But I do not think that those alternatives are possible given the state of integration today because Austria has no possibility to assure that the tax dept is paid off as soon as the taxpayer leaves Austria.

As the free movement guarantee is granted to natural persons, the justification that the incorporation theory is not accepted throughout Europe cannot be applied.[78] But the other justifications that are discussed above can be referred on as far as natural persons are concerned.

4. Effects of the Decision in the Centros Case

A Danish couple founded a corporation in Great Britain to avoid the stricter Danish requirements for founding a corporation. All its activities were carried out through a permanent establishment in Denmark. The Danish administration denied the registration because it characterised this construction as an evasion of the

[78] ECJ Case 81/87 (para. 19).

Danish requirements. But the ECJ rejected this justification because the freedom of establishment of the corporation was at stake and not the freedom of the shareholders. Furthermore, it rejected the justification that the creditors have to be protected because there are different requirements in Great Britain. This justification was denied with a reference to the harmonising directives[79].[80] Additionally, the registration would have been granted if Centros had conducted any business in Great Britain.[81]

Many authors think that with this decision the ECJ abolished the residence theory.[82] First, it has to be said that that probably had no consequence for the *Daily Mail* case[83] because, as shown in III.D.3, there are other justifications possible, too. Furthermore, the *Centros* case[84] only concerns the secondary freedom of establishment – the establishment through a permanent establishment – and not the primary freedom of establishment of the corporation itself.[85] Additionally, I disagree with the statement that the ECJ opposed the residence theory in this case. It is true that the ECJ rejected the protection of the creditors in that specific case, which is the most important reason for the residence theory.[86] But it has to be said that that argument was inconsistently relied upon by the Danish government because Denmark follows the incorporation theory.[87] Since in this case both member states involved follow the incorporation theory,[88] the ECJ had to base its considerations on the incorporation theory. Additionally, the ECJ argued that the establishment would have been registered if it carried on any business in Great Britain. That is not true for Austria, because the transfer of the place of management leads to a loss of identity of the corporation, no matter whether the corporation still concludes business in its former state of residence.

[79] 78/660/EEC, OJ 1978 L 222, p 11 and 89/666/EEC, OJ 1989 L 395, p 36.
[80] ECJ Case C-212/97 (paras. 35 et seq).
[81] ECJ Case C-212/97 (para. 15).
[82] For example, see Eilers/Wienands, IStR 1999, p 290; Meilicke, 'EuGH kippt Sitztheorie: Zulässige Errichtung der Zweigniederlassung einer Gesellschaft, die in einem anderen EU-Mitgliedstaat ihren Satzungssitz hat, dort aber keine Geschäftstätigkeit entfaltet', DB 1999, p 627, who even thinks that the infringement is that clear that an adherence to the incorporation theory could lead to a liability of the member state: p 628; Nowotny, 'OGH anerkennt Niederlassungsfreiheit für EU-/EWR-Gesellschaften', RdW 1999, p 697; Haunold/Tumpel/Widhalm, 'News aus der EU', SWI 1999, p 229.
[83] ECJ Case 81/87.
[84] ECJ Case 212/97.
[85] See Eicker, IWB 1999, F 11, G 3, p 234.
[86] ECJ Case C-212/97 (paras. 35 et seq).
[87] See Eicker, IWB 1999, F 11, G 3, p 236; different opinion, see Meilicke, DB 1999, p 627.
[88] See also Eicker, IWB 1999, F 11, G 3, p 235; Zehetner, Ecolex 1999, p 772.

So I think this decision cannot be applied to Austrian cases. *Eicker*[89] even reasons that the ECJ acknowledged with this case that the residence theory is less of an infringement than the incorporation theory because the incorporation theory needs additional anti-abuse legislation. Although all those arguments are quite convincing that the *Centros* decision cannot be conveyed to the Austrian legal system the OGH[90] (Oberster Geichtshof – Supreme Court) rashly ruled that the residence theory contradicts the EC Treaty without even making an application for a preliminary ruling of the ECJ.[91]

5. Conclusions

An abolishment of the taxation of capital gains on transfer of residence could end in taxpayers transferring all assets to other member states before selling them, to prevent capital gains tax. Those losses of tax revenue could force the member states to harmonise tax law to prevent tax evasion. On the other hand, the possible tax evasion could also be a justification before the ECJ.[92]

To sum up, it has to be said that the Austrian §§ 6 Z 6 and 31 (2) Z 2 are probably justified even if there are less infringing measures possible because those other measures are not practicable given the state of integration of the EU today.[93]

E. Deductible Amount on Investment in Accordance with § 10 EStG

§ 10 EStG grants an additional deductible amount on investments. But § 10 (2) EStG restricts that amount to assets that are used in Austrian permanent establishments. It is not a discrimination of taxpayers subject to limited tax liability because the deductible amount is granted to taxpayers subject to limited tax liability just like to taxpayers subject to unlimited tax liability. Nevertheless, it is a possible discrimination in the common market because it is more attractive to invest in Austria than in other member states. Thus, Austrians may prefer to invest

[89] IWB 1999, F 11, G 3, pp 235 et seq.
[90] OGH 6 Ob 123/99 b.
[91] See Zehetner, Ecolex 1999, pp 773 et seq.
[92] ECJ Case 81/87, conclusions AdvGen (para. 9); ECJ Case 229/83.
[93] Different opinion, see Hahn, *Internationales Steuerrecht*, pp 128 et seq.

in Austria because of tax reasons. And merely the fact that the domestic case is more attractive is a discrimination.[94] Additionally, the ECJ has already stated that such rules that make it less attractive to execute the freedom of establishment are a possible infringement of the EC Treaty.[95] Furthermore it can be argued – according to the *Baxter* decision[96] – that foreign companies are discriminated against because most of their investments have to be made in their state of residence.[97] Thus, the question is once again if that discrimination is justified. At the first sight the answer has to be no. The normal justifications were rejected by the ECJ and § 10 EStG is clearly not an anti-abuse rule. But in this case the answer is not that obvious. § 10 EStG is an incentive to invest in Austria but it can also be seen as an additional depreciation to compensate the fact that inflation is not taken into account in depreciation and, thus, the amount that is depreciated is not enough to buy a similar new asset. Since at least in cases in that a DTC with exemption method is applied, depreciation is also only taken into account in the state of the permanent establishment, that seems to be a justification in those cases. But that does not remove the problem of an infringement of EC law at DTCs with the credit method or if the ECJ does not characterise that deductible amount as an additional depreciation. In that case it can be said that such measures to support investments are common to all member states and it would not be appropriate to support investments if the resulting earnings cannot be taxed. But neither financial problems for the member states nor the fact that a practice is common across Europe is a possible justification at the ECJ. Maybe only the fact that the subsequent earnings may not be taxed may be a justification because the ECJ allowed in the *Futura-Singer* case[98] the loss carried forward to be restricted to losses that occurred in that member state because only the subsequent earnings were taxable. But the impossibility to tax earnings is not really true if the DTC follows the credit method. However, in other member states, such incentives to invest are granted by different depreciation methods. Those methods are very closely connected to the concept of § 10 EStG. Thus, those rules would have to be an infringement, too. But this would go too far because

[94] For example ECJ Case C-55/98; for further details, see III.K.2 and ECJ Case C-264/96; further details see III.L.4.
[95] For exemple ECJ Case 81/87; for further details, see III.D.2.
[96] ECJ Case C-254/97; for further details, see III.J.6.
[97] See Haunold/Tumpel/Widhalm, 'News aus der EU', SWI 1999, p 410.
[98] ECJ Case C-250/95; for further details, see III.J.4.

there is no method of depreciation that is generally right. Additionally, it could be argued that § 10 EStG is a basic feature of the Austrian tax system and that it is a nearly as basic feature as the tax rate. And in that case it can be argued according to the *Gilly* decision[99] that § 10 is not a discrimination at all. Thus, it is improbable that the ECJ would see an infringement in § 10 EStG, but how the ECJ will decide in a possible case cannot be predicted. Concerning the difficulty of § 10 EStG and the fundamental freedoms it is very interesting to take a look at the *Juntas Generales* case[100]. In that case the question is if reduced tax rates in structurally weak areas are an infringement of the EC Treaty. The AdvGen saw an infringement in those incentives to invest in those structurally weak areas.[101] On the one hand, the Spanish rule has the same intention as § 10 EStG. On the other hand, in that case the Spanish government decided on itself and because of its interest where those structurally weak areas are. Thus, the whole problem comes down to the question if those structurally weak areas are really structurally weak. Therefore in Austria different and more persuasive justifications are possible. However the ECJ will decide in *Juntas Generales* and even although the decision might not lead to important conclusions concerning § 10 EStG it may start a discussion about § 10 EStG.

F. Tax-Neutral Transfer of Reserves in Accordance with § 12 EStG

If the revenue from selling an asset is higher than its book value, the profit is taxable. But under certain circumstances – one of which is that the asset has to be used in Austria – those reserves can be transferred to another asset that is purchased. Thus, the profit that results from the sale of the old asset is not taxed. As a consequence, the base for depreciation and investment preferential treatment is reduced. Therefore, this rule only results in a deferral of the tax payment. § 12 EStG is no discrimination of non-residents because taxpayers that are subject to limited taxation may transfer reserves in the same way as taxpayers subject to unlimited taxation are allowed to. Nevertheless, this refusal of a

[99] ECJ Case C-336/96; for further details, see Hohenblum, *Freedom of Movement for Workers (Art 39 EC Treaty) and Tax Law* (2000), pp 81 et seq.
[100] ECJ Case C-400/97.
[101] See also Saß, 'Schwebende Verfahren vor dem Europäischen Gerichtshof zu den direkten Steuern', SWI 1999, p 480.

deferment is a disadvantage for an investment in another member state. And the ECJ has already shown in *ICI*[102] and *X-AB & Y-AB*[103] that a refusal of a deferment of a tax payment may be a discrimination. At that specific rule Austrian residents with a link to the EC are discriminated against Austrian residents without a link to the EC. An Austrian resident that wants to found a branch in Austria is able to immediately transfer reserves that are a result of selling assets of the headquarter. Later he is able to use the reserves that are a result of selling assets of the branch. All that is not possible if he founds a branch in another member state. Thus, § 12 EStG is an obstacle at founding a permanent establishment in another member state that makes it less attractive to invest in another member state. Therefore § 12 EStG is a discrimination of taxpayers subject to unlimited taxation that want to found a permanent establishment in another member state. The critical question is once again if this treatment is justified. I think that it is justified because the ECJ stated in the *Futura-Singer*[104] that it is no infringement that losses carried forward are only deductible if they originate in that country because only in that case is there an economic link. That argumentation can be transposed to this rule because only in those cases in which the profit can be taxed is it justified to compensate it by deducting the tranferred reserve. That could lead to an infringement of the EC Treaty in cases where no DTC, or a DTC that applies the credit method, is in force. The first problem is irrelevant because Austria has concluded a DTC with all member states of the EU. The second problem would have been considered by the ECJ in the *Futura-Singer* case if it really was a problem. Thus, I think that § 12 EStG is no infringement of the EC Treaty.

G. Deductibility of Insurance Premiums in Accordance with § 18 (1) Z 2 EStG

1. Legal Position

The payment of insurance premiums is only deductible if the insurance company has its seat, its management, or the permission to do business in Austria. That requirements had been interpreted in a discriminatory way for a long

[102] ECJ Case C-264/96; for further details, see III.L.4.
[103] ECJ Case C-200/98; for further details, see III.L.5.
[104] ECJ Case C-250/95; for further details, see III.J.4.

time by the fiscal administration because it required a permanent establishment in Austria.[105] That interpretation negated the freedom to provide services.

2. Commission / Belgium (Case 300/90) & Bachmann

a) Facts

In Belgium only insurance premiums that were paid to Belgian insurance companies were deductible from income. On the other hand, only insurance payments of Belgium insurance companies were taxed. Beside a discrimination of foreign workers[106] who were normally insured in their home country, this was a discrimination of insurance companies that wanted to provide their services in other member states because they had to set up a subsidiary in Belgium so that their clients could deduct their payments.

b) Decision of the ECJ

This differentiation is a covert discrimination because it nearly only affects nationals of other member states.[107] It also violates the freedom to provide services because an establishment, even a subsidiary, is needed to fulfil the requirements of the Belgian legislator.[108] But those violations were justified because of the coherence of the Belgian tax system[109] because the payments of foreign insurance companies were not subject to tax.[110] Thus, it was an allowed discrimination because no less-infringing measure was at hand to ensure the coherence of the Belgian tax system.[111]

c) Criticism

The ECJ has not gone far enough. Belgium does not tax insurance payments of persons who move away from Belgium but who are insured with a Belgian

[105] For the consequences of the decision of VwGH Case 98/13/0002 see III.G.3.c) and III.G.4.
[106] For further details of the *Bachmann* case's influence on the freedom of movement for workers, see Hohenblum, *Freedom of Movement for Workers*, pp 76 et seq.
[107] ECJ Case C-204/90 (para. 9).
[108] ECJ Case C-204/90 (para. 31).
[109] For further details and the development of the 'coherence principle' see II.A.8.b).
[110] ECJ Case C-204/90 (paras. 22 et seq); ECJ Case C-300/90 (paras. 8 & 14 et seq).
[111] ECJ Case C-204/90 (para. 27); ECJ Case C- 300/90 (para. 20).

company. Additionally the OECD Model DTC, and literally all Belgian DTCs with other member states follow the model on that point, grants the state of residence the right to tax insurance payments. Thus, payments of Belgian insurance companies are not taxable, either, if the worker moves to another member state.[112] Furthermore, there normally is no coherence for the workers involved because later they will normally return to their home country and, thus, will not be able to make use of the tax exemption for payments of insurance companies.[113] Another point of criticism is that the 'coherence principle' was too woolly to be useful as justification. Probably that was one of the reasons why the ECJ has continued to develop the 'coherence principle' but never used it as a justification again.[114]

Thus, this undermining of the freedom to provide services – a subsidiary was needed – was not justified and therefore it seems – especially in the light of the *Wielockx*[115] case – that the ECJ would probably decide differently today if it had to reconsider the case.[116]

d) Effects on Austrian Tax Law

A coherence was never possible under § 18 (1) Z 2 EStG because in Austria the taxation of insurance payments does not depend on the state of residence of the insurance company but only on the form of the payment.[117] If the insurance is paid in recurrent payments, the payments are taxed because of § 29 Z 1 EStG. This does not differentiate on the basis of whether the former payments to the insurance company were deductible. Only if the insurance is paid at once and the premiums were not deductible, are they tax free. So only in that very specific case was a coherence – in the sense of the *Bachmann*[118] case – possible.[119]

[112] See Thömmes, IWB 1996, F 11, G 2, pp 46 et seq; Hinnekens/Schelpe, EC Tax Review 1992, p 61; Knobbe-Keuk, EC Tax Review 1994, pp 80 et seq; Jacobs; *Unternehmensbesteuerung*[4], p 182.
[113] That was even admitted by the ECJ: ECJ Case C-300/90 (para. 9).
[114] See II.A.8.b).
[115] ECJ Case C-80/94; for further details, see II.A.8.b)(3).
[116] See Thömmes, Intertax 1995, p 603; Kamphuis/Pötgens, BIFD 1996, p 5; Rainer, IStR 1998, p 301.
[117] See Tumpel, *Harmonisierung*, p 398; Achatz, SWI 1993, pp 26 et seq; Hinnekens/Schelpe, EC Tax Review 1992, p 60; Saß, DB 1992, p 860.
[118] ECJ Case C-204/90.
[119] See Tumpel, *Harmonisierung*, pp 379 et seq; Lechner, *Harmonisierung*, p 13.

With this decision the ECJ accepted that a discrimination is justified if the aim cannot be achieved with less restrictive measures[120] ('principle of proportionality') and the aim serves a legitimate goal – in this case the goal of securing taxation.

