

## RESIDENTS AND NON-RESIDENTS IN THE DIRECT TAX JURISPRUDENCE OF THE ECJ:

### A PATH THROUGH COMPARABILITY

SUMMARY: 1. Introduction; 2. EU freedoms and the “national treatment” principle; 3. Comparability in the “host-State” environment; 3.1. *Avoir Fiscal*; 3.2. *Schumacker*; 3.2.1. The Opinion of AG Léger; 3.2.2. ECJ’s decision; 3.3. *Gschwind (vs. Schumacker)*; 3.4. Further consideration of comparability: *Asscher and Gerritse*; 3.5. National treatment and the interaction of DTTs with domestic provisions; 3.5.1. *Saint-Gobain*; 3.5.2. *Bouanich*; 3.6. Looking at *Schumacker* and *Saint-Gobain* in light of *Bouanich*; 3.7. Different treatment of interest payments, based on the residence of the recipients: *Truck Center* (as a follow-up of *ACT IV GLO*); 4. Comparability in the “origin-State” environment; 4.1. Inbound dividend cases: *Lenz, Manninen*, and *FII1*; 4.2. Interest deduction cases: *Bosal* and *Keller*; 4.3. Loss-relief cases: *Marks & Spencer* and *X Holding*; 5. “Host-State” vs. “origin-State”: (direct and indirect) discrimination and restriction; 6. Conclusions.

“In relation to direct taxes, the situations of residents and of non-residents are not, as a rule, comparable” (*Schumacker*, 31).

“The position is different (...) where the non-resident receives no significant income in the State of his residence” (*Schumacker*, 36).

“It is settled law that discrimination arises through the application of different rules to comparable situations or the application of the same rule to different situations” (*Wielockx*, 17).

“(…) [I]t needs to be examined whether (...) the difference in treatment of a shareholder (...) relates to situations which are not objectively comparable” (*Manninen*, 32).

#### 1. INTRODUCTION

According to a long-established principle of international law, residents and non-residents for tax purposes are not comparable.

The Court of Justice of the European Union (hereafter “ECJ”), however, has made it clear that, even though this principle stands as a general rule also within the EU, there are situations in which comparability between residents and non-residents can be set.

The present research considers to what extent the ECJ has held that such comparability occurs, and is formed of five sections: the first section gives account of the legal framework of EU freedoms; in the second one, cases where residents and

non-residents have been compared are analyzed; the third one provides the analysis of cases involving residents who exercised EU freedoms, treated less favorably than residents of the same Member State (hereafter “MS”) who did not; the fourth section draws categories of ECJ cases, and their differences; the last one provides some conclusions.

## 2. EU FREEDOMS AND THE “NATIONAL TREATMENT” PRINCIPLE

The Treaty on the Functioning of the European Union (hereafter “TFEU”) provides for that freedom of movement for workers shall be secured within the EU, and any discrimination on the grounds of nationality shall be abolished (Art. 45); restrictions on the freedom of establishment of nationals of a Member State and of companies incorporated under the law of a MS shall be prohibited, the freedom applying to restrictions on the setting-up of agencies, branches or subsidiaries (Art. 49); restrictions on the freedom to provide services shall be prohibited in respect of nationals and companies of MSs (Art. 56); and all restrictions on the movement of capital between MSs and between MSs and third countries shall be prohibited (Art. 63).<sup>1</sup>

The way through which EU freedoms are enacted is EU law supremacy<sup>2</sup>: MSs cannot discriminate non-nationals nor restrict the exercise of the freedoms, while they must grant “national treatment”, *i.e.* similar treatment in terms of rights and obligations between nationals and non-nationals exercising EU freedoms, or between nationals who exercised EU freedoms and nationals of the same MS who did not.<sup>3</sup> As a matter of facts, it is possible that the national exercising the freedoms is discriminated or restricted by a rule of the MS where the freedom is exercised: cases

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<sup>1</sup> For a comprehensive consideration of EU freedoms, TERRA-WATTEL, *European Tax Law*, 2005, pp. 38 ss.

<sup>2</sup> In this respect, *Costa v ENEL* (ECJ 15 July 1964, 6/64).

<sup>3</sup> The “national treatment” principle is expressed in paragraph 94 of *De Groot* (ECJ 12 December 2002, C-385/00), where the ECJ held that “Member States must (...) respect the principle of national treatment of nationals of other Member States and of their own nationals who exercise the freedoms guaranteed by the Treaty” (emphasis added).

as such will be referred to as “host-State” cases (e.g. *Avoir fiscal*<sup>4</sup>, *Schumacker*<sup>5</sup>, *Wielockx*<sup>6</sup>, *Futura*<sup>7</sup>, *Saint-Gobain*<sup>8</sup>, and *Truck Center*<sup>9</sup>); it is also possible that rules laid down by a MS restrict its own nationals from exercising the freedoms in other MSs: these cases will be referred to as “origin-State” cases (e.g. *Daily Mail*<sup>10</sup>, *Lenz*<sup>11</sup>, *Manninen*<sup>12</sup>, *Marks & Spencer*<sup>13</sup>, *FII*<sup>14</sup>, and *X Holding*<sup>15</sup>).<sup>16</sup>

While discrimination on the grounds of nationality (direct discrimination) is never admitted, unless justified by reasons provided for by the TFEU (e.g. public policy, public security, and public health in Art. 45, par. 3, TFEU), a different situation features when: (i) a discrimination which is not grounded on nationality, but on different criteria mainly affecting nationals of other MSs (indirect discrimination), occurs (e.g. *Sotgiu*<sup>17</sup>, *Biehl*<sup>18</sup>, and *Commerzbank*<sup>19</sup>); (ii) a restriction occurs, i.e. a rule hinders or deters the exercise of freedom rights (e.g. *Gebhard*<sup>20</sup> and *Futura*, from a host-State perspective; *Lenz*, from an origin-State case).