3. Safir

a) Facts

Sweden taxes life insurance companies by taxing a deemed yield of the company's assets across the board. As compensation, premiums paid to a foreign insurance company are taxed, too. The tax rate can be reduced or even set to 0 depending on the tax the insurance company has to pay in its home country. Therefore, the taxpayer has to provide the necessary information to the tax administration himself.

b) Decision of the ECJ

This differentiation is a discrimination because it complicates the provision of cross-border services compared to domestic services[121] because this taxation means more effort to the taxpayer. This additional effort consists of a tax he only has to bear himself, an additional documentary proof he has to bring in and the effort resulting from proving the information about the tax burden of the insurance company in another member state if he is insured with a foreign company.[122] Additionally, there is a negative effect from the fact that the tax can only be reduced if the foreign tax is at least one quarter of the Swedish tax. Thus, cross-border cases can be taxed higher.[123] Furthermore, the decision if a reduction is granted is made by the administration which leads to changing and arbitrary decisions.[124] All this leads to the result that cross-border insurance is less attractive to Swedish residents.[125] Thus, this rule is a discrimination. The Swedish government tried to justify this discrimination with the argumentation that this is necessary to get a revenue equivalent to the taxation of the fictive yield of Swedish

[120] See Knobbe-Keuk, EC Tax Review 1994, p 78.
[121] ECJ Case C-118/96 (para. 23).
[122] ECJ Case C-118/96 (paras. 26 & 28).
[123] ECJ Case C-118/96 (para. 31).
[124] ECJ Case C-118/96 (para. 29).
[125] ECJ Case C-118/96 (para. 30).

companies.[126] But the ECJ thinks that there are other measures that are less discriminatory, to reach that goal.[127] Thus, this discrimination is not justified and therefore is an infringement of the EC Treaty.[128]

It is remarkable that it was the first time the ECJ abandoned a coherent tax system because otherwise the member states had the possibility to undermine the fundamental freedoms with tax systems that would not be applicable to foreigners.[129]

c) Effects on Austrian Tax Law

A tax discrimination is forbidden on the level of the service provider as well as on the level of the customer. Furthermore, it is prohibited to discriminate a case because of the tax rate or even because of the fact that only the case with a link to the EC is liable to tax. Additionally, the ECJ showed that the fact that a tax system is not coherent with respect to international cases is not a justification.[130]

Thus, § 18 (1) Z 2 EStG is a violation of the EC Treaty because a foreign insurance company needs the permission to do business in Austria for the payments of premiums to be deductible.[131] It is an obstacle to the freedom to provide services. That is true at least for the interpretation of the administration that requires a permanent establishment and justifies this on the grounds that the necessary control would be impossible otherwise.[132] In *Futura-Singer*[133] the ECJ characterised the impossibility of inspection as a justification, but in the same decision, it characterised the prohibition of the deduction as disproportionate.

But 1999 the Austrian VwGH[134] (Verwaltungsgerichtshof – Supreme Administrative Court) ruled that every life insurance company that is resident

[126] ECJ Case C-118/96 (para. 24).
[127] ECJ Case C-118/96 (para. 33).
[128] ECJ Case C-118/96 (para. 34); for the influence of the *Safir* decision on the freedom of movement for workers, see Hohenblum, *Freedom of Movement for Workers*, pp 81 et seq.
[129] See Dautzenberg, FR 1998, p 517.
[130] See Rainer, IStR 1998, p 301.
[131] See Tumpel, *Harmonisierung*, p 378; Rahofer, 'EuGH-Entscheidungen zum Steuerrecht', Finanz-Journal (FJ) 1998, p 178; Saß, DB 1992, p 858; Thömmes, IWB 1993, F 11, G 2, p 132; Baldauf, 'Beiträge an ausländische Versicherungsunternehmen', SWK 1999, p 228.
[132] See Aus der Arbeit der BMF-Fachabteilungen, 'Rechtsansichten des Finanzministeriums zu steuerlichen Tagesfragen', SWI 1995, p 334; Baldauf, Steuer & Wirtschaftskartei (SWK) 1999, p 227.
[133] ECJ Case C-250/95, for further details, see III.J.4.
[134] VwGH 98/13/0002.

within the EC, has permission to do business in Austria in the sense of § 18 (1) Z 2 EStG because of the liberalisation within the EC[135] – the single licence system.[136] Because of this interpretation, § 18 (1) Z 2 EStG is no longer an infringement of the EC Treaty anymore.[137]

4. Conclusions

With the new interpretation § 18 (1) Z 2 EStG no longer infringes the EC Treaty. But a clarification of the EStG would be desirable for the legal certainty because it is settled case law of the ECJ that this uncertainty can only be eliminated by imperative domestic rules.[138] And even uncertainty about the legal position can be an infringement.[139]

H. Requirement of a Domestic Bank in §§ 18 (1) Z 4 and 95 (3) Z 2 EStG

§ 18 (1) Z 4 EStG states that certain kinds of shares have to be deposited at an Austrian bank for expenses that are connected to them to be deductible. § 95 (3) Z 2 EStG states that certain kinds of security papers (§ 93 (3) Z 1-4 EStG) have to be deposited at an Austrian bank otherwise the resulting earnings are not taxed at 25 per cent (§ 97 (1) EStG) but have to be assessed. Thus, in those cases it is more attractive to use an Austrian bank than a bank of another member state because otherwise the positive effects of §§ 18 (1) Z 4 and 95 (3) Z 2 cannot be utilised. Consequently, foreign banks have a disadvantage compared to Austrian banks because their customers have to bear a disadvantage. Therefore, this is an obstacle to the freedom to provide services and, thus, a discrimination of foreign banks against Austrian banks. The situation is quite similar to the *Bachmann*[140] and *Safir* cases[141]. As no justification was at hand in those cases – the 'coherence principle' is probably no longer a justification[142] – it is improbable

[135] Directive 92/96/EEC, OJ 1992, L 360.
[136] See Toifl, 'Internationale Entwicklungen auf dem Gebiet der gemeinschaftsrechtlichen Diskriminierungsverbote', SWI 1999, p 155.
[137] See Baldauf, SWK 1999, p 365.
[138] ECJ Case 168/85; ECJ Case 38/87; ECJ Case C-151/94, conclusions AdvGen (para. 17).
[139] Settled case law since ECJ 168/85; see also Toifl, SWI 1995, p 426.
[140] ECJ Case C-204/90; for further details, see III.G.2.
[141] ECJ Case C-118/96; for further details, see III.G.3.
[142] See II.A.8.

that a justification will be found in these cases. The only possible reasons for the differentiation between Austrian and foreign banks in that specific case are the wish to help Austrian banks, the connection to higher tax revenue if the investment results in higher profits of Austrian banks and the simple neglect to adopt to the changes caused by the accedence into the EU. Those reasons are no probable justification at a trial at the ECJ. The justification that investments at Austrian banks lead to higher tax revenue has even been declined by the ECJ in *Svensson-Gustavsson*[143] already. Thus, it is likely that the ECJ would see an infringement of the freedom to provide service in these rules. It is important to mention that Austrian taxpayers may appeal to the EC Treaty, although they are only indirectly affected by the discrimination of the foreign bank.[144] Furthermore the rules in question are even a possible infringement of the freedom of establishment because a subsidiary – an Austrian bank – is needed. That contradicts the free right of free choice between branch, agency and subsidiary which is granted by art. 43 EC Treaty. Thus, that rule contradicts the *Avoir Fiscal* decision[145]. Therefore the restriction of the favourable provisions to subsidiaries is an infringement of the EC Treaty because for that discrimination there is no justification probable either. But it is not enough to enlarge the scope of §§ 18 (1) Z 4 and 95 (3) Z 2 EStG to permanent establishments to comply to the demands of the EC Treaty because even if that would mean that there is no infringement of the freedom of establishment anymore, the infringement of the freedom to provide service would last. And the infringement of one fundamental freedom is enough for the ECJ to see an infringement of the EC Treaty in that rule if a case is submitted. Thus, the scope of the rules in question has to be enlarged to banks of other member states so that the favourable provisions can also be generated if a bank of another member state is used for the investment.

[143] ECJ Case C-484/93; for further details, see II.A.8.b)(4).
[144] ECJ Case C-294/97; for further details, see II.B.4.b).
[145] ECJ Case 270/83; for further details, see III.N.2.

I. Progression Relief in Accordance with § 37 EStG

1. Legal Position

In accordance with § 37 (4) § 37 (1) EStG grants a relief of half of the average tax rate for earnings on shares – in other words, taxpayers are entitled to that tax privilege for earnings from the sale of the shares and dividends. But § 37 (4) restricts the application of § 37 (1) to earnings on shares of Austrian corporations.

2. Baars

a) Facts

Baars held 100% of the shares of an Irish corporation. He tried to deduct an amount from his wealth of the net wealth tax for those shares. But this amount was restricted to shares in Dutch corporations. Thus, Baars took action at a national court on grounds of infringement of the EC Treaty.

b) Decision of the ECJ

The impossibility of a deduction if the corporation is established abroad encourages establishing corporations in the Netherlands because it makes an establishment abroad less attractive.[146] Thus, it is a discrimination against the establishment of corporations abroad – the case with the EC link – in respect to the establishment of corporation within the Netherlands – the domestic case. One question was whether the freedom of establishment or the free movement of capital can be relied upon. The ECJ stated that in that case both freedoms can be applied because a 100% interest on a subsidiary grants enough influence in the subsidiary to see it as an establishment.[147] Additionally, all circumstances connected to shares are subsumed under the free movement of capital.[148] Thus, an infringement of one of the freedoms results in a violation of the EC Treaty.

[146] ECJ Case C-251/98 (paras. 38 & 47).
[147] ECJ Case C-251/98 (paras. 32 et seq).
[148] ECJ Case C-251/98 (para. 30).

The Dutch government tried to justify this discrimination on the grounds of the rationale for the provision. It was introduced to avoid double taxation of the value of the corporation by the corporation itself and because of the value of the shares that are held by the entrepreneur.[149] But the ECJ rejected this justification because the rule did not take foreign net wealth tax into account and, thus, was not the least infringing possibility to achieve that goal.[150] Therefore, the ECJ held that the rule was an infringement of both, the freedom of establishment[151] and the free movement of capital.

c) Effects on Austrian Tax Law

There is no net wealth tax in Austria. But this decision has the same relevance for income tax. Thus, the progression relief of § 37 EStG has to be granted for companies and interests in companies in Austria as well as in the rest of the EC. For a controlling interest this consequence can be deduced from the freedom of establishment. But the discrimination of smaller – portfolio – investments is not allowed either, because those investments are protected by the free movement of capital principle in the EC Treaty that prohibits discrimination because of the place of investment. In this context, the decision in the *Verkooyen* case [152] is interesting, too, as it concerns the extension of the final taxation to dividends originating in other member states.

3. Conclusions

§ 37 (4) Z 1 and 2 EStG are an infringement of the EC Treaty. Dividends of foreign corporations can never be taxed with half of the average tax rate; income from selling shares only if they are taxed because of § 31 EStG. This discrimination cannot be justified by the coherence of the tax system[153] or by the special system of corporate and income tax in Austria because it is too general and does not take into account how tax systems work in other member states. And a justification based on the fact that for shares of foreign corporations the deduction of expenses is allowed is improbable because that seems to be a

[149] ECJ Case C-251/98 (para. 7).
[150] ECJ Case C-251/98 (paras. 40 et seq, 53 & 56 et seq).
[151] ECJ Case C-251/98 (para. 43).
[152] ECJ Case C-35/98.
[153] See II.A.8.b).

forbidden compensation of advantages. Thus, § 37 (4) EStG has to be changed to prevent a condemnation by the ECJ.

J. Limited Liability to Tax in Accordance with §§ 98 et seq EStG

1. Legal Position

If a natural person is not resident or does not spend more than 6 months in Austria, he is only subject to limited tax liability. Because of that, only most of his income originating in Austria is taxed. The definition of what is subject to tax is given in § 98 EStG. The fact that not the worldwide income but the income originating from the country in question is taxed is called the 'territorial principle'.[154] This differentiation is possibly discriminatory[155] as most people who live abroad are nationals of other (member) states. And this cannot be justified with advantages and disadvantages that are a consequence of the system.[156] *Dautzenberg*[157] even claims that all EU citizens must have the opportunity to be assessed as taxpayers subject to unlimited tax liability. Deductions connected to the taxpayer's personal life may only be deductible if the taxpayer proves that they cannot be taken into account in the member state of residence. With this, he anticipated the ECJ decision in the case *Schumacker*.[158] But he even went further because the *Schumacker* decision only provided the right to be treated as an taxpayer subject to unlimited tax liability if the EU citizen is in a comparable situation. Thus, it can only be relied upon if the EU citizen earns (nearly) all his income in one member state but is resident in another. Therefore, the ECJ has not completely condemned the limited tax liability but only in those case where a comparable situation is at hand.[159] To accommodate this decision of the ECJ, § 1 (4) EStG was implemented in the Austrian EStG.[160]

But there are still other problems with §§ 98 et seq EStG. § 99 governs taxation of taxpayers subject to limited tax liability. It determines that 20 % of the

[154] Doralt/Ruppe, *Steuerrecht I*[6], p 257.
[155] See Toifl, *Wegzugsbesteuerung*, p 157.
[156] ECJ Case 175/88.
[157] BB 1993, p 1568.
[158] ECJ Case C-279/93.
[159] See Toifl, *Wegzugsbesteuerung*, p 160; Klein, *Steuerrecht*, p 19; Thömmes, *Diskriminierung*, p 91.

gross earnings must be withheld by the person that pays the earnings.[161] Thus, no tax allowable expenses can be deducted, the rate cannot be lower than 20 per cent (of the gross) earnings, the profits cannot be set off against losses of other earnings in Austria and even the reimbursement of expenditure is taxed.[162] This is clearly a disadvantage for taxpayers subject to limited tax liability compared to taxpayers subject to unlimited tax liability. But § 102 (4) EStG grants the opportunity to be assessed. Thus, the disadvantages can be avoided. But there are some exceptions. Earnings originating from rent (§ 99 (1) Z 3 EStG), earnings of supervisory board members (§ 99 (1) Z 4) and earnings originating from technical or commercial counselling (§ 99 (1) Z 5) cannot be assessed. Thus, in such cases the disadvantage cannot be avoided. Therefore, the question is if there is a covert discrimination. Another problem occurs at the taxation of authors, lecturers and artists (§ 99 (1) Z 1). § 102 (1) Z 3 EStG imposes an additional requirement and an additional verification for deducting expenses for those taxpayers.

Another difficulty concerning the limited tax liability is loss carry-forward. § 102 (2) Z 2 restricts losses carried forward to that part of losses that are originating in an Austrian permanent establishment that exceeds the worldwide income of the taxpayer.[163] Thus, a loss has to be primarily compensated by foreign earnings. But an infringement of the EC Treaty is disputed by the BMF.[164] The VfGH already stated that that rule does not infringe the axiom of equality of the Austrian constitution,[165] but the ECJ has not examined that question yet.

Most case law involves taxpayers subject to limited tax liability because that is the most obvious covert discrimination. Thus, some cases are discussed below in order to draw conclusions from them.

[160] For the problems of § 1 (4) EStG, see III.B.
[161] See Doralt/Ruppe, *Steuerrecht I*[6], pp 259 et seq.
[162] See Tumpel, *Harmonisierung*, p 389; Werndl, WBl 1995, 232.
[163] See Achatz, SWI 1993, p 26.
[164] See Berger, SWI 1995, p 343.
[165] See Loukota/Wiesner, 'Internationale Aspekte der steuerlichen Strukturanpassung 1996', SWI 1996, p 345.

2. Commerzbank

a) Facts

The English permanent establishment of the Commerzbank, a German bank, made a credit available to an American borrower. Since the lending bank had no tax residence in Great Britain, the DTC USA-Great Britain did not allow Great Britain to tax the subsequent earnings. But it took some years until Commerzbank spotted that rule. Thus, Commerzbank paid taxes it did not have to pay. It reclaimed that money. The tax administration paid back the sum but refused to pay interest for the money because British law required a residence in Great Britain to grant interest payments, called repayment supplement.

b) Decision of the ECJ

Since this rule differentiates because of residence, it is a possible covert discrimination. The critical question is if this discrimination can be justified. The British government did not see any discrimination in the rule, as persons resident in Great Britain would not even get their tax back and, thus, could not claim interest, either.[166] Additionally, the British government tried to justify the rule on the grounds that taxpayers subject to limited tax liability would reclaim their money later because of the difficulties of the co-ordination of several tax systems. Thus, they could use paying tax as a means of 'investment' which could lead to an additional pecuniary burden of the administration.[167] But higher expenses are no justification. And the prohibition of discrimination is unconditional and cannot depend on DTCs.[168] Furthermore, the exclusion of the claim to get interest was not necessary because the introduction of a period in which the claim has to be raised would be enough to prevent the disadvantages listed by the British government. But still that would be less discriminatory.[169] The fact that British companies would not get the tax back is not a systematic connection and, thus, not an admissible coherence but a forbidden compensation of advantages.[170] Additionally, the exclusion of the repayment supplement is too general to be justified by the

[166] ECJ Case C-330/91, conclusions AdvGen (para. 10).
[167] ECJ Case C-330/91, conclusions AdvGen (para. 59).
[168] ECJ Case C-330/91, conclusions AdvGen (paras. 20 et seq).
[169] ECJ Case C-330/91, conclusions AdvGen (para. 60).

advantage resulting of the DTC in this specific case.[171] Resident corporations always get the repayment supplement but non-resident corporations are never able to get interest payments, even if all other requirements are fulfilled. Therefore, this rule is discriminatory.[172] Thus, the repayment supplement had to be granted to Commerzbank.

c) Effects on Austrian Tax Law

As there is nothing similar to the repayment supplement in Austrian tax law, the finding of the ECJ cannot be directly transposed to Austrian tax law. But more basically it has to be said that the ECJ denies the compensation of advantages and rejects a less advantageous treatment of non-residents. And AdvGen *Darmond*[173] stated again, differentiation because of residence is a possible covert discrimination. Thus, the whole system of limited tax liability has to be questioned as the earnings are determined the same way but are partly taxed differently from taxpayers subject to unlimited tax liability.[174] Basically, the ECJ allows different treatment of a taxpayer subject to limited tax liability but only if there are no similar circumstances.[175] On the other hand, the only circumstance that the ECJ has ruled as being not comparable was that the personal circumstances primarily have to be considered in the state of residence and only if they cannot be considered there, does the state of activity have to take them into account. If the circumstances are comparable, an objective reason for a differentiation has to exist. Otherwise, it is an infringement of the EC Treaty.[176] As those objective reasons are hardly ever given, *Meilicke*[177] argues that all privileges must be granted to residents and non-residents equally.

[170] ECJ Case C-330/91 (para. 19); see also Jacobs, *Unternehmensbesteuerung*[4], p 184; Thömmes, *Diskriminierung*, p 88.
[171] See Knobbe-Keuk, EC Tax Review 1994, p 78.
[172] ECJ Case C-330/91 (para. 18).
[173] ECJ Case C-330/91, conclusions AdvGen (paras. 35 & 51).
[174] ECJ Case C-330/91, conclusions AdvGen (para. 41); see also Dautzenberg, DB 1994, p 1542.
[175] ECJ Case C-80/94 (para. 19).
[176] ECJ Case C-107/94 (para. 42).
[177] RIW 1989, p 642.

3. Asscher

a) Facts

Mr. Asscher was a national of the Netherlands who lived and was established in Belgium, but worked in the Netherlands. Since he was not resident in the Netherlands, Mr. Asscher was subject to the foreigner rate (25%), instead of 13% which was the rate for Dutch residents, for the first bracket of income tax.

b) Decision of the ECJ

A higher tax rate for non-residents was a covert discrimination. Again, the critical point was if the discrimination was justified. The Dutch government argued that the higher tax rate was a result of the simplification of the tax and social security system that abolished the deductibility of payments to social security and, thus, resulted in the same base for both, taxes and social security payments. To compensate the higher effective taxes for all residents, the tax rate was lowered. As the negative effect was restricted to residents, the tax rate for non-residents was not lowered. Otherwise, non-residents would have profited more from the simplification than residents and, thus, would have in fact got a tax privilege.[178] Thus, the Dutch government proposed a coherence between the lower tax rate and the impossibility of deducting expenses for social security. Additionally, the Dutch government tried to justify the discrimination by arguing that taxpayers subject to limited tax liability evaded the progression effect in the Netherlands.[179] But the ECJ stated that the comparison to the legal position in the past was irrelevant. The only significant comparison was the one between a domestic case and one with a link to the EC. Thus, the higher tax rate was in fact a penalty tax for not being insured in the Dutch social system[180] because no advantages could be gained because of the higher tax or the Dutch social security.[181] Since the EC Treaty forbade member states to determine if their own or legal rules of another member state were applicable, they were not allowed to compensate the fact that

[178] ECJ Case C-107/94 (para. 51).
[179] ECJ Case C-107/94 (para. 46).
[180] ECJ Case C-107/94 (para. 53).
[181] ECJ Case C-107/94 (para. 60).

the taxpayer was insured in another member state by levying a higher tax.[182] A coherence was also not present because the compensation was not made within the tax system and therefore there was no direct connection at hand. This would be necessary to apply the 'coherence principle'.[183] Additionally, the taxpayer did not get any advantage from evading the tax progression in the Netherlands because the DTC Belgium-Netherlands, as well as the OECD Model, assigned exemption with progression to the state of residence.[184] Thus, a higher tax rate for non-residents was a violation of the EC Treaty and not lawful.[185]

c) Effects on Austrian Tax Law

The most obvious and crucial difference of this case in comparison to the *Werner*[186] decision is that since Mr Asscher – a national of the Netherlands – lived and resided in Belgium the EC Treaty was applicable because, thus, an economic link to the EC was given.[187] Another consequence of this decision is that a higher taxation of non-residents is forbidden.[188] Thus, the gross taxation of income that leads in some cases to a higher tax burden is probably an infringement of the EC Treaty since there is no justification that was not already mentioned in the *Asscher* case. Especially the disadvantage concerning the taxation of income originating from renting, income of supervisory board members and income originating from technical or commercial counselling is not acceptable, since for all other income an assessment is possible. There is no reason that justifies the different treatment of income of supervisory board members. This can already be concluded from the *Biehl*[189] decision, where the ECJ rejected the restriction of an assessment to taxpayers who are resident in Luxembourg for the whole year. Thus, there should be the possibility to opt for an assessment for all Austrian income of taxpayers subject to limited tax liability[190] because the equalisation of the tax rate is always

[182] ECJ Case C-107/94 (para. 61); see also Bohr/Falkner, "Rechtsprechungsübersicht Europäische Gerichte", Ecolex 1996, p 822.
[183] ECJ Case C-107/94 (para. 59).
[184] ECJ Case C-107/94 (paras. 47 et seq).
[185] ECJ Case C-107/94 (para. 62); for the influence of the *Asscher* decision on the freedom of movement for workers, see Hohenblum, *Freedom of Movement for Workers*, pp 62 et seq.
[186] ECJ Case C-112/90; for further details, see II.A.4.b).
[187] ECJ Case C-107/94 (para. 33).
[188] See Jacobs, *Unternehmensbesteuerung*[4], p 205; Rainer, IStR 1996, p 130; Thömmes, IWB 1998, F 11a. p 248.
[189] ECJ Case 175/88.
[190] See Tumpel, *Harmonisierung*, p 390.

an obligation of the state of activity and not bound to the fact that (nearly) all income originates in the state of activity.[191]

4. Futura-Singer

a) Facts

The Luxembourg permanent establishment – Singer – and the French corporation – Futura – calculated their tax profit or loss by apportionment of their total income between the permanent establishment and the headquarters. This method was accepted for calculating the profits as taxable base. But when Singer wanted to reduce the its income with losses carried forward it came out that those were only acknowledged if the losses were determined according to Luxembourg law which meant that there had to be an exact accounting in Luxembourg and the books had to be kept in Luxembourg.[192]

This case is especially interesting because more and more multinational groups begin to see the EC as one single market. Thus, they establish a single subsidiary in the EC and are only present with a branch in most member states.[193]

b) Decision of the ECJ

As shown in II.A.7, the comparison in this case is made between a Luxembourg enterprise that has a permanent establishment in Luxembourg and a non-resident enterprise that has a permanent establishment in Luxembourg. The Luxembourg government claimed that there was no discrimination because resident corporations had to keep and retain books in Luxembourg, too, to carry losses forward. As normally the central accounting is located at the headquarters, the requirement for an accounting in Luxembourg was no additional effort for Luxembourg enterprises. But a non-resident had to set up an additional accounting unit, apart from the impossibility of keeping the original documents in two member states. Furthermore, the law of the state of residence normally also requires an accounting for foreign permanent establishments. Thus, this requirement meant that the corporation had to keep double books. This clearly

[191] See Thömmes, *EuGH-Rechtsprechung*, p 181; Urlesberger, WBl 1996, p 348.
[192] ECJ Case C-250/95 (paras. 8 et seq).

was a disadvantage for non-residents.[194] And a differentiation for losses carried forward was especially critical because residents and non-residents were basically treated the same way.[195] Thus, non-residents were discriminated against with respect to residents. The Luxembourg government tried to justify the discrimination with the argument that apportionment of the total income was not exact enough to be seen as an exact accounting and, thus, the loss was not able to be carried forward but in profitable years the profit had to be taken as taxable base because otherwise the profit would have been tax-free.[196] Furthermore, the Luxembourg government argued that the books had to be retained in Luxembourg to make it permanently possible to audit them.[197] The ECJ stated that it can be claimed that the profit is determined according to Luxembourg rules[198] but it is not necessary to restrict the measures to determine the profit/loss to the ones provided by Luxembourg law.[199] In particular, it may not be required that the accounting has to be kept in Luxembourg because one of the reasons for setting up a permanent establishment is that fewer costs occur at permanent establishments than at subsidiaries. Thus, such additional costs resulting from an additional accounting department contradicts the idea of free choice between branch and subsidiary.[200] The necessity of audits was declined with a reference to the 'Mutual Assistance' directive[201]. Furthermore, a less infringing rule, to require that the taxpayer shows the books to the fiscal administration once and then returns them to France, was possible if the 'Mutual Assistance' directive did not provide enough information.[202] Thus, the requirement that the books be kept in Luxembourg is inappropriate.[203] *Toifl*[204] concludes that the member states may obligate the taxpayer to co-operate on facts that cannot be provided by mutual assistance but it may not obligate the taxpayer to prove the facts because that could lead to the duty to keep books in and according to the rules of the host state.

[193] Thömmes, IWB 1997, F 11a, p 195.
[194] ECJ Case C-250/95, conclusions AdvGen (paras. 34 et seq); see also Anido/Carrero, EC Tax Review 1999, p 31.
[195] ECJ Case C-250/95, conclusions AdvGen (paras. 39 et seq).
[196] ECJ Case C-250/95, conclusions AdvGen (para. 53).
[197] ECJ Case C-250/95 (para. 27).
[198] See Jacobs, *Unternehmensbesteuerung*[4], p 189.
[199] ECJ Case C-250/95 (para. 40).
[200] ECJ Case C-250/95, conclusions AdvGen (para. 30).
[201] 77/799/EEC, OJ 1977 L 336/15.
[202] ECJ Case C-250/95, conclusions AdvGen (para. 70).
[203] Different opinion: OFD Düsseldorf, 'Ort der Buchführung und sonstigen Aufzeichnungen (§ 146 Abs. 2 AO) – Verlagerung der Buchführung ins Ausland', DB 1997, p 1896.

The consequence is that the resulting use of mutual assistance could easily overburden the system. A fact that is often missed by the legal commentators is that the ECJ allowed the member state to require exact records so that the loss carried forward can be exactly determined.[205] Thus, the ECJ did not see an infringement of the EC Treaty in this specific case because Futura and Singer were unable to prove the exact sum of the loss carried forward.

With this decision the ECJ stated that the possibility of tax audit is a possible justification if it obeys the limits of objectivity.[206] Since the ECJ declined the requirement of records according to the law of the host country, *Anido/Carrero*[207] even think that the ECJ rejected that accounting is the best method for ascertaining the company's tax base and, thus, it somehow contradicted its *GT-Link*[208] decision. But I do not agree with them because this decision does not forbid requiring the determination of the tax base according to the host countries rules but only the requirement to keep the books according to those rules. Some authors think that this decision was a further step from the interpretation of the fundamental freedoms as prohibitions of discrimination to prohibitions of restrictions for tax law purposes.[209] But merely the fact that the ECJ emphasised more the testing of justifications and not the search for a comparable domestic case, that was already provided by the AdvGen[210], is not enough to show there has been a change of settled case law.[211]

c) Effects on Austrian Tax Law

The restriction of losses carried forward to losses incurred in the host country is possible as only profits incurred in the host country are taxed because the requirement for an economic link between the profits taxed and the losses deducted is proportionate.[212] But this is probably not true for the Austrian rule that the loss that can be carried forward has to originate in an Austrian permanent

[204] 'Neue EuGH-Entscheidung zur Betriebsstättendiskriminierung', SWI 1997, p 320.
[205] ECJ Case C-250/95 (para. 43).
[206] See Toifl, SWI 1997, pp 317 et seq.
[207] EC Tax Review 199, pp 36 et seq.
[208] ECJ Case 242/95 (para. 42).
[209] For example, see Toifl, SWI 1997, p 317.
[210] ECJ Case C-250/95, conclusions AdvGen (para. 34).
[211] See II.A.7.
[212] See Jacobs, *Unternehmensbesteuerung*[4], p 189.

establishment and that only the part can be carried forward that exceeds the worldwide income.[213] This second requirement is a discrimination because residents may carry their loss forward unrestrictedly and a restriction is only possible on the loss that incurred in the host country.[214] *Loukota*[215] tried to justify this discrimination with the axiom that losses carried forward are linked to the taxation of the worldwide income. But the ECJ disproved that argument in the *Futura-Singer* case. Additionally, it argued that the consequence of giving up that requirement could lead to a double dipping of the loss.[216] But that possibility is not a justification and additionally it would be the problem of the state of residence if it does not tax all it can. Furthermore, the performance of another member state is no justification. The offer of the Austrian tax administration to extend the losses carried forward according to EC Treaty requirements with bilateral treaties on a mutual basis[217] is not enough because lack of reciprocity is no justification of a discrimination.[218] And there can be no further reason for that rule than additional tax revenue. And that is not a justification, either.[219] Most authors agree that § 102 (2) Z 2 EStG may not be applied if the DTC with the state of residence of the corporation includes a prohibition of the discrimination of permanent establishments. That is even affirmed by the tax administration in certain cases.[220] But thus, § 102 (2) Z 2 may never be applied to nationals/residents of other member states because the freedom of establishment of the EC Treaty also includes a prohibition of discrimination of permanent establishments.[221] Additionally, the ECJ had already stated that the absence of a rule in a DTC is no justification for discrimination.[222] Lately, the ECJ stated in the *X-AB & Y-AB* case[223] explicitly that the fundamental freedoms complete the prohibitions of discrimination of DTCs. Thus, the absence of that rule cannot be a justification for a different treatment.

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[213] § 102 (2) Z 2 EStG.
[214] See Tumpel, *Harmonisierung*, pp 380 et seq; Toifl, SWI 1997, p 321.
[215] See Loukota, 'Verlustvortrag für Steuerausländer – Mit Maß und Ziel', ÖStZ 1990, p 62.
[216] See Loukota, ÖStZ 1990, p 63.
[217] See Loukota, ÖStZ 1990, p 63.
[218] See II.A.8.b); see also Konezny, 'Die Sonderregelung für in österreichischen Betriebsstätten erlittene Verluste nach dem Entwurf des DBA Ö-D', SWI 1999, p 352.
[219] See II.A.8.b); established case law; for example ECJ Cases 270/83, 175/88 and C-39/90.
[220] Staringer, 'Rechtsprechung zum Internationalen Steuerrecht', SWI 1999, p 232; Konezny, SWI 1999, p 350.
[221] For example: ECJ Case 81/87; for further details, see III.D.2; see also Kerfs, 'Taxation of Permanent Establishments in Conflict with Non-discrimination Provisions in Tax Treaties', ET 1994, p 116.

Furthermore, this decision leads to the conclusion that a claim for exact accounting is possible but books kept in the state of residence should be enough to ensure this exact accounting.[224] This interpretation could lead to quite a few problems because the rules in the member states are different and, thus, there problems could arise in determining the exact profit/loss according to the law of the host country. It is clear that the ECJ characterised the requirement of keeping and retaining books in the host country as excessive and disproportionate because it leads to a double requirement of accounting in the host and in the home country.[225] But exactly that is required by § 131 (1) BAO. Thus, § 131 (1) BAO is a clear violation of the EC Treaty. Additionally, in specific cases § 125 (1) BAO and § 13 HGB can lead to the duty to keep books in Austria and, thus, are an infringement of the EC Treaty, too.[226] Therefore, there is still much need to adapt Austrian laws to the interpretation of EC Treaty by the ECJ in the *Futura-Singer*[227] case.

5. Royal Bank of Scotland

a) Facts

In Greece corporations are subject to a 35 per cent tax rate. Only if they issue bearer shares that are not listed at Athens's stock exchange, or if they are non-resident, they are subject to a 40 per cent tax rate. Constrained by Greek law, all Greek banks have to issue registered shares. Thus, all Greek banks are subject to 35 and all foreign banks are subject to 40 per cent tax, no matter which legal form they choose.[228]

b) Decision of the ECJ

A non-resident bank can never fulfil the necessary requirements.[229] Thus, there is a covert discrimination at hand.[230] The justification that was argued by the

[222] See Jacobs, *Unternehmensbesteuerung*[4], p 191.
[223] ECJ Case C-200/98; for further details, see III.L.5.
[224] See Anido/Carrero, EC Tax Review 1999, p 32.
[225] See Anido/Carrero, EC Tax Review 1999, p 25.
[226] For further details, see Toifl, SWI 1997, pp 321 et seq.
[227] ECJ Case C-250/95; for further details, see III.J.4.
[228] ECJ Case C-311/97, conclusions AdvGen (para. 9).
[229] ECJ Case C-311/97 (paras. 24 et seq).
[230] See Wouters, EC Tax Review 1999, p 106.