However, in all situations of discrimination and restriction, the condition for MSs to grant – and for EU nationals to receive<sup>21</sup> – national treatment is that there must be comparability between the situations of the EU national who exercised the freedom and the EU national who did not, the latter possibly being a national of a different

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<sup>4</sup> ECJ 28 January 1986, Case 270/83.

<sup>5</sup> ECJ 14 February 1995, C-279/93.

<sup>6</sup> ECJ 11 August 1995, C-80/94.

<sup>7</sup> ECJ 15 May 1997, C-250/95.

<sup>8</sup> ECJ 21 September 1999, C-307/97.

<sup>9</sup> ECJ 22 December 2008, C-282/07.

<sup>10</sup> ECJ 27 September 1988, Case 81/87.

<sup>11</sup> ECJ 15 July 2004, C-315/02.

<sup>12</sup> ECJ 7 September 2004, C-319/02.

<sup>13</sup> ECJ 13 December 2005, C-446/03.

<sup>14</sup> ECJ 12 December 2006, C-446/04.

<sup>15</sup> ECJ 25 February 2010, C-337/08.

<sup>16</sup> The classification of “host-State” and “origin-State” cases has been developed by and is explained in O’SHEA, *EU Tax Law and Double Tax Conventions*, 2008, pp. 34-42; ID., *European Tax Controversies: A British-Dutch Debate: Back to Basics and Is the ECJ Consistent?*, in *World Tax Journal*, February 2013, pp. 119-121.

<sup>17</sup> ECJ 12 February 1974, Case 152/73, where for the first time the ECJ stated that “[t]he rules regarding equality of treatment (...) forbid not only overt discrimination by reason of nationality but also all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result” (*Sotgiu*, 11).

<sup>18</sup> ECJ 8 May 1990, C-175/88.

<sup>19</sup> ECJ 13 July 1993, C-330/91.

<sup>20</sup> ECJ 30 November 1995, C-55/94.

<sup>21</sup> Subject to the condition that different treatment is not justified, and – if so – disproportionate. Justifications and proportionality are out of the scope of this research.

MS (host-MS) or of the same MS (origin-MS)<sup>22</sup>: comparability of the migrant, who exercised the freedoms, and the non-migrant, who did not, is thus a key-concept from both host-State and origin-State perspectives.<sup>23</sup>

### 3. COMPARABILITY IN THE "HOST-STATE" ENVIRONMENT

In the direct tax area, the ECJ first affirmed comparability in two landmark decisions: *Avoir fiscal*<sup>24</sup>, concerning different treatment depending upon the MS where insurance companies had established their registered seat, and *Schumacker*, regarding different tax treatment of a non-resident worker.

#### 3.1. AVOIR FISCAL

In *Avoir fiscal*, the ECJ dealt with French rules which applied "disparity in the treatment in regard to the shareholders' tax credit"<sup>25</sup> (in French, "avoir fiscal") of insurance companies whose registered seat was in France *vis-à-vis* insurance companies having branches in France and their registered seat in other MSs. The case sprang from an infringement action brought by the Commission, pursuant to current Art. 258 TFEU<sup>26</sup>, for the purposes of the freedom of establishment, and revolved around comparability of French companies and foreign companies with branches in France.

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<sup>22</sup> An analytical tool of analysis of the national treatment test is the "migrant/non-migrant test", where the situation of a national who exercised the freedom right (*i.e.* "the migrant"), and the national who did not (*i.e.* "the non-migrant") are to be compared (see O'SHEA, *EU Tax Law*, p. 42).

<sup>23</sup> Importance of comparability from both perspectives is stressed by O'SHEA, *National Treatment*, at [www.ccls.qmul.ac.uk/docs/staff/oshea/52207.pdf](http://www.ccls.qmul.ac.uk/docs/staff/oshea/52207.pdf) (last visited 22 August, 2013), pp. 6-7.

<sup>24</sup> *Avoir fiscal* is commonly considered to be ECJ's first tax case. Nevertheless, ECJ's first tax case is *Humblet* (ECJ 16 December 1960, Case 6/60), a competence case dealing with the taxation of the salary of a ECSC official. Belgium, Mr Humbet's State of residence, applied the exemption with progression method, so that the salary was indirectly taken into account by taxing domestic income at a higher rate, while the salary had to be exempt under ECSC Treaty. The ECJ held that such a rule provided for an indirect taxation of the official's salary and had the same effect of taxing it directly. On this case, O'SHEA, *Freedom of establishment tax jurisprudence: Avoir fiscal re-visited*, in *EC Tax Review*, 2008-6, pp. 260-261.

<sup>25</sup> *Avoir fiscal*, 10.

<sup>26</sup> ECJ cases may derive either from:

- an action of the Commission ("infringement cases"), which deems that a MS failed to fulfill an obligation provided for by the TFEU or the Treaty of European Union ("TEU");
- the request from a domestic judge ("preliminary ruling cases"): under Art. 267 TFEU, the ECJ shall have jurisdiction to give preliminary rulings on the interpretation of the TFEU and TEU, and on the validity of the acts of EU institutions, bodies, offices or agencies of the EU, upon request of a tribunal or a court of a MS.

According to the Commission, French rules did “discriminate against branches (...) in France of insurance companies whose registered office is in another MS by comparison with companies whose registered office is in France.”<sup>27</sup>

The French Government, in replying, sought to demonstrate that the disparity questioned by the Commission was justified by objective differences between resident and non-resident insurance companies, “an essential distinction in tax law (...) also applicable in the context of Article 52 of the Treaty.”<sup>28</sup>

At the outset, the ECJ noted that, for companies, the registered office “serves as the connecting factor with the legal system of a particular state, like nationality in the case of natural persons”<sup>29</sup>, and accepting that a host-MS “may freely apply (...) a different treatment solely by reason of the (...) registered office (...) in another Member State would thus deprive that provision of all meaning.”<sup>30</sup>

Then, the ECJ, in setting the comparability between French and foreign companies, held that the French tax system did not distinguish between French companies and foreign companies with a branch in France, for the purpose of determining taxable profits<sup>31</sup>: in facts, they were both “liable to taxation on profits made in undertakings carried on in France, to the exclusion of profits which are made abroad.”<sup>32</sup> The ECJ concluded that, since the French tax system placed French companies and foreign companies with a branch<sup>33</sup> “on the same footing for the purposes of taxing their profits, those rules cannot, without giving rise to discrimination, treat them differently in regard to the grant of an advantage related

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<sup>27</sup> *Avoir fiscal*, 11.