Greek government was that 40 per cent was the normal tax rate and the 35 per cent should be an incentive to help the going public. But the ECJ decided that an incentive for going public was no justification. The only question was if the two cases were objectively diverse enough to justify a differentiation. But as no differentiating circumstances are considered in the determining of the profit[231] and even the DTC Greece-Great Britain acknowledges that there are no differences between a permanent establishment and a resident corporation,[232] no objective difference is given. Thus, this rule was an infringement of the freedom of establishment.

c) Effects on Austrian Tax Law

Since in Austria the determining of the profits for residents and non-residents follows the same rules, there is no justification for different tax rates in Austria, either. Less relevant for Austrian tax law is that the ECJ indirectly affirms the comparability of a listing on a national and on a stock exchange in another member state. Because of this, the ECJ characterises a differentiation because of that attribute as a covert discrimination. Thus, one of the possible justifications to differentiate between resident and non-resident companies is gone. That is especially problematic for member states that have a corporate tax system that applies different tax rates for distributed and retained profits and that have a specific rule for non-resident corporations, because there they cannot tax the dividends.[233]

6. Baxter

a) Facts

For one year there had been an exceptional tax levied on pharmaceutical producers in France. The taxable base were the sales minus the research costs of that year that occurred in France. That was a disadvantage for foreign

[231] ECJ Case C-311/97 (para. 30).
[232] ECJ Case C-311/97 (para. 31).
[233] See Saß, 'Anmerkung zur Rs. C-311/97', DB 1999, pp 1199 et seq.

corporations because the research is normally mainly concentrated at the headquarters.[234]

b) Decision of the ECJ

Since the research and development is typically concentrated at the headquarters, a discrimination of foreign companies in relation to French companies occurs.[235] The French government tried to justify this measure with the fact that it was an extraordinary and repercussive measure and could, thus, only be an infringement if economic data of that year showed that it had discriminatory effects. Additionally, it argued that mergers in the pharmaceutical industry lead to the result that research was not necessarily centred at the residence of the corporation.[236] Additionally, the French government claimed that the audit in other member states was impossible and therefore the inspection of payments that occurred in other member states was impossible.[237] But the ECJ decided that an exceptional, retrospective measure does not justify a discrimination. The duty to prove the foreign expenditure would have been less restrictive and thus that measure was inadequate.[238] Therefore, an infringement of the EC Treaty existed.[239]

c) Effects on Austrian Tax Law

The prohibition of deduction of foreign costs that typically occur in the state of residence for non-residents is a violation of the EC Treaty. The consequence for Austrian tax law is that the exceptional costs that are restricted to the assessment as a taxpayer subject to unlimited tax liability is a violation of the EC Treaty if that expenditure typically occurs in the state of residents. Another critical point is that artists (or others enumerated in § 99 (1) Z 1 EStG) may not deduct expenses unless they prove that the receiving person is taxed in Austria. Only if the receiving person is subject to unlimited taxation in Austria that evidence is not necessary (§ 102 (1) Z 3 EStG). Thus, those expenses normally can not be deducted if they are

[234] ECJ Case C-254/97 (para. 7).
[235] ECJ Case C-254/97 (paras. 12 et seq).
[236] ECJ Case C-254/97 (para. 8).
[237] ECJ Case C-254/97 (para. 16).
[238] ECJ Case C-254/97 (paras. 19 et seq).
[239] ECJ Case C-254/97 (para. 21).

paid abroad and in some circumstances even if they are paid in Austria. Requirements like those are similar to those in the *Baxter* case. Especially, if it is considered that non-residents are more likely to spend their money abroad which means that the receiving person is most likely subject to limited tax liablility in Austria. Therefore, at least as far as § 102 (1) Z 3 EStG concerns expenses that normally occur in the state of residence, such a prohibition is a discrimination. Because I cannot see any allowed justification – the necessity of tax audit is normally denied by the ECJ with a reference to the 'Mutual Assistance' directive[240]; less tax revenue is no justification – this rule is probably an infringement of the EC Treaty. The fact that the expenditure is deductible in the state of residence is no justification because a foreign tax system can never be a justification.

7. Conclusions

It must be said that the legislator has tried to adapt the EStG to comply with the framework given by the ECJ in the *Schumacker*[241] decision. But, as shown in III.B, it failed to comply with the spirit of the decision. Thus, the possibility to be assessed as subject to unlimited tax liability was not granted to enough persons. And the fact that people that are subject to limited tax liability, even if the *Schumacker* decision is complied with, can be discriminated because the application of §§ 98 et seq EStG has not been noticed by the legislator yet. Thus, there are still some rules that are an infringement of the EC Treaty. And the justification that there is the possibility to opt for § 1 (4) EStG, which is argued by the BMF, is no justification for other discriminating rules against taxpayers subject to limited tax liability. The reason for that is that the ECJ never introduced the strict 90 per cent rule and this rule can only be a justification for ignoring the personal circumstances.

There is no justification for the taxation of income originating from renting, income of supervisory board members and income originating from technical or commercial advising at 20 per cent of the gross income because that can lead to a

[240] 77/799/EEC, OJ 1977 L 336/15.
[241] ECJ Case C-279/93.

higher effective tax rate. Especially if there is the possibility to be assessed for all other kinds of income.

The next rule that is a probable infringement of the EC Treaty is § 102 (2) Z 2.[242] The restriction of the deduction of loss carry forward to losses originating in Austria is possible. But the restriction to losses that exceed worldwide income is an infringement because residents may deduct all (Austrian[243]) losses carried forward. Additionally, the tax administration may not deny deductibility for expenditure that typically occurs in the state of residence only because it does not occur in the host country. That has consequences for determining the tax base. And, additionally, certain exceptional expenditure has to be deductible for non-residents, too. In this context it has to be also mentioned that the requirement to keep and retain books in Austria is also an infringement of the EC Treaty. Additionally, artists are not allowed to deduct expenses they have paid to persons that are not taxed in Austria. This contradicts the *Baxter*[244] decision. Furthermore, the taxpayer has to prove that the payee is taxed in Austria. And it was already shown in *Futura-Singer*[245], *Safir*[246] and *Vestergaard*[247] that this kind of additional effort is an infringement of the EC Treaty. Thus, in this area there is still much to be adapted to the aim of the EC Treaty.

K. Increased Duty to Co-operate in Foreign Cases

1. Legal Position

In contrast to Germany,[248] the increased duty to co-operate in foreign cases is not stated in any law.[249] Nevertheless, this duty is also given in Austria since it is

[242] See also Zöchling, 'VfGH bestätigt subsidiären Verlustvortrag für Steuerausländer', ÖStZ 1995, p 376; Konezny, SWI 1999, p 350.
[243] In the case of a DTC with exemption method. For details on the conflict between DTCs with exemption method and the EC Treaty, see III.O.2.
[244] ECJ Case C-254/97; for further details, see III.J.6.
[245] ECJ Case C-250/95; for further details, see III.J.4.
[246] ECJ Case C-118/96; for further details, see III.G.3.
[247] ECJ Case C-55/98; for further details, see III.K.2.
[248] See Thömmes, *EuGH-Rechtsprechung*, p 186.
[249] See. Renner/Steiner, 'Gewinnverlagerungen durch Einschalten von Domizilgesellschaften – Rechtliche Aspekte', Österreichische Steuer-Zeitung (ÖStZ) 1995, p 366.

settled case law of the VwGH.[250] But it contradicts the aim of the common market because the common market should lead to equal treatment of cross-border activities and cases that only concern one member state.

2. Vestergaard

a) Facts

In Denmark costs for educational courses are deductible as tax allowable expenses if they serve as refresher courses. But if they take place abroad, the tax administration assumes that they primarily serve tourist purposes. Thus, the costs are not deductible.[251] The only exception is made if there is an urgent professional reason – for example, a specific archaeological excavation for an archaeological seminar. This assumption of the tax administration has to be proven wrong by the taxpayer, in order for the costs to be deductible. But at domestic seminars the reason was not checked and, thus, also seminars in tourist hotels were deductible.[252] Mr Vestergaard, who was a tax consultant and certified public accountant, attended a seminar about the reform of Danish tax law that was held on Crete. The tax administration denied the deduction of those costs and did not recognise the facts that Mr Vestergaard put forward, as proof for the reason and purpose of the seminar.

b) Decision of the ECJ

The administration is bound to apply the EC Treaty.[253] Thus, it has to interpret the law in the light of EC law. Therefore a discriminatory administration practice is enough to be an infringement of the EC Treaty.[254] And a differentiation between the event being located in Denmark and in the rest of the EC is such a differentiation if it is not objectively justified. The differentiation between those two cases is that only seminars that were located abroad were strictly checked. Whereas even seminars located in tourist areas in Denmark were deductible and

[250] For example, VwGH 1415/68; VwGH 85/14/0056.
[251] ECJ Case C-55/98 (para. 5).
[252] ECJ Case C-55/98 (para. 7).
[253] See II.A.1.
[254] ECJ Case C-212/97 (para. 34); see also Dautzenberg, BB 1992, p 2401.

no check was performed.[255] Aggravating is that in that case the seminar on Crete was cheaper than that in Denmark and that the tax administration even denied the deduction although Mr Vestergaard proved that the proportion of working to spare time was within the limits of other seminars that were deductible. Additionally, the argument that a seminar abroad is pedagogically useful because it gives the employee time away from the office was not recognised. The tax administration argued that the practice is necessary to assure the possibility of tax audit.[256] The ECJ denied this with a reference to the 'Mutual Assistance' directive.[257] Thus, the treatment of foreign cases was a discrimination[258] because that way hotels in Denmark were more attractive because of tax reasons.

c) Effects on Austrian Tax Law

Neither law nor the practice of the administration may discriminate against EU citizens or expenses that originate in other member states, in the sense of the EC Treaty. Thus, a different treatment of foreign cases is a discrimination[259] because the taxpayer has more duties than in domestic cases and therefore a domestic case is more attractive. *Rainer*[260] already concluded this from the *Safir* case[261]. And a justification by the impossibility for the authorities to check the facts is not very probable because the ECJ rejects this with a reference on the 'Mutual Assistance' directive[262]. Thus, the administration and the courts in Austria have to change their practice because a differentiation between domestic and EC cases is forbidden by the EC Treaty.

3. Conclusions

A case that is linked to the EC may not lead to a higher effort for the taxpayer in tax procedure. And the necessity of tax audit is normally no justification because the ECJ argues that sufficient information can be received by relying on the 'Mutual Assistance' directive. Thus, the increased duty to co-operate is

[255] ECJ Case C-55/98 (paras. 21 et seq).
[256] ECJ Case C-55/98 (para. 25).
[257] ECJ Case C-55/98 (paras. 23, 26 & 28).
[258] ECJ Case C-55/98 (para. 29).
[259] See Toifl, SWI 1999, p 161; Thömmes, *EuGH-Rechtsprechung*, p 187.
[260] IStR 1998, p 301.
[261] ECJ Case C-118/96; for further details, see III.G.3.
[262] 77/799/EEC, OJ 1977 L 336/15.

inappropriate. This is agreed on by the doctrine, but rejected by the tax administration.[263]

L. Requirement to be Subject to Unlimited Liability to Tax for Application of § 9 KStG

Most member states are very restrictive with respect to the transfer of losses between corporations (group taxation) because corporations are independent legal persons.[264] And only Denmark allows a cross-border transfer of losses.[265]

1. Legal Position

In Austria fiscal unity ('Organschaft') is the only way to transfer losses between corporations.[266] This fiscal unity ('Organschaft') is tied to very restrictive requirements. To get a fiscal unity ('Organschaft') the subsidiary has to be financially, organisationally and economically subordinate to the parent.[267] For the financial domination the parent has to own more than half – many authors think more than 75 per cent – of the voting rights.[268] Organisational subordination means that there has to be identity of the managers or something similar.[269] Economic domination occurs if the business purpose of the subsidiary serves the parent.[270] Additionally, a contract has to be concluded between the parent and the subsidiary that obliges the parent to cover all losses and consequently the subsidiary is obliged to purge the whole profit – a contract to transfer profits/losses.[271] Furthermore, parent[272] as well as subsidiary[273] have to be specific forms of companies that are listed in § 9 KStG. The point that is the most

[263] See Lang, 'Bundesabgabenordnung und internationales Steuerrecht', SWI 1999, p 328.
[264] Bertl/Djanani/Kofler (Hrsg.), *Handbuch der österreichischen Steuerlehre* (1998), p 298.
[265] See Saß, 'Zur Berücksichtigung der Verluste ausländischer Tochtergesellschaften bei der inländischen Muttergesellschaft in der EU', BB 1999, p 449.
[266] See Zehetner, 'Besteuerung von Unternehmensgruppen und Auslandsverluste', in Gassner/Lang/Wiesner (Hrsg.), *Besteuerung von Unternehmensgruppen: Bestandsaufnahme und Vorschläge zur Reform der Organschaft im Körperschaftsteuerrecht* (1998), p 145.
[267] See Bauer/Quantschnigg, *KStG*, para 33; Wiesner/Schneider/Spanbauer/Kohler, *Körperschaftsteuergesetz KStG 1988*, para. 7; Stefaner, *Gesellschaftsrechtliche und körperschaftsteuerrechtliche Probleme der Organschaft* (1987), pp 77 et seq.
[268] See Bauer/Quantschnigg, *KStG*, paras. 41 et seq.
[269] See Bauer/Quantschnigg, *KStG*, paras. 64 et seq.
[270] See Bauer/Quantschnigg, *KStG*, paras. 72 et seq.
[271] See Bauer/Quantschnigg, *KStG*, paras. 102 et seq; Wiesner/Schneider/Spanbauer/Kohler, *KStG 1988*, para. 13; Stefaner, *Organschaft*, pp 89 et seq.
[272] See Bauer/Quantschnigg, *KStG*, paras. 7 et seq.
[273] See Bauer/Quantschnigg, *KStG*, paras. 29 et seq.

obvious possible discrimination is that § 9 (2&3) claim that the parent as well as the subsidiary have to be subject to unlimited tax liability in Austria.[274] Thus, a cross-border fiscal unity ('Organschaft') is nearly impossible.[275] *V. Raad*[276] even reasons that the *Avoir Fiscal*[277] showed that a differentiation between a permanent establishment and a corporation, like a corporation being a requirement for the fiscal unity ('Organschaft'), is a discrimination under to the EC Treaty.

2. Discrimination?

If all other relevant requirements are fulfilled and only the absence of a residence in the host country is the reason for the unequal treatment, discrimination occurs.[278] Therefore, it is critical to find a comparable case that shows that different treatment. In this specific case there are several comparable cases possible. Such a comparable case does not have to be generally in the same position but only in respect to the rule in question.[279] Since fiscal unity ('Organschaft') requires two corporations there are several comparable cases possible. At first, of course, it is obvious to compare resident and non-resident taxpayers.[280] The benchmark is always the possible fiscal unity ('Organschaft') between parent and subsidiary that are both resident and have their effective management in Austria.

- The first comparable case is the one in which the subsidiary is resident in Austria but the parent is not. Thus, a fiscal unity ('Organschaft') is not possible. In Austria a fiscal unity ('Organschaft') is not even possible between a permanent establishment of a foreign parent in Austria and an Austrian subsidiary. This is possible in Germany.[281] In that case it even cannot be argued that the parent is not taxable in Austria. This is a discrimination of

[274] See Schuch, 'Organschaft und Gruppenbesteuerung im Abkommensrecht', in Gassner/Lang/Wiesner (Hrsg.), *Besteuerung von Unternehmensgruppen: Bestandsaufnahme und Vorschläge zur Reform der Organschaft im Körperschaftsteuerrecht* (1998), p 197.
[275] See Wiesner/Schneider/Spanbauer/Kohler, *KStG 1988*, para. 6; Bauer/Quantschnigg, *KStG*, paras. 13 et seq; Zehetner, *Unternehmensgruppen*, p 145.
[276] EC Tax Review 1995, pp 196 et seq.
[277] ECJ Case 270/83; for further details, see III.N.2.
[278] See Wouters, EC Tax Review 1999, p 106.
[279] See Knobbe-Keuk, EC Tax Review 1994, p 78.
[280] See Jann, *Auswirkungen*, p 59.
[281] See Blumenberg, 'ECJ to Rule on Tax Discrimination of German PEs', Tax Notes International 1997, p 1026.

permanent establishments and, thus, *Tumpel*[282] reasons that it can already be concluded from *Avoir Fiscal*[283] that this treatment is a discrimination. Consequently, in this case there is no justification. Therefore, the first step should be to enlarge fiscal unity ('Organschaft') to those cases.

- The next comparison is possible to a parent that is resident in Austria and a subsidiary that is resident in another member state. Thus, fiscal unity ('Organschaft') is impossible. This consequence makes it less attractive to set up a subsidiary in another member state and is therefore an obstacle in exercising the freedom of establishment.

- The third comparison can be made between a subsidiary that is resident in Austria and does all ordinary business in a permanent establishment in another member state compared to a subsidiary that resides in that member state. Thus, there is no difference for tax purposes because all profits are taxed at the permanent establishment but fiscal unity ('Organschaft') is basically possible, nevertheless.[284] But it has to be noticed that if a DTC with exemption method is applied, most income of the subsidiary is exempt.

Additionally, there is one comparison that makes the unequal treatment even more obvious. It is agreed on by the legal commentators that fiscal unity ('Organschaft') is also possible if both corporations are subject to unlimited tax liability in Austria but a DTC determines another country as state of residence.[285] In this case Austria may not tax the worldwide income. Thus, fiscal unity ('Organschaft') is possible although the DTC grants Austria the same right to tax as in the case that parent or subsidiary is a taxpayer subject to limited tax liability.

3. Justification?

Since it should be clear that § 9 is a discrimination, the critical question is whether a justification is possible. One possible justification could be that subsidiaries in other member states determine their profit/loss according to different rules. Thus, the foreign loss cannot be charged against Austrian

[282] *Harmonisierung*, p 396.
[283] ECJ Case 270/83; for further details, see III.N.2.
[284] See Schuch, *Organschaft*, pp 182 et seq.
[285] See Zehetner, *Unternehmensgruppen*, p 145.

profit/loss. But the ECJ has already stated in the *Futura-Singer*[286] decision that it is not possible to claim that books must be kept according to the rules of the host state because it is less infringing to adapt the determination of the result to national rules. And adaptation of the profit/loss is also possible in the case of fiscal unity ('Organschaft'). Thus, the impossibility to transfer losses is inappropriate compared to the differences in determining the result of the company. Additionally, the objection that a financial, organisational and economic cross-border integration is impossible is bound to fail because of the common market. Furthermore, the Austrian government could argue that it is impossible to conclude a cross-border contract to transfer profits/losses. But that is a formal obstacle similar to the requirement of a residence in the host country. Thus, this is no justification if it is possible to conclude a contract that has the same consequences.[287] Moreover, the Austrian government cannot justify the restriction of fiscal unity ('Organschaft') to domestic cases with the necessity to audit and check the requirements of the subordination because the ECJ regularly rejects such arguments with a reference to the 'Mutual Assistance' directive[288].[289] A justification using the 'coherence principle' is not possible either, because coherence is present at the level of tax revenue and not at the level of the individual taxpayer, similar to the facts in the *ICI* case[290].[291] And DTCs cannot be a justification because they prohibit Austria from taxing profits but not from considering losses.[292] Additionally, arguments like offsetting with advantages of non-residents, absence of mutuality, absence of harmonisation, absence of a rule in the DTC and additional problems of the administration for foreign cases have already been rejected by the ECJ.[293] Furthermore, the impossibility of a fiscal unity ('Organschaft') across a border that does not exist anymore for economic purposes because it is not in line with the idea of the common market. Generally, it has to be said that a justification is hardly possible.[294]

[286] ECJ Case C-250/95; for further details, see III.J.4.
[287] See Saß, EWS 1998, p 349.
[288] 77/799/EEC, OJ 1977 L 336/15.
[289] Established case law, for example, see ECJ Case C-250/95; for further details, see III.J.4.
[290] ECJ Case C-264/96; for further details, see III.L.4.
[291] See de Weerth, IStR 1998, p 470.
[292] For further details, see III.O.1.
[293] See Jacobs, *Unternehmensbesteuerung*[4], p 191.
[294] See de Weerth, RIW 1995, p 930.

4. ICI

a) Facts

In Great Britain a transfer of losses between a subsidiary, its subsidiary and the parent company was only possible if all companies of the group – or of the consortium – were resident in Great Britain. ICI and another – British – corporation formed a consortium that held shares of 23 corporations – 4 resident in Great Britain, 6 in other member states and 13 in third states. Thus, the transfer of losses of a British subsidiary to ICI was denied.

b) Decision of the ECJ

Differentiating on grounds of the state of residence is a possible covert discrimination.[295] The disadvantage for parent companies of non-residents in this case is that there is no possibility to transfer losses. In this case a resident company with subsidiaries in other member states – case with a link to the EC – is discriminated[296] against, a parent that only has subsidiaries in Great Britain – the domestic case. Thus, although not a national of another member state is directly concerned, this case falls under the fundamental freedoms of the EC Treaty.[297] This is established case law[298] if the discriminated home national has acquired rights concerning the EC Treaty because in that case he is comparable to a national of another member state. The British government recriminated that the extension to consortiums that consist of corporations that are resident in other countries would lead to tax evasion and less tax revenue because profits of those corporations cannot be taxed.[299] But the ECJ characterises the rule to be too general to be an anti-abuse measure because it was not tailored to be applicable to abusive use only.[300] Thus, the rule infringes the 'principle of proportionality'.[301] And a loss of tax revenue is no justification.[302] Additionally, coherence is not at hand because the ECJ saw no matching rule in the taxation of profits of

[295] For the problem and the consequences whether it is a overt discrimination see II.A.6.
[296] See Daniels, EC Tax Review 1999, p 40.
[297] ECJ Case C-264/96 (para. 21).
[298] For example: ECJ Case 81/87; for further details, see III.D.2; see also Saß, BB 1999, p 450.
[299] ECJ Case C-264/96 (para. 24).
[300] ECJ Case C-264/96 (para. 26).
[301] See Saß, BB 1999, p 450.
[302] ECJ Case C-264/96 (para. 28); see also Saß, BB 1999, p 450.

subsidiaries and the possibility to transfer losses to the parent company.[303] But in this specific case the ECJ did not see an infringement of the EC Treaty because there was no discrimination concerning the EC since the loss transfer was prohibited because most subsidiaries were resident in third states.[304]

The ECJ did not test compliance with the free movement of capital after it held that no infringement of the freedom of establishment principle had occurred. But it is not possible to conclude from this that if one fundamental freedom is not violated the other fundamental freedoms cannot be violated, either. That fact was only due to the formulation of the questions by the British court.[305]

c) Effects on Austrian Tax Law

Home nationals are protected by the fundamental freedoms if the state of residence imposes obstacles for establishing in other member states that discriminate against them with respect to other residents that are only established in that member state.[306] With this decision the ECJ emphasised once again that all actions that take place within the EC have to be treated like comparable cases that are limited to one member state.[307] The similarity of the British rule in question with Austrian fiscal unity ('Organschaft') is obvious.[308] § 9 KStG nearly completely restricts the possibility of a loss transfer to domestic cases. Thus, fiscal unity ('Organschaft') is also discriminatory. After the *ICI* decision this conclusion was not accepted by all legal commentators because the facts did not imply a cross-border transfer of losses. But after *X-AB & Y-AB*[309] it is clear that § 9 KStG is a discrimination.

Since the council has blocked a directive on the subject of cross-border transfer of losses between parent and subsidiary for decades, the ECJ once again filled (a bit) of that vacuum with this decision because it enlarged all possibilities of transferring losses between corporations within a member state to cross-border cases. To prevent a double dip of losses the member states are free to introduce

[303] ECJ Case C-264/96 (para. 29).
[304] ECJ Case C-264/96 (para. 33).
[305] See Toifl, SWI 1999, p 158.
[306] See de Weerth, 'Anmerkung zu EuGH Rs. C-264/96, *ICI*', IStR 1998, p 470.
[307] See de Weerth, IStR 1998, p 470.
[308] For the similarity to the German fiscal unity ('Organschaft') see de Weerth, IStR 1998, p 470.
[309] ECJ Case C-200/98; for further information see III.L.5.

rules that impose the obligation for the parent company to pay the tax that was saved by deducting the foreign losses in the year in which the subsidiary is able to deduct the loss itself. Furthermore, the member states may claim that the loss has to be adapted to its rules of determining profits/losses.[310]

Another important conclusion of this decision is that tax evasion is not the shifting of income from one member state to another because then the other member state may tax that income. For tax evasion there have to be additional circumstances than the use of different tax rates.[311] That is also confirmed by the decision of the ECJ in the *Gilly* case[312].

5. X-AB & Y-AB

a) Facts

In Sweden it is possible to even out the results of several corporations in a group by payments between the corporations that reduce/increase the tax base of the paying and receiving company. That privilege is also granted if some companies in question are resident in one other country if the DTC with that country contains a prohibition of discrimination.[313] But if the relevant foreign companies are resident in more than one country that privilege is not granted because the Swedish administration refuses to apply two DTCs in one step. This is even true if, as in this case, both transferring companies reside in Sweden and only one of the intermediary companies that holds the shares of the subsidiary is a foreign company.[314]

b) Decision of the ECJ

As the parent company held 100 per cent (roughly) of the subsidiary and, thus, had controlling interest in it, the freedom of establishment was concerned in this case. The discrimination was that an immediate tax burden reduction resulting from a loss of one of the companies of the group was impossible if the relevant

[310] See Saß, BB 1999, p 450.
[311] See Hahn, IStR 1999, pp 613 et seq.
[312] ECJ Case C-336/96; for further details, see Hohenblum, *Freedom of Movement for Workers*, pp 81 et seq.
[313] ECJ Case C-200/98 (para. 24).
[314] See Dautzenberg, 'Keine Beschränkung des innerkonzernlichen Verlustausgleichs auf Transferzahlungen inländischer Gesellschaften', IStR 1999, p 534.

companies resided in more than one other member state.[315] It was remarkable that the Swedish government admitted that that was an infringement of the EC Treaty because for EC purposes the fundamental freedoms added to the prohibitions of discrimination in DTCs and did not try to justify this discrimination.[316] Thus, the decision of the ECJ was no surprise. It stated that the rule was an infringement.[317]

c) Effects on Austrian Tax Law

One effect is that the administration may not restrict the possibility to carry a loss forward of taxpayers subject to limited tax liability in accordance with § 102 (2) Z 2 EStG to cases in which a DTC prohibits discrimination. Additionally, once again the ECJ stated that a transfer of losses in a group may not be restricted to domestic cases but has to be enlarged to all EC cases, no matter how many other member states are concerned. Thus, the Austrian fiscal unity ('Organschaft') can probably not be defended at the ECJ.[318]

6. Conclusions

It must be said that it is unreasonable to think that the Austrian fiscal unity ('Organschaft') can pass examination by the ECJ. An extension of the scope of § 9 KStG to corporations that are resident in other member states is the least Austria must do to repair an infringement of that rule.[319] To avoid a double dipping of losses it is possible that Austria only grants a deferment of the tax burden until the loss is tax-effective in the other member state.[320] *Jacobs*[321] even claims that loss set off has to be possible for all subsidiaries. He does not sustain that claim on the discrimination in the system of fiscal unity ('Organschaft') but on a discrimination between the treatment of foreign subsidiaries and permanent establishments. But I think that this is not discrimination because in Austria it is normally not possible to set off losses of foreign permanent establishments due to DTC rules. This is a

[315] ECJ Case C-200/98 (paras. 27 et seq).
[316] ECJ Case C-200/98 (para. 29).
[317] ECJ Case C-200/98 (para. 31).
[318] For the legal position in Germany see Dautzenberg, IStR 1999, p 535.
[319] See also Saß, SWI 1999, pp 476 et seq.
[320] See Rief, 'Auslandsverluste und Verlustübertragung im EG-Stuerrecht', in Gassner/Lechner (Hrsg.), *Österreichisches Steuerrecht und europäische Integration* (1992), pp 212 et seq.
[321] *Unternehmensbesteuerung*[4], p 206.

difference with the former German legal position. Additionally, it is common to all member states that it is possible to allocate results between branch and parent but normally impossible between subsidiary and parent. Of course it is settled case law[322] of the ECJ that rules that are common to all member states are not necessarily not an infringement of the EC Treaty. But in that case it is one of the most important principles of commercial law distinguishing branches from subsidiaries that only branches can transfer their results to the parent. Additionally I want to put forward that as branches and subsidiaries are listed in art. 43 EC Treaty, the member states agreed on those two forms of establishments and on their basic differences. Therefore, I think that *Jacobs'* claim is more than can be justified as a consequence of the fundamental freedoms.

M. Difference between § 10 (1) and § 10 (2) KStG

§ 10 (1) KStG exempts all dividend payments resulting from shares of Austrian corporations. § 10 (2) KStG is the implementation of the 'Parent-Subsidiary' Directive[323] and sets additional requirements in order to achieve the same result as § 10 (1) KStG. Those requirements are that the shares have to be held for 2 years and that the voting rights have to exceed 25 per cent. This complies with the requirements of the directive[324] but the specific rule of § 10 (1) KStG makes it questionable if it complies with the EC Treaty[325] because the income originating from domestic shares are privileged against those from shares of firms of other member states. And it is settled case law that rules that convert secondary law have to obey the fundamental freedoms, too.[326] The requirement of 25 per cent is not an infringement of the freedom of establishment because the ECJ stated in the *Baars* case[327] that a controlling interest has to exist for an infringement of the freedom of establishment to be possible. But that controlling interest does not have to be a majority interest because the ECJ applied the

[322] For example, ECJ Case C-279/93.
[323] 90/435/EEC, OJ 1990 L 225/6
[324] The infringement that was shown by Jann/Toifl, 'EuGH-Entscheidung zur Behaltefrist nach der Mutter/Tochter-Richtlinie', SWI 1996, pp 490 et seq was corrected.
[325] See Toifl, SWI 1999, p 159.
[326] For example, see ECJ Cases C-158/96 (paras. 25 et seq), C-348/96 (paras. 28 et seq) and C-410/96 (para. 25).
[327] ECJ Case C-251/98; for further details, see III.I.2.

freedom of establishment in the *ICI* case,[328] where ICI only held 49 per cent. But less than 25 per cent of the shares does not seem to be enough to characterise it as controlling interest. Nevertheless, this requirement is still critical in the light of the free movement of capital. But the requirement that the shares have to be held for at least 2 years is also critical with respect to the freedom of establishment. Thus, the question is if it can be justified. Once again, discrimination because of obstacles in checking foreign facts is inappropriate. The Austrian government could put forward that the tax privilege is only deferred. But that is not true if the shares are sold within 2 years of the purchase. Additionally, that argument could have also be put forward at the fiscal unity ('Organschaft') but that did not justify the discrimination in the *ICI* and *X-AB & Y-AB* cases[329]. On the other hand, the ECJ gives the EC legislator more freedom in reference to an infringement of the fundamental freedoms. However, it has to be said that in that case the directive is not infringing itself, but the interplay of the Austrian domestic rule and the Austrian form of converting the directive is a possible infringement and additionally the directive could have been converted in a non-discriminating way. Thus, § 10 (2) KStG should be changed to prevent a decision of the ECJ.

N. Restriction of the Deduction of Interest on Equity to Corporations that are Subject to Unlimited Liability to Tax in Accordance to § 11 (2) KStG in the Form of the SteuerreformG 2000

1. Legal Position

To make equity financing of a business more advantageous, the SteuerreformG 2000 introduced tax-deductible deemed interest on equity. That interest is calculated on the basis of the increase in equity compared to the average of the last seven years. On the other hand, the same amount that is deductible is taxed as a special income at a lower tax rate. Thus, this rule grants a tax rate reduction. To avoid a cascading effect changes in the value of shares do not result in changes in equity. But this is only true for domestic shares.

[328] ECJ Case C-264/96; for further details, see III.L.4.

Consequently, changes in the value of foreign shares have an influence on the relevant equity. To compensate for the fact that foreign shares have an influence on the relevant equity, non-resident corporations are not allowed to deduct deemed interest on equity. Thus, a cascading effect is avoided. But that puts foreign corporations at a disadvantage because they are not able to deduct deemed interest. Thus, this is a discrimination. Additionally, a less infringing rule is possible because foreign corporations could be allowed to deduct interests on equity and Austrian holders of shares in those corporations could be obliged to take the deemed interest of the subsidiary into account proportionally. That would mean additional effort for the administration but that is no justification for a discriminatory rule. Given that the most obvious justifications were rejected by ECJ[330] and no other imperative reason can be seen, this rule is probably an infringement of the EC Treaty. Since this rule represents a discrimination of permanent establishments of foreign corporations, relevant conclusions can be drawn from the *Avoir Fiscal* case[331].

2. Avoir Fiscal

a) Facts

In France the administration granted a credit that equalled the amount of tax paid by the subsidiary on the distributed profit to the addressee of dividends to reduce double taxation of dividends. But that credit was only granted to shareholders that resided in France and to foreigners that got it because of a provision of the relevant DTC. Thus, permanent establishments often were not covered by the scope of that rule. Therefore, permanent establishments were discriminated against in relation to French companies which lead to a restriction in the freedom to choose between subsidiary, branch or agency. That discrimination was especially obvious for permanent establishments of foreign insurance companies because they had to secure the provisions of bad debts with assets.