<sup>28</sup> *Avoir fiscal*, 17.

<sup>29</sup> *Avoir fiscal*, 18.

<sup>30</sup> *Avoir fiscal*, 18.

<sup>31</sup> Conversely, for a full equation of national companies and permanent establishments, and no distinction between direct and indirect discrimination, SCHÖN, *The Free Choice between the Right to Establish a Branch and to Set-up a Subsidiary - a Principle of European Business Law*, in *European Business Organization Law Review*, 2, 2001, p. 341.

<sup>32</sup> *Avoir fiscal*, 19.

<sup>33</sup> TERRA-WATTEL, *European*, p. 150, define ECJ’s approach as “*economic* (...)”, disregarding legal personality by equating branches and subsidiaries.” It is respectfully submitted that the ECJ does not adopt an economic approach, as: (i) it was repeatedly stated that, as a rule, residents and non-residents are not comparable; (ii) comparison is never made between a resident company and a branch, but between a resident and a non-resident: in *Avoir fiscal* comparability was set because France exempted foreign income of French companies (*i.e.* also French companies were taxed on French-sourced income only) (*Avoir fiscal*, 19) and placed foreign companies on the same footing of national companies when taxing their profits (*Avoir fiscal*, 20).

to taxation.”<sup>34</sup> In other words, “both were taxed in the same way – both should have received the *avoir fiscal* in the same way.”<sup>35</sup>

Therefore, the disparity in treatment regarding the *avoir fiscal* amounted to a discrimination constituting a restriction of the right of establishment and, as such, was prohibited by EU law. France had thus to grant national treatment to foreign companies with a branch, as far as the “*avoir fiscal*” was concerned.

*Avoir fiscal* is remarkably significant because, for the first time in the international tax law scenario, comparability between national and foreign companies was maintained. Furthermore, *Avoir fiscal* stated principles of law which have been widely upheld by the ECJ in subsequent decisions, as it can be showed by taking into consideration *Schumacker*.

### 3.2. SCHUMACKER

#### 3.2.1. THE OPINION OF AG LÉGER<sup>36</sup>

*Schumacker* dealt with different treatment of workers on the grounds of residence for tax purposes.

In this respect, AG Léger noted that “[t]he criterion of residence is the main pillar of international tax law. Chosen by almost every State in the world, it is given precedence over nationality.”<sup>37</sup> States usually tax residents on their worldwide income (“unlimited taxation”), and non-residents on the income produced within the boundaries of the State (“limited taxation”), on the grounds that they are in totally different tax situations. This derives from the fact “by choosing to reside in a particular State, a person assumes the obligation to contribute to the costs of public administration and the public services made available to him by that State. It is therefore logical that that State should tax the entirety of his income (...). It is also

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<sup>34</sup> *Avoir fiscal*, 20.

<sup>35</sup> O’SHEA, *Freedom*, p. 263.

<sup>36</sup> AG’s Opinion to *Schumacker*, delivered on 22 November 1994.

<sup>37</sup> AG’s Opinion to *Schumacker*, 35, and with the relevant exception of the United States, which taxes US citizens and green card holders on their worldwide income, beside individuals physically present in the country according to a “substantial presence” test. For a full summary, MILLER-OATS, *Principles of International Taxation*, 2012, pp. 41-42.

that State, where the taxpayer has focused his family life, which will grant him allowances and reliefs. There is a personal link between the taxpayer and his State of residence."<sup>38</sup> On the contrary, the State of source – *i.e.* the State of employment, in *Schumacker* – “taxes the non-resident in a quasi objective manner only on his income arising in its territory. The taxpayer, indeed, has no other link with that State than the economic activity.”<sup>39</sup> Absence of link with non-residents usually leads States to apply withholding taxes to non-residents, who might seek relief of the (potential) double taxation through Double Tax Treaties (hereafter “DTT”), if available, or domestic unilateral provisions.

From this analysis is clear that a distinction between a resident and a non-resident occurs “because they are not, objectively, in the same situation.”<sup>40</sup>

This statement, however, must be considered in light of two aspects, namely the potential (indirect) discrimination arising from a different treatment on the grounds of tax residence, and whether comparability of residents and non-residents may be established.

On the first aspect, the ECJ had highlighted that also provisions which do not constitute discrimination on the grounds of nationality may “be tantamount, as regards their practical effect, to discrimination on the grounds of nationality.”<sup>41</sup> In these circumstances, the ECJ investigates whether the various rules at stake constitute indirect discrimination, *i.e.* ascertains whether the different criterion adopted by MSs should be viewed as a distinction on the grounds of nationality. In this respect, AG Léger “conceded that the majority of non-residents are non-nationals and that a benefit reserved exclusively for residents conceals discrimination based on nationality.”<sup>42</sup>

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<sup>38</sup> AG’s Opinion to *Schumacker*, 36.

<sup>39</sup> AG’s Opinion to *Schumacker*, 37.

<sup>40</sup> AG’s Opinion to *Schumacker*, 38.

<sup>41</sup> *Sotgiu*, 11; see also *Biehl*, 14, and *Commerzbank*, 15.

<sup>42</sup> AG’s Opinion to *Schumacker*, 51.