[329] ECJ Cases C-264/96 and C-200/98, respectively.
[330] See II.A.8.b).
[331] ECJ Case 270/83.

b) Decision of the ECJ

The discrimination is obvious. The critical question is once again if this discrimination is justified. The French government claimed that taxes had not been harmonised.[332] Furthermore, it was argued that the differentiation was not based on nationality but on residence which was common throughout tax laws across Europe. Additionally, it was argued that double taxation was avoided by a balanced system of DTCs and, thus, such privileges were only granted on mutual basis.[333] Moreover, the French government reasoned that an enlargement to permanent establishments would lead to a drop in tax revenue.[334] Besides, it was claimed that there were no consequences observable in the prices charged of foreign insurance companies. Additionally, the French government put forward that the freedom of establishment was not infringed as there was no disadvantage because it was possible to set up a subsidiary and that that difference was inherent to the differences between a subsidiary and a permanent establishment. And, thus, it was offset by other advantages.[335] But the ECJ stated that the absence of harmonisation measures is no justification for a discrimination.[336] Since the differentiation because of the residence is nearly congruent to a differentiation on grounds of nationality, a covert discrimination[337] occurs.[338] Mutuality as a condition is possible in international law but it contradicts the fundamental freedoms of the EC Treaty.[339] A loss of tax revenues is not a justification either.[340] The freedom of establishment is not complied with if it is possible to avoid discrimination by one form of legal entity. Therefore, it is necessary to have a free choice between the varying forms of legal entities. This is especially true if the treatment is equal in most other features, like, for example, in the determination of the tax base.[341] The offsetting of advantages is forbidden since even small

[332] ECJ Case 270/83, conclusions AdvGen (para. 6).
[333] ECJ Case 270/83, conclusions AdvGen (para. 7).
[334] ECJ Case 270/83, conclusions AdvGen (para. 8).
[335] ECJ Case 270/83, conclusions AdvGen (para. 9).
[336] ECJ Case 270/83 (para. 24).
[337] See II.A.6.
[338] ECJ Case 270/83 (para. 18).
[339] ECJ Case 270/83 (para. 26).
[340] ECJ Case 270/83 (para. 25).
[341] ECJ Case 270/83 (para. 22); see also Jacobs, *Unternehmensbesteuerung*[4], p 180.

discriminations are infringements of the EC Treaty.[342] Thus, the French rule was a violation of the EC Treaty.[343]

c) Effects on Austrian Tax Law

Every company has to have the free choice to be present in other member states through a branch, an agency or a subsidiary. That choice must not be distorted by tax measures. Thus, it is an infringement of the EC Treaty that § 11 (2) KStG grants deemed interest on equity only to subsidiaries and not to branches and agencies of foreign corporations.

3. Conclusions

As this rule is a discrimination, no justification is at hand and even a less infringing measure is possible, it is quite clear that the ECJ would characterise this rule as an infringement of the EC Treaty. But it is questionable whether the ECJ will ever have to decide on this subject because the revenue of the deemed interest on equity is very little. Thus, it probably will not pay to take the costly way to the VwGH that may submit the question to the ECJ which again causes additional costs, to be allowed to get a tax rate that is a bit – nine per cent points if the shares are held by a corporation; 0-25 per cent points if they are held by a natural person – lower on the amount that is characterised as interest on equity.

O. Influence on DTCs

For DTCs special co-ordination is needed since there is always more than one member state concerned. Thus, rules that do not entail discrimination by themselves are a possible discrimination if the interplay of DTCs and the national legal systems of the different member states are taken into account.[344]

1. DTCs as Justification for Discrimination

DTCs are the result of negotiations between two sovereign countries. They are a result of the negotiating skills of the involved countries. And they are an

[342] ECJ Case 270/83 (para. 21).
[343] ECJ Case 270/83 (para. 28).
[344] See Dautzenberg, DB 1994, p 1543.

expression of the different tax systems of the countries involved.[345] Additionally, they are treaties of international law and have the character of both, bilateral treaties and national law. This raises the question of whether DTCs are a justification for discrimination. On the other hand the EC is a supranational organisation and, thus, the EC Treaty prevails over other contracts between nations.[346] That is especially true for treaties between two member states, but also for treaties between a member state and a third state. Thus, DTCs have to respect the fundamental freedoms.[347] Furthermore, DTCs do not compel taxation, they only grant the right to tax.[348] Thus, the member states do not have to infringe EC law. Therefore, DTCs allow member states to obey the fundamental freedoms and not to tax a specific case that they could under the DTC. Consequently, a DTC cannot infringe EC law because member states do not have to tax as much as a DTC allows them to. But the combination of DTCs with national law and the fact that the advantages of the DTC are not granted to all EU citizens can lead to distortions of competition if a subsidiary gets a privilege that is not granted to permanent establishments.[349] Thus, discrimination is possible in this area.[350] Additionally, DTCs have to be transformed into national law in some way in most countries,[351] so that they are effective for taxpayers and grant the same rights to residents as national laws.[352] As national law, they are open to a possible review of the ECJ.[353] And this is true for DTCs between member states but also between member states and third countries. This was confirmed by the ECJ in the *Wielockx*[354] decision.[355]

[345] See Herzig/Dautzenbreg, DB 1992, p 2520.
[346] See Jacobs, *Unternehmensbesteuerung*[4], p 223; Hinnekens, EC Tax Review 1994, p 146.
[347] See Commissioner Scrivener, in Hinnekens, EC Tax Review 1994, p 151; Hinnekens, EC Tax Review 1994, p 154; Rädler, 'Most-favoured-nation Clause in European Tax Law?', EC Tax Review 1995; Prechal, in Offermanns, EC Tax Review 1995, p 97; Hinnekens, 'Compatibility of Bilateral Tax Treaties with European Community Law – Application of the Rules', EC Tax Review 1995, p 202.
[348] See Lang, 'Kein Verstoß von Doppelbesteuerungsabkommen gegen die Grundfreiheiten des EGV?', IWB 1996, F 11, G 2, p 256 et seq; Herzig/Dautzenbreg, DB 1992, p 2521; Lang/Schuch, *DBA D-Ö*, Vor 1, para. 34.
[349] See Lang, IWB 1996, F 11, G 2, p 258.
[350] See Lang, IWB 1996, F 11, G 2, p 256.
[351] For the situation in Austria and Germany, see Lang/Schuch, *DBA D-Ö*, Vor 1, para. 24.
[352] Staringer, 'Triangular Cases', in Gassner/Lang/Lechner (Hrsg.), *Aktuelle Entwicklungen im Internationalen Steuerrecht: Das neue Musterabkommen der OECD* (1994), p 83.
[353] ECJ Case C-307/97, conclusions AdvGen (para. 77); see also Lang, IWB 1996, F 11, G 2, p 256; Thömmes, *EuGH-Rechtsprechung*, p 191; Lehner, *Resümee*, p 263; Wiedow, *Steuerharmonisierung*, p 53.
[354] ECJ Case C-80/94; for further details, see II.A.8.b)(3).
[355] See Rainer, IStR 1995, p 476.

It is settled case law since *Avoir Fiscal*[356] that the fundamental freedoms grant unconditional rights and may not be subject to the requirement of mutuality or to a specific rule in a DTC.[357] *Rainer*[358] sees a consistent line in the *Avoir Fiscal*[359], *Commerzbank*[360] and *Wielockx* decisions that DTCs are not a justification for discrimination.[361] This settled case law was continued in the *St. Gobain*[362] decision. Although the ECJ sometimes referred to the OECD Model, even a DTC that follows the OECD Model cannot be a justification because the OECD Model is only a recommendation, but the EC Treaty is binding and prevails even national law.[363] Thus, DTCs have to be concluded and exercised according to the EC Treaty.[364] That was also emphasised in the *Schumacker*[365] decision.[366] Discrimination in the area of DTCs has to be justified and appropriate just like all other discrimination.[367] Thus, member states do not have the right to override EC law with bilateral treaties[368] because otherwise they would have the possibility to influence the interpretation of the EC Treaty and this they are not allowed to do.[369] Since third states are not bound to the fundamental freedoms, they cannot be prosecuted because of an infringement of the EC Treaty. But the member state involved has the duty to eliminate the discrimination as far as it is able to. If it cannot totally eliminate the discrimination, it is even guilty of an infringement because it ratified the DTC.[370] And the member state may be liable for the damage that resulted from a DTC that violates EC law.[371]

[356] ECJ Case C-270/83 (para. 26); for further details, see III.N.2; ECJ Case C-307/97, conclusions AdvGen (para. 25).
[357] See Jann, *Auswirkungen*, pp 72 et seq; Toifl, *Grundfreiheiten*, p 170; Meilicke, RIW 1989, p 642.
[358] IStR 1995, p 475.
[359] ECJ Case 270/83; for further details, see III.N.2.
[360] ECJ Case C-330/91; for further details, see III.J.2.
[361] See Lang, *Grundfreiheiten*, p 30; Dautzenberg, BB 1992, p 2404; Herzig/Dautzenberg, DB 1992, p 2521; Hinnekens, EC Tax Review 1994, p 161; different opinion, see Thömmes, *Steuerrecht*, p 521.
[362] ECJ Case C-307/97 (para. 57); for further details, see III.O.3.a).
[363] See also Bachmann, RIW 1994, p 858; Thömmes, Intertax 1993, p 614.
[364] See Jann, *Auswirkungen*, pp 54 et seq; Eckhoff, *Diskriminierung*, p 482; Hinnekens, EC Tax Review 1995, p 202.
[365] ECJ Case C-279/93.
[366] Rainer, IStR 1995, p 476.
[367] See Hinnekens, EC Tax Review 1994, p 152.
[368] See Hinnekens, EC Tax Review 1994, p 152; see also I.A.
[369] ECJ Case 22/70; see also de Weerth, RIW 1995, p 928.
[370] See Hinnekens, EC Tax Review 1994, p 162.
[371] See Offermanns, EC Tax Review 1995, p 98.

2. Credit or Exemption Method?

DTCs provide two different methods to avoid double taxation. One method is the credit method. In this method the state of residence taxes the worldwide income and credits the foreign tax payments against the domestic tax burden. The other method is the exemption method in which the state of residence excludes the earnings that are taxed in other states from the tax base. Normally, in the tax rate the state of residence takes the worldwide income into account ('exemption with progression'). The question is whether the EC Treaty prefers one of those methods, or if one of them even leads to discrimination and an infringement of the EC Treaty.

The big advantage of the credit method is that it takes the entire worldwide income into account in the determination of the tax base. Thus, the tax burden can never be higher in any year than it would be without the DTC. The reason for this is that the worldwide income (including foreign permanent establishments) is taken as the tax base. The tax burden is calculated and then foreign tax payments are deducted. In the exemption method the procedure is totally different. In it, the foreign profit and losses are exempt from the tax base. Thus, losses of foreign establishments cannot be deducted from the tax burden.[372] This means that DTCs with credit method are advantageous in that aspect to DTCs with exemption method. DTCs with exemption method can even mean an obstacle in executing the freedom of establishment since it is more advantageous to invest in the state of residence compared to another member state with which the DTC provides the exemption method because in that case the losses – especially because losses are nearly unavoidable in the first years – cannot be used to reduce the domestic tax burden.[373] But that consequence is not 'compulsory' as the Netherlands and Great Britain allow a set off of losses of foreign permanent establishments even if the DTC provides the exemption method. To avoid a doubled utilisation of losses, the Netherlands prescribes that the taxes that have been saved because of the offsetting of foreign losses in previous years have to be paid in the years in that

[372] See Rief, *Auslandsverluste*, p 195.
[373] See Rief, *Auslandsverluste*, p 196; Lang, *DBA*, p 34; Lang/Schuch, *DBA D-Ö*, Vor 1, para. 37.

the loss is set off by the permanent establishment.[374] Such a rule is not needed for credit systems because in later years when the loss is set off by the permanent establishment, there is less foreign tax to credit.[375] The question is whether in Austria there have been, in addition to constitutional also EC law reasons to interpret the exemption method in a way similar to the interpretation in the Netherlands since 1995 because of Austria's accedence to the EU in that year.

The disadvantage of the credit method is that it always burdens the taxpayer with the higher effective tax rate[376] because if the tax rate for the permanent establishment is higher than in the state of residence, only part of the tax payment can be credited and if it is the other way around, the state of residence levies its tax and only that payment that was paid in the state of activity can be credited. Thus, the exemption method also distorts competition.

The question is if one of those methods is an infringement of the EC Treaty. In both methods there is the possibility of an unequal treatment of two cases that are equal except that one is a domestic case and the other one crosses a border within the EC. The exemption method discriminates against losses of foreign permanent establishments. That problem can be solved by introducing the possibility of deducting foreign losses and taxing them in subsequent years. As in this case a less infringing rule is possible and it is settled case law that a DTC rule – exemption- instead of credit method – is no justification for discrimination[377] and all other obvious justifications – tax evasion,[378] more effort for the administration, no mutuality,...[379] – have already been rejected by the ECJ it is possible that the ECJ would see an infringement of the EC Treaty in this rule. At least, this would be quite possible if the ECJ follows the normal scheme of examination. But one may

[374] See Lechner; Die Auswirkungen des EU-Rechts auf die „Befreiung" von Verlusten nach dem Doppelbesteuerungsabkommen; in Gassner/Lang/Lechner (Hrsg.), *Doppelbesteuerunggsabkommen und EU-Recht – Auswirkungen auf die Abkommenspraxis* (1996), pp 90 et seq.
[375] See Saß, BB 1999, p 448.
[376] See Lehner, 'EU-Recht und die Kompetenz zur Beseitigung der Doppelbesteuerung', in Gassner/Lang/Lechner (Hrsg.), *Doppelbesteuerunggsabkommen und EU-Recht – Auswirkungen auf die Abkommenspraxis* (1996), p 19.
[377] For example ECJ Case 270/83; for further details, see III.N.2.
[378] ECJ Case C-264/96; for further details, see III.L.4; see also Saß, BB 1999, p 450.
[379] See II.A.8.b).

question this because of the fact that the ECJ normally avoids taking a clear position on DTCs.[380]

Under the credit method, on the other hand, discrimination is unavoidable if the state of residence levies higher taxes than the state of activity because then the permanent establishment has to bear higher taxes than a competing subsidiary. Thus, the choice of establishing a subsidiary and a permanent establishment is no longer a free one. That restriction of the possibility to choose freely was forbidden by the ECJ in the *Avoir Fiscal* case[381]. But in this case the discrimination originates in the state of residence. That the reason is a rule in a DTC – credit method instead of exemption method – is no justification. And one can deduce from *Daily Mail*[382] that it is irrelevant that the discrimination originates in the state of residence. And even in this case it can be said that a less infringing rule – the exemption method – is possible. But, on the other hand, it has to be noted that in *Gilly*[383] the ECJ did not see a discrimination in higher tax rates. Thus, it is unpredictable how the ECJ would decide in a case concerning the credit method.

That the ECJ intends to allow a cross-border transfer of losses can be seen in the *ICI*[384] and *X-AB & Y-AB*[385] cases, in which the court allowed a transfer of losses between corporations within the EC if that was also allowed if both corporations resided in the same member state.[386] As the transfer of losses between a branch/agency and the parent in one member state is always possible, it could be concluded that the ECJ would characterise the exemption method as an infringement of the EC Treaty. This result is unsatisfactory because it could lead to more DTCs with credit method. But under the exemption method the discrimination is inherent and which, unlike under the exemption method, cannot be eliminated. The Commission also recognised that the situation is unsatisfactory. Thus, it proposed a directive.[387] However, this directive did not

[380] But that habit could have changed, see ECJ Case C-307/97; for further details, see III.O.3.a).
[381] ECJ Case 270/83; for further details, see III.N.2.
[382] ECJ Case 81/87; for further details, see III.D.2.
[383] ECJ Case C-336/96; for further details, see Hohenblum, *Freedom of Movement for Workers*, pp 81 et seq.
[384] ECJ Case C-264/96; for further details, see III.L.4.
[385] ECJ Case C-200/98; for further details, see III.L.5.
[386] Saß, EWS 1998, p 348.
[387] OJ 1991, C 53/30.

make it through the Council.[388] But as present rules of the DTCs are problematic in the light of the fundamental freedoms, it is possible that the directive only has a clarifying character because an infringement of a fundamental freedom occurs and the proposed directive is one way of avoiding that infringement. However, the Commission did not see the problems inherent in the credit method, or at least acknowledged that it is common to DTCs and did not want to go so far as to abolish it. Thus, the directive contained the possibility to transfer losses according to the credit method or according to the exemption method with a deferred taxation of the transferred losses.[389] Another problem of this system is that to secure that losses can be used only once loss carry-forward and carry-back has to be harmonised in Europe.[390] Since this has not happened, the aim of the proposed directive can hardly – only with disadvantages for member states with more lenient rules concerning losses carried forward and back – be reached.[391] *Rief*[392] sees the danger that the state of residence has to finance tax privileges of the state of activity. But I do not see a real problem here because this financing has only a temporary effect that is equally distributed between the member states. And it cannot be the intention of a member state to reduce the tax bases to a negative result because that would also influence resident companies and, thus, the tax revenue would dry up.

3. Application of DTCs to Persons Subject to Limited Tax Liability

Until recently, the majority opinion was that the advantages of DTCs are only granted to taxpayers subject to unlimited tax liability in at least one of the contracting states.[393] But it has been claimed for a long time that those advantages are also granted to non-residents. Some authors think that that claim can be sustained under the non-discrimination provision of DTCs. This is, of course, even more obvious if nationals of EC member states are concerned because they are protected by the non-discrimination prohibitions of the EC

[388] See Saß, DB 1993, p 121.
[389] See Rief, *Auslandsverluste*, p 200 et seq.
[390] See Rief, *Auslandsverluste*, p 221.
[391] For further details, see Rief, *Auslandsverluste*, p 199; see also Saß, DB 1993, p 119.
[392] *Auslandsverluste*, pp 209 et seq.
[393] See Schuch, *Organschaft*, p 177; Jann, *Auswirkungen*, p 46.

Treaty.[394] Additionally, it is easier for EU citizens to enforce their rights because in that case there is the possibility of requesting a preliminary ruling from the ECJ.[395] That problem is relevant for triangular cases. These are cases in which a parent has a permanent establishment in another member state which again earns profits in a third (member) state. The problem is that the DTC of the third state and the state of the parent cannot lead to the necessary relief because the parent has not got the right to tax (in the case of an exemption method) or credits the taxes of (in the case of a credit method) the earnings of the permanent establishment because of the DTC with the state of the permanent establishment. Thus, it cannot exempt the earnings twice / the credit is restricted because it is primarily set off by the earnings of the permanent establishment.[396] Therefore, double taxation still can occur. Hence, the state of the permanent establishment has to grant the advantages of its DTC with the third state to avoid a double taxation. *Meilicke*[397] even reasons that the granting of privileges resulting from a DTC to non-residents is a logical consequence of the *Avoir Fiscal* case. As the exclusion of permanent establishments of a DTC is clearly a disadvantage to resident companies, the question is whether this discrimination can be justified. The strict use of the 'coherence principle'[398] does not provide a possibility to justify an exclusion of the advantages of a DTC.[399] A justification because the difference in treatment is based on a DTC is impossible.[400] Other justifications are also improbable.[401] Additionally, a violation of the EC Treaty could be seen because art. 293 EC Treaty provides that member states must enter into negotiations to abolish double taxation.[402] But it is agreed by legal commentators that art. 293 does not grant individual rights EU citizen.[403]

[394] See Lang, *DBA*, p 33; Schuch, *Organschaft*, p 197; Staringer, *Triangular Cases*, p 85; Jann, *Auswirkungen*, p 81; Lang/Schuch, *DBA D-Ö*, Vor 1, para. 35.
[395] See Staringer, *Triangular Cases*, p 86.
[396] Staringer, *Triangular Cases*, pp 74 et seq; Saß, DB 1992, p 863.
[397] RIW 1989, p 643.
[398] For further details, see II.A.8.b).
[399] See also Jann, *Auswirkungen*, p 77.
[400] See III.O.1.
[401] See Jann, *Auswirkungen*, p 81.
[402] See Lechner, *Harmonisierung*, p 5.
[403] ECJ Case 137/84 (para. 11); ECJ Case C-336/96 (paras. 16 et seq).

a) Saint Gobain

The *Saint Gobain*[404] case put an end to the uncertainty because the ECJ examined these problems. This was the first case in which the ECJ expressly dealt with DTCs.[405]

(1) Facts

St. Gobain ran a permanent establishment in Germany. Several shares of foreign corporations were part of the assets of the permanent establishment. But St. Gobain was denied the tax exemption for those shares that was granted to German corporations because of German national tax law and German DTCs.

(2) Decision of the ECJ

The differentiation between taxpayers subject to unlimited and limited tax liability led to disadvantages for non-residents[406] because they were denied an exemption for assets and earnings from taxable income. Foreign corporations were not able to get the same tax privileges as German corporations even if they fulfilled all the other requirements.[407] Thus, the seat of the corporation was the only difference between the foreign and the domestic corporation.[408] This made permanent establishments less attractive[409] and therefore was a possible violation of the freedom of establishment.[410] The German government replied that the differentiation was justified because there was a different tax system for taxpayers subject to limited and unlimited tax liability.[411] Additionally, the Portuguese government claimed that that not granting of tax privileges is offset by an advantage – that the transfer of profits of permanent establishments to the headquarter cannot be taxed in contrast to the distribution of dividends – and, thus, coherence was an issue.[412] Here, it has to be mentioned that taxation of dividends of subsidiaries that belong totally to their parent – which is also true for a

[404] ECJ Case C-307/97.
[405] See Thömmes, 'European Court of Justice to Decide on Discrimination of Permanent Establishments', Intertax 1997, p 452.
[406] ECJ Case C-307/97, conclusions AdvGen (para. 37).
[407] ECJ Case C-307/97 (paras. 36 & 38).
[408] ECJ Case C-307/97 (para. 37).
[409] ECJ Case C-307/97 (para. 42).
[410] ECJ Case C-307/97 (para. 34); ECJ 270/83; see also Blumenberg, Tax Notes International 1997, p 1029.
[411] ECJ Case C-307/97, conclusions AdvGen (para. 39).
[412] ECJ Case C-307/97, conclusions AdvGen (para. 65).

permanent establishment – may not be taxed anymore under the 'Parent-Subsidiary' Directive.[413] Germany also claimed that it is the duty of the state of residence to eliminate double taxation.[414] Furthermore, the elimination would lead to a drop in Germany's tax revenue.[415] But the ECJ stated that avoiding loss of tax revenue is not a justification.[416] Additionally, compensation by other advantages is not a justification, either.[417] A justification based on the 'coherence principle' is not possible, either, because the taxation of dividends is a taxation of the parent and not of the subsidiary. Thus, another taxpayer profits from the advantage that the dividends are not taxed. Therefore, coherence is not possible.[418] Moreover, there is no reason why the state of residence should grant a relief because it already relieves the income of the permanent establishment.[419] And it is impossible for the state to grant relief twice for one income – for the permanent establishment including the shares and additionally for the shares. And it is not a possible justification that another member state also has the possibility to avoid discrimination.[420] The ECJ also stated that the differences in the tax system for residents and non-residents were not big enough to justify a differentiation in this case.[421] Additionally, a DTC is not a justification for discrimination.[422] And as the liability to tax is independent of the state of residence, the avoidance of double taxation has to be independent of the residence, too.[423] As no justification was present, the rules were an infringement of the EC Treaty.[424] Thus, the ECJ agreed with the argumentation provided in III.O.1 and stated – one could say once again – that DTCs are no justification for discrimination. Therefore, advantages resulting from a DTC have to be granted to permanent establishments to avoid a violation of the EC Treaty.[425]

[413] 90/435/EEC, OJ 1990 L 225/6.
[414] ECJ Case C-307/97, conclusions AdvGen (para. 56).
[415] ECJ Case C-307/97, conclusions AdvGen (para. 57).
[416] ECJ Case C-307/97 (para. 50).
[417] ECJ Case C-307/97 (para. 53); established case law; for example ECJ 270/83.
[418] ECJ Case C-307/97, conclusions AdvGen (paras. 69 et seq).
[419] ECJ Case C-307/97, conclusions AdvGen (para. 61).
[420] ECJ Case C-307/97, conclusions AdvGen (para. 62).
[421] ECJ Case C-307/97 (para. 48).
[422] ECJ Case C-307/97, conclusions AdvGen (para. 25); see also III.O.1.
[423] ECJ Case C-307/97, conclusions AdvGen (para. 51).
[424] ECJ Case C-307/97 (para. 43).
[425] ECJ Case C-307/97 (para. 58); Lausterer, 'Saint.Gobain: Betriebsstättendiskrimierung', IStR 1997, p 560.

(3) Effects on DTCs

Since it is up to the state of activity – the state of the permanent establishment – to eliminate discrimination, it has to grant privileges to taxpayers subject to limited tax liability on a unilateral basis which it restricted to taxpayers subject to unlimited tax liability until now with the argument that they are granted because of DTCs.[426] That is necessary although taxpayers subject to limited tax liability are normally not included by the scope of DTCs. Even though this consequence is only relevant for those DTC partners that are member states, it can also be applied for the advantages that are granted by member states in DTCs with third states since the balance of DTCs is not distorted by unilateral measures.[427] For discrimination resulting from advantages granted by the third state, the member state may be liable because it signed the treaty.[428] Furthermore, anti-abuse measures are often taken as justification for the exemption of non-residents from the advantages of DTCs.[429] The same reasoning holds for subsidiaries with a foreign parent.[430] But normally anti-abuse rules are too general to be a possible justification.[431]

b) Conclusions

From the *St. Gobain* decision on, it should be clear that non-residents are able to rely on rules of DTCs to get those privileges.[432] But only time can tell if that consequence is accepted by the administration itself or if it will take another decision of the ECJ or VwGH – or at least attentive tax counsellors – to get the resulting advantages for the taxpayers subject to limited tax liability. But in Austria it is very probable that the administration will apply it without additional pressure

[426] ECJ Case C-307/97 (para. 58); N. N., 'Kommentar zu EuGH Rs. C-307/97', FR 1999, p 1144; de Weerth, 'Das EuGH-Urteil Rs. C-307/97 „Saint Gobain"', IStR 1999, p 628; Haunold/Tumpel/Widhalm, 'News aus der EU', p 507.
[427] ECJ Case C-307/97 (para. 59).
[428] For further information see III.O.1.
[429] See Hinnekens, EC Tax Review 1994, p 152.
[430] See Essers, in Hinnekens, EC Tax Review 1995, p 97.
[431] See Prechal, in Hinnekens, EC Tax Review 1995, p 98.
[432] See also Schuch, 'Gemeinschaftsrecht verschafft beschränkt Steuerpflichtigen Abkommensberechtigung', SWI 1999, p 451.

because it already granted advantages of DTCs to taxpayers subject to limited tax liability because of an decree.[433]

Additionally, there is another consequence that could make triangular cases advantageous for tax reasons. A corporation resides in member state R, has a permanent establishment in member state A which earns passive income in member state S. If the DTC R-A exempts the permanent establishment's income, the DTC A-S exempts passive income and the DTC R-S credits the tax payments on passive income but restricts S's source tax to 5 per cent, the passive income is only taxed at 5 per cent. The reason for this is that the passive income is earned by the permanent establishment, which is part of the corporation that resides in R. Thus, S applies the DTC R-S and restricts the taxation to 5 per cent. But R exempts all income of the permanent establishment – including the passive income. And A applies its DTC with S and, thus, exempts the passive income, too. This unsatisfying solution for the member states can only be eliminated by harmonising DTCs, a multilateral DTC, or maybe by the possible case law of the ECJ concerning most-favoured-nation clauses.[434]

Since the legislator is committed to changing national law although discrimination can be avoided by a direct application of the EC Treaty,[435] it can be argued that DTCs should be changed because they are not substantially different from national law.[436] Thus, all DTCs between the member states themselves and with third states would have to be renegotiated. A clause would have to be inserted that grants permanent establishments entitlement to the DTC. Since that would mean that (nearly) all DTCs within the EC would have to be renegotiated, this opportunity should be used to introduce a multilateral DTC.[437] If a member state fails to renegotiate, it has to grant permanent establishments the advantages it grants enterprises by domestic law. If it does not even start to renegotiate it is even possible that the member state will be liable for costs occurring because of disadvantages that are the fault of a third country. In the light of the *Saint Gobain*

[433] See BMF, 'Österreichische KG mit britischer Betriebsstätte und deutschen Gesellschaftern', SWI 1999, p 289.
[434] Jann/Toifl, 'EuGH entscheidet über Abkommensberechtigung von Betriebsstätten', SWI 1999, p 493 do not see that problem, because they think that S should apply the DTC S-A.
[435] See I.A.
[436] See III.O.1.
[437] See III.O.4.d).

decision, limitation of benifits (LOB) clauses[438] that only grant special advantages if the enterprise conducts most business in the state of residence, are very questionable. *Jann/Toifl*[439] do not think that DTCs have to be renegotiated because it should be enough to grant such equal treatment by domestic law. But in that case the permanent establishment could still be treated less favourably by the third state – especially in the case of an active trade or business clause. Thus, *Jann/Toifl* implicitly deny that the member state discriminates permanent establishments simply by signing DTCs which have the consequence that the third state discriminates against permanent establishments.

4. Most-Favoured-Nation Clause (MFN)

The question with respect to MFNs is whether a member state may treat a citizen of one member state more advantageously than a citizen of another member state. Thus, in this case the question is if the ECJ characterises a discrimination of a non-resident citizen of one member state against another non-resident citizen of another member state as an infringement of the EC Treaty. That question is very relevant because DTCs vary between different member states. Therefore, member state A has different rules in DTCs with member state B and C. Thus, citizen of B may be discriminated against in relation to citizen of C, but not in relation to citizen of A, because A has given up its right to tax income that it would tax in the hands of home nationals.[440] The question is now if the EC Treaty enables a national of member state B to rely on a rule of the DTC between A and C because that would grant a more advantageous taxation.[441] Until now, the ECJ has avoided making a statement of its position on an MFN in DTCs.[442] But a decision probably cannot be avoided for eternity. On the other hand, MFNs are common in other areas. Community preference forbids a member state to treat a non-resident citizen of one member state less favourably than a non-resident

[438] See for example art. 16 DTC Austria-USA.
[439] SWI 1999, p 492.
[440] See Herzig/Dautzenberg, DB 1992, p 2521.
[441] See also Lang/Schuch, *DBA D-Ö*, Vor 1, para. 36.
[442] See Lang, *Erbschaften*, p 272; Thömmes, *Diskriminierung*, pp 101 et seq.

citizen of another member state.[443] And there is no obvious reason why this established case law of the ECJ[444] should not be enlarged to DTCs.

a) Applying Rules of DTCs with Member States Because of MFNs

Since in those cases a discrimination of a national of one member state against a national of another member state by a third member state, occurs, the question is if those two taxpayers are comparable. An argument for this is that art. 12 EC Treaty prohibits any discrimination on grounds of nationality. That means that not only the discrimination of a foreigner against a home national, but also all discrimination of two foreigners because of their nationality is prohibited. The problem is that art. 12 is only applicable if no other rule is applicable. Thus, for tax purposes, one of the fundamental freedom always prevails.[445] But those fundamental freedoms do not contain such an exact definition of discrimination. Thus, it is not sure if discrimination of two nationals of different – foreign – member states are prohibited by the fundamental freedoms. An argument for this thesis is that the fundamental freedoms are a special expression of the general rule of art. 12.[446] For the freedom to provide services it is even expressly mentioned in art. 54 EC Treaty that member states may not discriminate on grounds of nationality. And that can be interpreted as the duty to treat citizens of two foreign member states equally.[447] Additionally, different DTC rules distort the competition[448] and grant nationals of different states varying possibilities to gain access to a member state. And that is exactly what the EC Treaty is meant to prevent. Thus, it is probably also possible to compare two non-resident taxpayers.[449] As comparability and discrimination are given, the critical problem is once again the possibility of a justification.[450] There are no additional justifications in DTCs,[451] and most normal justifications – a loss of tax revenue is probably the most important one in this

[443] See Hinnekens, EC Tax Review 1994, p 152.
[444] For example ECJ Case 235/87, in which a citizen of one member state may rely on a bilateral treaty of another member state.
[445] For further details, see I.D.1.
[446] ECJ C-112/91 (para. 20).
[447] See Randelzhofer, in Grabitz/Hilf, *EU,* Art. 65, para. 1.
[448] See Saß, 'Zielkonflikte bei der Besteuerung in der EU', SWI 1996, p 112; Herzig/Dautzenberg, DB 1992, p 2520.
[449] See also Schuch, *Meistbegünstigung*, p 116.
[450] See also Herzig/Dautzenberg, DB 1992, p 2522.
[451] See III.O.1.

case – have been rejected by the ECJ[452] and a general denial of an MFN is too general for anti-abuse to be a possible justification. Furthermore, the member states cannot argue that the granting of that advantage is incompatible to the tax system because it has been granted to a citizen of another member state.[453] Thus, the advantages of other DTCs have to be granted to all EU citizens.[454] The primary consequence of the application of an MFN would be that the taxpayer would have to search through all DTCs of the state of activity to find the most advantageous rule for every case. That would lead to an additional loss of tax revenue. And this would be an additional incentive for all member states to get together and negotiate one multilateral DTC for all member states.[455] But for that to be practicable national tax systems would have to be harmonised at least with respect to their main features because otherwise it is nearly impossible to set a common DTC – like a roof – above them. Thus, an MFN could lead to a 'boost' in harmonising tax systems across Europe. One could argue that those consequences could lead the ECJ to reconsider giving a positive decision on MFNs. But it has to be said that the ECJ is a court that is extremely adapting and advancing the application of the EC Treaty if that is necessary to abolish discrimination. Thus, this argument would probably not influence the decision since the ECJ is only committed to a successful implementation of the EC Treaty. An additional argument that the ECJ could rule in favour of the MFN is that it has stated that a coherence is only possible if it exists on a DTC level. Furthermore, the question of MFNs was also brought up by Kaefer, the advocate of Schumacker in the *Schumacker* case[456].[457] The reporting judge also emphasised this issue.[458] But the ECJ skirted of explicitly deciding about an MFN.[459] Nevertheless, the decision has the same effect as an MFN. Therefore, this can be an indication that the ECJ would rule in favour of an MFN but is hesitating as long as it can because of the consequences of such a decision.[460] Thus, it can be reasoned that discrimination can only be justified if the advantage is not granted to citizens of

[452] See II.A.8.
[453] See Herzig/Dutzenberg, DB 1992, p 2522.
[454] See Schuch, *Meistbegünstigung*, p 135.
[455] See, for example, Hinnekens, EC Tax Review 1994, p 164.
[456] ECJ Case C-279/93.
[457] See Rädler, FR 1994, p 706.
[458] See Rädler, FR 1994, p 708.
[459] See also Thömmes, *EuGH- Rechtsprechung*, p 188.
[460] See also Rädler, 'Fragen aus dem Schumacker-Urteil des EuGH', DB 1995, p 796.

any member state. This would mean that advantages have to be granted to all EU citizens or to none and that would lead to an MFN.[461] On the other hand, *Saß*[462] argues that an application of an MFN could lead to double non-taxation cases – for example, an Austrian corporation that gets, under the DTC GB-Italy, the tax of the British subsidiary refunded and additionally those earnings are exempt under § 10 (2) KStG in Austria. In those cases a discrimination is eliminated but a distortion of competition is created.[463] On the other hand, it can be argued that in that specific case the ECJ would not grant an MFN because the domestic legal position of the Austrian corporation is not comparable to the one of the Italian corporation. *Vogel*[464] reasons that the MFN can also lead to total tax-free profits. But it seems that he interprets MFN in such a way that the taxpayer may choose the DTC that the state of activity has to apply and additionally even another DTC that the state of residence has to apply to the same case. Otherwise, it is impossible that profits could be tax-free because every DTC assigns the authority to tax to the first or the second state. Thus, such a situation can only result from the interplay of the different DTCs and domestic law. *Vogel*[465] acknowledges the problems of different DTCs and, thus, argues for a multilateral DTC. But I think that such a 'boost' in harmonisation cannot be achieved without the pressure that results from a pro-MFN decision of the ECJ. On the other hand, it has to be considered that the ECJ is more willing to grant double advantages than to allow discrimination. Additionally it is up to the (EC) legislator to eliminate such double advantages by further harmonisation. Furthermore, even *Jacobs*[466] who is a critic of the MFN concept in DTCs admits that with increasing integration it will be impossible to avoid MFNs, or preferably a multilateral DTC, forever.[467]

(1) Halliburton

(a) Facts

A group of companies reorganised. One consequence was that the Dutch permanent establishment was changed into a subsidiary. Transfers caused by

[461] Consent: Hinnekens, EC Tax Review 1994, p 153; Rädler, EC Tax Review 1995, p 67.
[462] SWI 1996, p 111 et seq.
[463] See also Jacobs, *Unternehmensbesteuerung*[4], p 210.
[464] 'Problems of a Most-Favoured-Nation Clause in Intra-EU Treaty Law', EC Tax Review 1995, p 264.
[465] EC Tax Review 1995, pp 264 et seq.
[466] *Unternehmensbesteuerung*[4], pp 227 et seq.

reorganising groups of companies were exempt of land purchase tax. But one prerequisite was that the real estate was passed from one Dutch corporation to another Dutch corporation. Additionally, taxation because of the reason that one of the involved corporations was an US corporation was impossible because that was impeded by the DTC Netherlands-USA.[468] Nevertheless, the exemption was not granted because the donating corporation was a German one.