This leads to consider the second aspect<sup>43</sup>, given that – as the ECJ also made it clear – discrimination, being it direct or indirect, only “arises through the application of different rules to comparable situations or the application of the same rule to different situations.”<sup>44</sup> In order to ascertain whether comparable situations occurred, AG Léger analyzed the facts of *Schumacker*.

Mr Schumacker, national of and resident in Belgium, was a frontier worker employed in Germany, who earned almost all of his income from his employment, having no or almost no income in his State of residence. Germany denied him the “splitting”, a tax advantage available to resident married couples, because he was not tax resident in Germany. On the other hand, Belgium could not take into account Mr Schumacker’s personal circumstances because (i) there was no income from that State, and (ii) Belgium applied the exemption method in the DTT concluded with Germany. Mr Schumacker, then, could not have his personal and family circumstances taken into account in either State: Belgium exempted his income, and could not grant any personal deduction; Germany did not grant the “splitting” facility to non-residents, because personal and family circumstances are to be considered by the State of residence.

In general terms, the approach of an objective taxation of non-residents by the State of source allows to avoid the granting of a double benefit (*i.e.* deductions for personal circumstances in both States), with the State of residence in a privileged position at assessing the ability to pay of its residents.

However, this system displayed “a weakness where the non-resident taxpayer receives all (or almost all) his income in his State of employment and (...) such income is taxable only in the latter State.”<sup>45</sup> Consequently, comparability between residents and Mr Schumacker was affirmed: they were “for tax purposes in the same

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<sup>43</sup> In respect of which AG Léger asked whether “an objective difference of circumstances which could justify different treatment” occurred (AG’s Opinion to *Schumacker*, 57).

<sup>44</sup> *Wielockx*, 17.

<sup>45</sup> AG’s Opinion to *Schumacker*, 65.

situation"<sup>46</sup>, because "the non-resident receives all his income in his State of employment."<sup>47</sup> The non-resident, though, had still "to pay tax on the income received in his State of employment without his personal circumstances and his family responsibilities being taken into consideration."<sup>48</sup>

AG Léger concluded that German rules which applied different treatment, depending upon tax residence, constituted indirect discrimination prohibited by EU law.

### 3.2.2. ECJ'S DECISION

The ECJ delivered the judgment in *Schumacker* along the lines of Léger's Opinion.

For what concerns indirect discrimination, the ECJ confirmed that rules such as the ones at stake, although applicable irrespective of taxpayers' nationality, were "liable to operate mainly to the detriment of nationals of other Member States. Non-residents are in the majority of cases foreigners."<sup>49</sup> Accordingly, tax advantages granted only to residents for tax purposes may "constitute indirect discrimination by reason of nationality."<sup>50</sup>

However, a discrimination arises only to the extent that different rules apply to comparable situation, or the same rules apply to different situations<sup>51</sup>, and, in this respect, "the situations of residents and of non-residents are not, as a rule, comparable"<sup>52</sup>: therefore, denying to non-residents tax advantages available to residents "is not, as a rule, discriminatory."<sup>53</sup>

Most importantly, the ECJ stated that freedom of movement for workers does not always prevent MSs from taxing non-resident workers more heavily than resident

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<sup>46</sup> AG's Opinion to *Schumacker*, 68.

<sup>47</sup> AG's Opinion to *Schumacker*, 75.

<sup>48</sup> AG's Opinion to *Schumacker*, 70.

<sup>49</sup> *Schumacker*, 28.

<sup>50</sup> *Schumacker*, 29.

<sup>51</sup> *Schumacker*, 30.

<sup>52</sup> *Schumacker*, 31.

<sup>53</sup> *Schumacker*, 34.

workers<sup>54</sup>: MSs are precluded to do so, only if the non-resident worker is in a comparable situation to resident workers, *i.e.* when “the non-resident receives no significant income in the State of his residence (...), [which] is not in a position to grant him the benefits resulting from taking into account of his personal and family circumstances.”<sup>55</sup> In a situation as such, the ECJ concluded that “there is no objective difference”<sup>56</sup> between a non-resident and a resident who performs a comparable employment.

The outcome of *Schumacker*, according to which – at certain conditions – residents and non-residents are in a comparable situation, is a keystone of ECJ’s jurisprudence, as proved for instance in *D*.<sup>57</sup> Such principle is even more distinct if contrasted with *Gschwind*.<sup>58</sup>

### 3.3. *GSCHWIND (VS. SCHUMACKER)*

Mr Gschwind, a Dutch national, was a frontier-worker employed in Germany. He lived in the Netherlands with his wife, where she was employed. In the relevant years (1991 and 1992), Mr Gschwind had earnings equal to 58% of the household’s aggregate income, which – according to the relevant Germany-Netherlands DTT – was taxable in Germany; however, the Netherlands were entitled “to include in the tax base income taxable in Germany, whilst deducting from the tax so calculated the part of it corresponding to the taxable income in Germany.”<sup>59</sup> Mrs Gschwind’s income, equal to 42% of the household’s aggregate income, was taxable in the Netherlands. Under German rules introduced in 1995 (after *Schumacker* and *Wielockx*), German tax authorities assessed Mr Gschwind “as a person subject to

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<sup>54</sup> *Schumacker*, 35.

<sup>55</sup> *Schumacker*, 36.

<sup>56</sup> *Schumacker*, 37.

<sup>57</sup> ECJ 5 July 2005, C-376/03, where the ECJ, recalling *Schumacker*, held that “a taxpayer who holds only a minor part of his wealth in a Member State other than the State where he is resident is not, as a rule, (...) comparable to (...) residents of that other Member State” (*D.*, 38). On *D.*’s relations with *Schumacker* and the earlier *Matteucci* (ECJ 27 September 1988, C-235/87), O’SHEA, *The ECJ, the ‘D’ case, double tax conventions and most-favoured nations: comparability and reciprocity*, in *EC Tax Review*, 2005-4, pp. 192-194; 195.

<sup>58</sup> ECJ 14 September 1999, C-391/97.

<sup>59</sup> *Gschwind*, 10.

unlimited taxation but treated him as if he were a single.”<sup>60</sup> He was in fact denied “splitting” tax relief, on the grounds that such a relief was available only if his spouse had an income equal to less than 10% of the household’s aggregate income or lower than a certain threshold (DEM 24.000): Mrs Gschwind’s income exceeded both thresholds.

The ECJ dealt with the question whether EU law precluded provisions such as the German ones, which granted the “splitting” to non-resident couples, but only subject to the condition that the household’s income arising outside Germany was below certain thresholds.

The ECJ, after recalling the conditions laid down in *Schumacker* for comparability of residents and non-residents, stressed that such comparability did not occur in *Gschwind*, where the situation was “clearly different from (...) *Schumacker* (...). Mr Schumacker’s income formed almost the entire income of his tax household and neither he nor his spouse had any significant income in their State of residence allowing account to be taken of their personal and family circumstances.”<sup>61</sup> Unlike *Schumacker*, a significant part (42%) of the total household’s income of Mr and Mrs Gschwind arose in their State of residence: this means that – potentially, at least – “that State is in a position to take into account Mr Gschwind’s personal and family circumstances”<sup>62</sup>, “owing to the existence of a sufficient tax base in the State of residence.”<sup>63</sup>

The literature has correctly highlighted that “the reasoning in the decision is that the residence state is in a position to take family circumstances into account, not that it actually does so.”<sup>64</sup> As Mr Schumacker, Mr Gschwind was not granted any

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<sup>60</sup> *Gschwind*, 11.

<sup>61</sup> *Gschwind*, 28.

<sup>62</sup> *Gschwind*, 29.

<sup>63</sup> *Gschwind*, 30. This conclusion was upheld in the later *Wallentin* (ECJ 1 July 2004, C-169/03), whose outcome was that the State of source (Sweden) had to grant to the non-resident (Mr Wallentin) allowances available only to residents, even though the non-resident had income in his State of residence (Germany); however, such income was not taxable according to the German tax system. *Wallentin* can be explained by using the words of *Gschwind*: Sweden had to grant the allowances, since there was “no sufficient tax base” in Germany, whereas not taxable income is not included in the tax base.

<sup>64</sup> AVERY JONES, *What is the difference between Schumacker and Gschwind?*, in *British Tax Review*, 2000, 4, p. 195.

personal allowance, because his State of residence did not take his "circumstances into account, either in taxing him, because his income was exempt, or in taxing his wife, because allowances are transferable only if the transferor has no income, and he did have some income although it was exempt."<sup>65</sup> In light of these facts, this literature reaches the conclusion that "if, as in *Schumacker*, the income taxable in the residence state is too low for there to be any allowances there, the source state must give the allowances"<sup>66</sup>; on the contrary, if the spouse's income is enough to benefit from allowances in the State of residence, as in *Gschwind*, the source State is not obliged to grant national treatment, even though the State of residence does not actually accord personal allowances.<sup>67</sup>

In conclusion, there is no title for EU nationals to the better treatment between the State of residence (origin-State) and the State of employment (host-State), a potential disadvantage deriving from lack of harmonization: the employee is entitled to host-MS's national treatment as long as he is comparable to residents of the host-State (as in *Schumacker*). If no comparability can be set, (i) the employee will only benefit from the tax advantages of his State of residence, as long as the conditions laid down by the tax system of the State of residence are fulfilled (which did not happen in *Gschwind*), and (ii) the State of employment is not required to grant national treatment, and can tax non-resident workers more heavily than residents.<sup>68</sup>

#### 3.4. FURTHER CONSIDERATION OF COMPARABILITY: *ASSCHER* AND *GERRITSE*

*Gschwind* allows to highlight a landmark aspect of comparability analysis, namely that the judgment was delivered in relation to "the application of tax provisions such as those in question."<sup>69</sup> This means that comparability analysis must be run while

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<sup>65</sup> AVERY JONES, *What is*, p. 195.

<sup>66</sup> AVERY JONES, *What is*, p. 197.

<sup>67</sup> Also O'SHEA, *EU Tax Law*, p. 52, stressed that *Gschwind* can be distinguished from *Schumacker* on the grounds that "the residence State could take into account the personal and family circumstances of the *Gschwind* family because the "tax base" is sufficient there to enable them to be taken into account."

<sup>68</sup> As expressly stated in *Schumacker*, 35.

<sup>69</sup> *Gschwind*, 30.

taking into consideration the aim pursued by the relevant provisions (*i.e.* teleological interpretation).<sup>70</sup>

This objective-oriented approach is essential in order to set the range of comparability: this is proved by contrasting *Gschwind* with the earlier *Asscher*<sup>71</sup> and the later *Gerritse*<sup>72</sup>, in which the migrants were entitled to national treatment, even though their income in the host-State was lower than 90%.

Mr Asscher (a Belgian resident, exercising freedom of establishment in the Netherlands, as self-employed) and Mr Gerritse (a Dutch resident, exercising freedom to provide services in Germany), as non-residents for tax purposes, suffered a higher taxation than residents. In particular, according to the Dutch tax system, Mr Asscher suffered higher taxation than residents in the first tax-bracket (25% compared to 13%).<sup>73</sup> Similarly, under the applicable German rules, Mr Gerritse was taxed on his German-sourced income through a final 25% deduction at source on gross income, while income arising in the hands of residents was taxable on a net basis, according to a progressive table, under which an exemption was also granted up to a certain threshold.<sup>74</sup>

Both host-States' tax systems provided for an optional regime, according to which non-residents could opt for being taxed as residents, provided that 90% of their income was sourced within the host-State, or – only in *Gerritse* – income arisen outside the host-State was below a fixed threshold.<sup>75</sup> Neither Mr Asscher, nor Mr Gerritse met these requirements (*i.e.* they were not in a *Schumacker*-like situation), and were thus treated less favorably than residents. On these grounds, Messrs Asscher and Gerritse claimed that they were indirectly discriminated.<sup>76</sup>

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<sup>70</sup> As noted by O'SHEA, *European Tax Controversies – Quis Custodiet Ipsos Custodes?*, in *The EC Tax Journal*, vol. 12, 2011-12, p. 54. On teleological interpretation adopted by the ECJ, also having regard to TFEU-TEU provisions, MADURO, *Interpreting European Law: Judicial Adjudication in a Context of Constitutional Pluralism*, in *European Journal of Legal Studies*, 2007, Vol. 1, no. 2, pp. 5-6.