(b) Decision of the ECJ

The denial of the exclusion of the land purchase tax leads to a lower price that would have been achievable.[469] Therefore, it is discrimination with relation to a case where the donating corporation was a Dutch or US one. Thus, art. 43 et seq was applied, although the selling only served the internal reorganisation.[470] The reason for the application of the EC Treaty was that a German corporation was indirectly affected.[471] As justification it was argued that the area has not been harmonised yet[472] and that the effort necessary for comparing the legal forms of companies across Europe would be too high.[473] But the ECJ stated that the absence of harmonising measures is no justification for the member states to neglect the comparison if the legal forms are similar[474] and that the higher effort for the tax administration is no justification.[475] Thus, an infringement of the EC Treaty had occurred.

(c) Effects on DTCs

According to *Schuch*[476] and *Hinnekens*,[477] the considerations of the ECJ and the AdvGen[478] show that the ECJ is in favour of an MFN because the effect was the same as if it applied a rule of the DTC Netherlands – USA to a German corporation.

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[467] See also Lehner, *Resümee*, p 264.
[468] ECJ Case C-1/93 (para. 6).
[469] ECJ Case C-1/93 (para. 19).
[470] ECJ Case C-1/93, conclusions AdvGen (para. 21).
[471] ECJ Case C-1/93 (para.20); see also Toifl, *Wegzugsbesteuerung*, p 158.
[472] ECJ Case C-1/93, conclusions AdvGen (para. 34).
[473] ECJ Case C-1/93 (para. 21).
[474] ECJ Case C-1/93, conclusions AdvGen (paras. 41 et seq).
[475] ECJ Case C-1/93 (para. 22).
[476] *Meistbegünstigung*, p 134.
[477] EC Tax Review 1994, p 153.
[478] ECJ Case C-1/93, conclusions AdvGen (para. 46).

(2) Metallgesellschaft and Hoechst

(a) Facts

For dividend payments the corporation had to pay advance corporation tax within a fortnight. The tax base for that advance corporation tax was the dividend payment. That advance payment could be charged against the corporation tax payment of that year at the earliest and that payment was due at least 8½ months later. But, if the parent is a British corporation, both corporations can opt for group taxation. As a consequence, there is no payment of advance corporation tax. If they do not so opt, the British parent obtains a tax credit that it can charge against its own advance corporation tax. Thus, the parent does not have to pay additional advance corporation tax at the distribution of its profits. Some DTCs grant the tax credit to foreign corporation. If their British tax credit exceeds their tax, the excess part can be refunded.

In the combined cases *Metallgesellschaft*[479] and *Hoechst*[480] the two German corporations claim that restriction of group taxation to British corporations is an infringement of the freedom of establishment. If this claim is rejected, they claim to be treated like corporations of member states that obtain a tax credit because of a DTC.

(b) Possible Decision of the ECJ

Adapting the principle of the decisions in *ICI*[481] and *X-AB & Y-AB*[482] that group taxation may not be forbidden because some subsidiaries have their seat in other member states, I think that it is probable that the ECJ will decide the first question in favour of the plaintiff. The impossibility to opt for group taxation, or to get a tax credit, is an obvious disadvantage. The only distinctive feature is the seat of the parent. Thus, discrimination occurs. A justification that has not already been rejected in *ICI* or in other cases cannot be seen. The denial of granting a tax credit in particular cannot be justified since it is granted in some DTCs. Therefore, this discrimination is an infringement of the EC Treaty. Thus, I assume that the ECJ will characterise the restriction of group taxation to domestic cases as a violation

[479] ECJ Case C-397/98.
[480] ECJ Case C-410/98.
[481] ECJ Case C-264/96; for further details, see III.L.4; see also Hahn, IStR 1999, p 61.
[482] ECJ Case C-200/98; for further details, see III.L.5.

of the EC Treaty with the consequence that it has to be possible for corporations with a parent in another member state to deny the payment of advance corporation tax. Another reason for the likelihood of that decision is that with this decision the ECJ can avoid taking a clear position on the application of an MFN to DTCs.

(c) Possible Effects on DTCs

Since it is nearly established case law of the ECJ to avoid a statement concerning MFNs and DTCs, it is quite probable that it will use the possibility to avoid such a statement in this decision once again. Nevertheless, it is of course possible that the ECJ will take this opportunity to give an explicit statement concerning MFNs. But even if it avoids an explicit statement this decision may give hints as to what the ECJ's opinion concerning MFNs and DTCs is. If it is argued that the discrimination is not justified because the advantage is granted to nationals of some (member) states, it is a clear sign that the ECJ is in favour of an application of MFNs in DTCs. That is even true if that argument only concerns the domestic rule because every advantage of a DTC can be granted by domestic law.[483]

b) Applying Rules of DTCs with Third States Because of MFNs

It is generally agreed that non-EU citizens may not be treated more favourably than EU citizens.[484] This is called 'community preference'. It is not explicitly laid down in the EC Treaty but was developed by legal commentators and the ECJ.[485] Thus, taxpayers of third states may not be privileged compared to EU citizens, either. Consequently, DTCs with third states may not contain more favourable rules than DTCs with member states. Thus, such preferential treatment is discriminating and those rules can also be relied upon in the concept of MFN.[486] The only justification for more favourable rules in DTCs with third states that I can imagine is development aid. Development aid is accepted across Europe. It can be granted by direct payments or by incentives for corporations to do business in

[483] For further details, see III.O.1.
[484] See Rief, *Auslandsverluste*, pp 197 et seq.
[485] See Hinnekens, EC Tax Review 1994, p 152.

those countries. One of those incentives are tax privileges that are granted in DTCs. Thus, this is a possible justification for the ECJ. But for all rules that are not development aid, it should be possible to take them into account in MFNs.

c) §§ 48 & 236 BAO

To avoid higher tax burdens because of different rules in DTCs the tax administration could lower taxes under §§ 48 & 236 BAO (Bundesabgabenordnung – Federal Fiscal Code). §§ 48 & 236 could also be applied in other cases to avoid discrimination. They are discussed here because the primary historical reason for § 48 BAO was to avoid double taxation if there was no DTC. But the problem with § 48 BAO for a long was time that it was reserved for residents[487] and to mutual treatment of Austrian taxpayers in the other country. But this has now, at least partly, changed.[488] Nevertheless, there is still the problem that §§ 48 & 236 BAO basically grant discretionary power to the tax administration and, thus, the taxpayer does not have an entitlement. Some authors argue that the application of §§ 48 & 236 BAO is enough to avoid a discrimination. They reason that there are constitutional limits to discretionary power[489] that derives from art. 7 (1) B-VG (Bundes-Verfassungsgesetz – Federal Constitutional Act).[490] Furthermore, there are limits because the EC Treaty has to be applied by the administration.[491] Thus, discriminatory use is impossible. But it has to be said that in *Commission / Luxembourg*[492] AdvGen *Jacobs* argued that discriminatory rules have to be abolished by binding rules.[493] Thus, a rule that grants discretionary power is not enough. It is quite probable that the Luxembourg constitution contains similar limits to arbitrariness like the Austrian constitution, but that was not seen as a justification.[494] And the argument that the EC Treaty sets limits to the discretionary powers of the administration has already been rejected in *Commission / Italy*[495]. Additionally, the purpose of §§ 48 & 236 BAO is to eliminate individual excessive tax burdens but not to correct systematic

[486] See also ECJ Case C-1/93; for further details, see III.O.4.a)(1).
[487] See Berger, SWI 1995, p 344.
[488] See BMF, SWI 1999, p 289.
[489] See also Funk, *Verfassungsrecht*[9], pp 193 et seq.
[490] See Funk, *Verfassungsrecht*[9], p 281.
[491] See Toifl, SWI 1995, p 429.
[492] ECJ Case C-151/94.
[493] ECJ Case C-151/94, conclusions AdvGen (para. 17); see also Toifl, SWI 1995, p 426.
[494] ECJ Case C-151/94, conclusions AdvGen (para. 23).

problems.[496] And that purpose is also recognised by the ECJ.[497] Thus, the possibility to rely on §§ 48 & 236 BAO is probably not enough to eliminate or justify discrimination.[498] Furthermore, the *Futura-Singer*[499] and the *Safir*[500] decisions can be interpreted to mean that additional effort in the procedure is an infringement.[501] And the need to claim the application of §§ 48 or 236 BAO can be seen as such an additional effort.

d) Conclusions

The application of an MFN is necessary because of the fundamental freedoms. Thus, it has to be applied by the administration from the first instance on.[502] But in practice it is not applied by the tax administration. And that practice will not change until the ECJ takes a clear position in favour of applying an MFN to DTCs. An interesting question is if an MFN can be used to transfer as many profits as possible to low-tax member states. That could be argued along the lines of AdvGen *Mancini* in the *Avoir Fiscal* case,[503] at least if the less favourable treatment is seen on the level of the individual taxpayer. But the ECJ stated in *Gilly*[504] that different tax rates are not discrimination and that a possible MFN in a DTC may not be used to transfer profits to member states to minimise the tax burden.[505]

If the ECJ finally decides to make up its mind concerning an MFN in DTCs and its decision is in favour of MFNs this would lead to a 'boost' in harmonisation. An MFN is not favoured by the member states because the taxpayer may pick the best rules from different DTCs. To end this unsatisfactory situation, the member states would probably be willing to enter into negotiations for a multilateral DTC,[506] or at least harmonise DTCs. Such harmonisation has to be accompanied by a

[495] ECJ Case 168/85 (para. 13).
[496] See Werndl, WBl 1995, p 230.
[497] ECJ Case C-151/94, conclusions AdvGen (para. 20).
[498] See also Toifl, SWI 1997, p 321; Toifl, SWI 1995, p 429.
[499] ECJ Case C-250/95; for further details, see III.J.4.
[500] ECJ Case C-118/96; for further details, see III.G.3.
[501] Anido/Carrero, EC Tax Review 1999, p 31; Rainer, IStR 1998, p 301.
[502] See Toifl, *Grundfreiheiten*, p 178; Lechner, *Harmonisierung*, p 9.
[503] ECJ Case 270/83, conclusions AdvGen (para. 4); for further details, see III.N.2.
[504] ECJ Case C-336/96; for further details, see Hohenblum, *Freedom of Movement for Workers*, pp 81 et seq.
[505] See Toifl, SWI 1999, p 157; Thömmes, *EuGH-Rechtsprechung*, pp 190 et seq.
[506] See Lang, IWB 1996, F 11, G 2, p 670; Saß, SWI 1996, p 112.

harmonisation of basic features of national tax law because otherwise the multilateral DTC probably could not be linked to the national tax systems.[507]

[507] See Saß, SWI 1996, p 113; Saß, DB 1992, p 863; Hinnekens, EC Tax Review 1994, p 154; Thömmes, contribution to the discussion, in Thömmes, *Diskriminierung*, p 112.

IV. Summary and Conclusions

A. *Influence of the Fundamental Freedoms*

The fundamental freedoms forbid discrimination. But the term 'discrimination' has been enlarged step by step. At first it was enlarged by adding covert discrimination – discrimination that is not based on nationality itself. Later additional comparable items were added. In the beginning, residents without a link to the EC were compared with non-residents. Later, residents without a link to the EC were also compared with residents with a link to the EC. And now it is probable that the ECJ will also allow comparison of non-residents with non-residents and maybe even a resident with a link to the EC with another resident with another link to the EC. With this measure the ECJ enlarged the scope of the fundamental freedoms. Thus, more activities were protected by the prohibition of discrimination. Through this enlargement of the scope the legislators of the member states were forced to adapt their legal systems to the demands of the ECJ. In some parts of the legal system – and, thus, also the tax system – this led to harmonising without secondary law because there was only one way to fulfil the demands of the ECJ. But even in that area discrimination is still present because often the requirements of the ECJ are not clear cut and the infringement of EC law is not obvious. Thus, often a citizen is needed to show that there is discrimination and to appeal to the EC Treaty. Because only the following decision of the ECJ can show if a discrimination is at hand.

The situation is even more hopeless if there is more than one way to fulfil the requirements of the ECJ. In these cases discrimination can result from the interplay of different rules in the member states. The problem is that every rule may be in accordance with the EC Treaty on its own. But the connection with the different rule in another member state leads to discrimination. In those cases the ECJ cannot act as motor of integration because no member state can be blamed for what another member state does or omits. In those cases EC-wide harmonisation – through secondary EC law – is needed to eliminate distortion in the common market.

B. Probable Harmonisation

In direct taxation harmonisation is very hard to achieve. The reason is that taxation is very vital for the governments of the member states. Without the competence to tax the member states are not able to determine their revenue and giving away the competence to tax would also mean abandoning major means to realise political influence and control. But harmonisation of the framework of direct taxation is important to avoid distortions in competition. Different tax systems somehow also contradict the concept of one common market, especially in the light of one currency in eleven member states. Nevertheless, such broad harmonisation does not seem to be achievable in the near future. The Commission has not even proposed it because the Council is not even able to agree on details of harmonisation, like taxation of interests and royalties, the cross-border transfer of losses, or even the harmonisation of loss carry forward and carry back.

In the near future harmonisation is only probable in areas where it is not badly needed. This means in areas in which the ECJ is able to abolish discrimination. Thus, tax revenue is decreasing in all member states. Therefore, they will be more willing to agree on harmonisation to secure their tax revenue. One example is that a possible decision of the ECJ for applying an MFN in DTCs may lead to a harmonised, multilateral DTC. But in that case a broader harmonisation would have to be the next – or, better, first – step because a multilateral DTC on totally different tax systems would be like a roof on a house with walls of different height. Such a broader harmonisation may lead to equal tax burdens across Europe. But this will still take a giant leap for European mankind, because in the long run it could lead to a ‘harmonisation’ of tax revenue. This would have to lead to a convergence in the social systems and in politics in general. Therefore, sovereign member states would become obsolete and they would become mere federal states. Nevertheless, it has to be said that such a harmonisation of the tax burden must not be restricted to the tax rate but has to take the determination of the taxable base into account, too.

C. Conclusions

A real harmonisation of tax law in Europe is not in sight. And the national systems are not free of discrimination. Thus, it is up to the taxpayer, his advisor, the legal commentators and the ECJ to show and abolish discriminatory rules. This development really started only a few years ago because in the last years the number of cases that concern tax law submitted to the ECJ has risen significantly. With that in mind, EC law is becoming more and more important for tax law and every domestic rule has to fulfil the standards of the ECJ. Additionally, it is up to the ECJ to further enlarge the scope of the fundamental freedoms to be able to abolish still more discriminatory domestic rules.

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