<sup>71</sup> ECJ 27 June 1996, C-107/94.

<sup>72</sup> ECJ 12 June 2003, C-234/01.

<sup>73</sup> *Asscher*, 7-9, 45.

<sup>74</sup> *Gerritse*, 3-5.

<sup>75</sup> *Asscher*, 6; *Gerritse*, 7.

<sup>76</sup> *Asscher*, 9; *Gerritse*, 13, 30.

In *Asscher*, the Netherlands Government held that the provisions at stake were grounded on the fact that the higher rate prevented “that certain non-residents escape the progressive nature of the tax because their tax obligations are confined to income received in the Netherlands.”<sup>77</sup> Analogously, in *Gerritse*, the German tax authority argued that, “if the basic tax table were to be applied without restriction, (...) Mr Gerritse would escape the progressive element of that tax, even though his worldwide income required the application of a higher rate.”<sup>78</sup>

The ECJ observed that – since the DTTs concluded by the Netherlands with Belgium (*Asscher*) and Germany (*Gerritse*) provided for the exemption with progression method for relieving double taxation – Belgium and the Netherlands did apply progressivity in taxing, respectively, Messrs *Asscher*<sup>79</sup> and *Gerritse*.<sup>80</sup>

Accordingly, the ECJ replied to the Dutch Government’s argument that “the fact that a taxpayer is a non-resident (...) does not enable him, in the circumstances under consideration, to escape the application of the rule of progressivity”<sup>81</sup>: therefore, Mr *Asscher* was deemed to be comparable to residents. Similarly, in *Gerritse*, the ECJ also affirmed the comparability of residents and non-residents, because progressivity did apply in the Netherlands, according to the relevant DTT.<sup>82</sup> In addition, for what concerns the domestic rules which did not authorize the deductibility of business expenses incurred by non-residents, the ECJ held that “the business expenses in question are directly linked to the activity that generated the taxable income in Germany, so that residents and non-residents are placed in a comparable situation in that respect.”<sup>83</sup>

One may now ask why Mr *Gschwind* was not found to be comparable to residents, while Messrs *Asscher* and *Gerritse* were deemed comparable to residents, neither one of the latter two taxpayers being in a *Schumacker*-like situation.

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<sup>77</sup> *Asscher*, 46.

<sup>78</sup> *Gerritse*, 34.

<sup>79</sup> *Asscher*, 47-48.

<sup>80</sup> *Gerritse*, 52.

<sup>81</sup> *Asscher*, 48.

<sup>82</sup> *Gerritse*, 53.

<sup>83</sup> *Gerritse*, 27.

In order to reconcile these three cases, it is of capital importance to stress that comparability analysis was run having regard to “the circumstances under consideration”<sup>84</sup> in *Asscher*, and to the direct link between business expenses and profits<sup>85</sup>, and “to the progressivity rule” in *Gerritse*.<sup>86</sup>

In other words, comparability was set having regard to the aim pursued by domestic provisions, *i.e.* preventing non-residents from escaping progressivity, which did not happen in the facts at stake, and allowing the deduction of expenses directly linked to the production of taxable income. This reasoning, but with opposite conclusion, was applied in *Gschwind*: no comparability was found because the State of residence was already in the position to take into account personal and family circumstances, and – having regard to the objective of the provisions granting personal and family allowances – Mr Gschwind was not comparable to residents of the host-State.

### 3.5. NATIONAL TREATMENT AND THE INTERACTION OF DTTs WITH DOMESTIC PROVISIONS

In *Avoir fiscal*, *Schumacker*, *Gschwind*, *Asscher*, and *Gerritse*, domestic provisions laid down by the host-MSs were deemed to be incompatible with EU law; rules set by the DTTs were considered only to the extent of defining the liability of the taxpayers and which method of relief was applicable.

The ECJ brought its comparability analysis a step forward when had to judge whether DTTs provisions, granting rights to residents of contracting States<sup>87</sup>, may interact with domestic provisions and contribute to setting the national treatment.

The ECJ dealt with the interaction between domestic rules and rights accorded by DTTs in *Saint-Gobain*.

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<sup>84</sup> *Asscher*, 48.

<sup>85</sup> *Gerritse*, 27.

<sup>86</sup> *Gerritse*, 53.

<sup>87</sup> DTTs usually apply to residents of the Contracting States, as in Art. 1 OECD MTC.

### 3.5.1. SAINT-GOBAIN

Compagnie de Saint-Gobain S.A. (hereafter "Saint-Gobain SA") was a French company, with a German branch (Saint-Gobain ZN). Saint-Gobain SA held through Saint-Gobain ZN shares of a number of companies whose registered seats were in Germany, Switzerland, and United States.

Companies subject to unlimited taxation in Germany benefitted in the relevant fiscal year (1988) from various tax advantages, some of them being available under DTTs Germany entered into with non-MSs (United States and Switzerland)<sup>88</sup>, while non-resident companies with branches, subject to limited taxation, were precluded from enjoying such tax advantages, on the grounds that they were not liable to tax in Germany on their worldwide income.

Saint-Gobain SA, as subject to limited taxation in Germany, was denied the tax advantages available to residents, and questioned such denial on the grounds of incompatibility with EU law. The case went before the German Finanzgericht which asked the ECJ whether freedom of establishment prohibited provisions, as the German ones, which placed Saint-Gobain SA and its branch in less favorable position than companies subject to unlimited taxation.

The ECJ at the outset affirmed that freedom of establishment can be exercised either through a subsidiary, a branch, or an agency<sup>89</sup>, and repeated the principle of *Avoir fiscal* according to which registered seat works for companies as connecting factor, "like nationality for natural persons."<sup>90</sup> Then the ECJ explained that, under German tax law, companies subject to unlimited taxation are "companies considered to be resident in Germany for tax purposes, that is to say companies"<sup>91</sup> with

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<sup>88</sup> In particular, as summarized in *Saint-Gobain*, 32:

- an exemption from corporate tax on dividends received by companies resident in non-MSs, provided for by the DTTs entered into with such non-MSs;
- a foreign tax credit, against German corporate tax, for corporate tax paid by the subsidiaries established abroad, provided for by German law;
- an exemption from capital tax for the shares held in companies with registered seat located in non-MSs, provided for by German law.

<sup>89</sup> *Saint-Gobain*, 34.

<sup>90</sup> *Saint-Gobain*, 35.

<sup>91</sup> *Saint-Gobain*, 37.

registered seat in Germany. By means of this clarification, the ECJ introduced the key-concept of the decision, namely the comparability of resident companies and non-resident companies with German branches, for what concerns dividends and shareholdings taxation.

The German Government put forward that non-resident companies “are in a situation which is objectively different from that of companies resident in Germany”<sup>92</sup>, given the unlimited taxation of the latter *vis-à-vis* limited taxation of the former.

The ECJ, in response of this argument, narrowed the field of comparability, as in paragraph 35 of *Gschwind*<sup>93</sup>, and said that, unlike what the German Government maintained, “as regards liability to tax on dividends (...) in Germany from shares in foreign subsidiaries (...), companies not resident in Germany having a permanent establishment there and companies resident in Germany are in objectively comparable situations.”<sup>94</sup> As a matter of facts, dividends (for the purposes of corporate tax) and shareholdings (for the purposes of capital tax) were taxable irrespective of the residence of the shareholder, while “difference in treatment applied only to the tax concessions.”<sup>95</sup> Comparability was even greater in light of the fact that denying the tax advantages in question to non-resident companies with branches in Germany determined “that their tax liability , theoretically limited to ‘national’ income and assets, comprises (...) dividends from foreign sources and shareholdings in foreign companies limited by shares.”<sup>96</sup> Therefore, the ECJ set that non-resident companies with German branches, *having regard to dividends taxation*, were in a comparable situation to resident companies.

The ECJ then rejected all the justifications put forward by MSs’ Governments, namely that (i) “[t]o extend to other situations the tax advantages provided for by

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<sup>92</sup> *Saint-Gobain*, 46.

<sup>93</sup> *Gschwind* was delivered a week earlier than *Saint-Gobain*, judge rapporteur of both decisions being Melchior Wathelet.

<sup>94</sup> *Saint-Gobain*, 47.

<sup>95</sup> O’SHEA, *Freedom*, p. 265.

<sup>96</sup> *Saint-Gobain*, 48.

treaties concluded with non-member countries would not be compatible with the division of competences under Community law"<sup>97</sup>; and (ii) the principle of reciprocity DTTs are based on would be violated "if the benefit (...) was extended to companies established in Member States which were not parties of them."<sup>98</sup>

In respect of these observations, the ECJ importantly highlighted what role DTTs play within the EU framework.<sup>99</sup>

The ECJ agreed that MSs retain the competence of allocating powers of taxation between themselves, by means of DTTs, in respect of which MSs are free<sup>100</sup>, but, "[a]s far as the exercise of the power of taxation so allocated is concerned, the Member States (...) may not disregard Community rules [because,] although direct taxation is a matter for the Member States, they must nevertheless exercise their taxation powers consistently with Community law."<sup>101</sup> As a consequence, having regard to DTTs entered into by a MS and non-MSs, "the national treatment principle requires the Member State which is party to the treaty to grant to permanent establishments of non-resident companies the advantages provided for by that treaty on the same conditions as those which apply to resident companies."<sup>102</sup>

This, however, does not mean that a non-resident company is entitled to the rights granted by a DTT concluded for the benefit of residents of the Contracting States. On the contrary, it was for Germany – through a unilateral extension – to grant the national treatment, so that neither balance nor reciprocity of DTTs "would (...) be called into question (...) since such an extension would not (...) affect the rights of the non-member countries (...) parties of the treaties and would not impose any new obligation on them."<sup>103</sup>

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<sup>97</sup> *Saint-Gobain*, 54.

<sup>98</sup> *Saint-Gobain*, 55.

<sup>99</sup> The same principles were confirmed in the later non-tax case *Gottardo* (ECJ 15 January 2002, C-55/00).

<sup>100</sup> *Saint-Gobain*, 56.

<sup>101</sup> *Saint-Gobain*, 57. The same statement featured *e.g.* in *Schumacker*, 21, *Wielockx*, 16, *Asscher*, 36, and *Futura*, 19, and is a sort of standard formula for tax cases.

<sup>102</sup> *Saint-Gobain*, 58. Analogously, "the fundamental principle of equal treatment requires that that Member State grant nationals of other Member States the same advantages as those which its own nationals enjoy under that convention unless it can provide objective justification for refusing to do so" (*Gottardo*, 34).

<sup>103</sup> *Saint-Gobain*, 59. This conclusion had been put forward by AG Mischo of his Opinion to *Saint-Gobain*, delivered on 2 March 1999 (paras. 81-82).

In conclusion, in *Saint-Gobain* (and in the later *Gottardo*) the ECJ pointed out that also rights granted by DTTs (and international agreements) to residents (or nationals) fall within the scope of the national treatment, if residents and non-residents (nationals and non-nationals) are in objectively comparable situations.

However, *Saint-Gobain* had not showed the complete picture of the interaction of DTTs and domestic provisions<sup>104</sup>, which was further brought into focus by *Bouanich*.<sup>105</sup>

### 3.5.2. BOUANICH

Ms Bouanich, a French resident, held shares in a Swedish public limited company, which made payments to Ms Bouanich in 1998, in connection with a reduction in its share capital.

The Swedish tax regime in the relevant year distinguished between resident and non-resident shareholders who received such payments. The amount received by resident shareholders was taxed at 30% tax-rate as capital gain, and the acquisition cost of the repurchased shares could be deducted. On the contrary, the sum paid to non-resident shareholders was considered as a dividend, taxed at 30% tax-rate, and no deduction of the acquisition cost was available.

Nevertheless, if a DTT were in place, different rules would apply.

The relevant DTT, entered into by France and Sweden, provided for that dividends may be taxed by the source-State by means of a withholding tax not exceeding 15% of the gross amount. In addition, if the payments were connected to a reduction of the share capital, "an amount corresponding to the nominal value of the repurchased shares"<sup>106</sup> could be deducted.<sup>107</sup>

Under these provisions, Sweden levied a 15% withholding tax on the whole amount of the payments. Ms Bouanich sought refund of the whole amount and,

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<sup>104</sup> On the role of DTTs within the EU, KEMMEREN, *Double Tax Conventions on Income and Capital and the EU: Past, Present and Future*, in *EC Tax Review*, 2012-3, pp. 157 ss.

<sup>105</sup> ECJ 19 January 2006, C-265/04.

<sup>106</sup> *Bouanich*, 16.

<sup>107</sup> As affirmed by the OECD Commentary to Art. 13, par. 31.

alternatively, of the amount corresponding to the nominal value of repurchased shares. The Swedish tax office accepted the alternative refund, but rejected the main refund claim. This latter denial was appealed, and the ECJ was asked whether: (i) the preclusion to deduct acquisition cost on the grounds of the shareholder's foreign residence, while resident shareholders were allowed to do so, was compatible with free movement of capital rights; (ii) the same provisions which banned the deduction of acquisition cost to non-resident shareholders are compatible with free movement of capital rights when a DTT provided for the deduction of the nominal value of the shares.

In response to the first question, the ECJ stated that the relevant rules provided for a tax advantage (*i.e.* deduction of acquisition cost), available to resident and not to non-resident shareholders: therefore, such regime constituted a restriction on the freedom of establishment.<sup>108</sup> In addition, the ECJ held that, in order to be compatible with EU law, such rules had to be justified, and that it was then necessary to verify "whether the different tax treatment of income (...) relates to situations which are not objectively comparable."<sup>109</sup>

In setting the comparability, the ECJ held that acquisition cost was "directly linked to the payment made on the occasion of a share repurchase so that, in this regard<sup>110</sup>, residents and non-residents are in a comparable situation. There is no objective difference (...) such as to justify different treatment (...)."<sup>111</sup>

Having regard to the second question, the ECJ premised that, since France-Sweden DTT "forms part of the legal background to the main proceedings (...), the Court of Justice must take it into account in order to give an interpretation of Community law that is relevant to the national court."<sup>112</sup> Therefore, in order to answer to the question *sub* (ii), the ECJ pointed out that it is necessary to ascertain

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<sup>108</sup> *Bouanich*, 34-35.

<sup>109</sup> *Bouanich*, 39.

<sup>110</sup> Again, the ECJ adopted a teleological interpretation of the relevant rules, narrowing down the range of the comparability analysis.

<sup>111</sup> *Bouanich*, 40.

<sup>112</sup> *Bouanich*, 51.

whether resident shareholders were “treated more favourably than non-resident shareholders”<sup>113</sup>, and this depended upon the figures of acquisition cost and nominal value. From this flows that the relevant DTT – which fixed a lower taxation on dividends, compared to domestic rules – may remove “the restriction on fundamental freedom that has been found to exist”<sup>114</sup> at the domestic level *sub (i)*.

For this reason, the ECJ held that the national legislation resulting from domestic provisions and the DTT’s rules was incompatible with EU law, “except where, under such national legislation, non-resident shareholders are not treated less favourably than resident shareholders.”<sup>115</sup>

The outcome of *Bouanich* is extremely important for two reasons.

First, the ECJ made it clear that a DTT may heal restrictions provided for by domestic provisions, in principle, prohibited by EU law: this would be the case, if the tax paid according to the 15% tax-rate on the repurchase price, deducted the nominal value of shares, were equal to the tax paid under the domestic rules, *i.e.* the national treatment (30% tax-rate on the repurchase price, deducted the acquisition cost).

Secondly, from *Bouanich* flows that while EU law precludes MSs from treating residents more favorably than non-residents in comparable situations, EU law does not require identical treatment: as a matter of facts, EU law provides for “no less favourable treatment”, and, as a result of the interaction of domestic and DTT rules, the ECJ cleared that non-residents can be treated more favorably than resident.<sup>116</sup>

### 3.6. LOOKING AT *SCHUMACKER* AND *SAINT-GOBAIN* IN LIGHT OF *BOUANICH*

From *Saint-Gobain* and *Gottardo* derives that the position which residents gain by means of DTTs concluded by their MS of residence sets the standard of national treatment. In addition, *Bouanich* brought along that a DTT may heal domestic

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<sup>113</sup> *Bouanich*, 53.

<sup>114</sup> *Bouanich*, 48.

<sup>115</sup> *Bouanich*, 56.

<sup>116</sup> For a critical view of this outcome, GRAETZ-WARREN, *Dividend taxation in Europe: When the ECJ makes tax policy*, in *44 Common Market Law Review*, 2007, 6, pp. 1601-1602.

regimes which place resident in a more favorable position than comparable non-residents.

The outcomes of these decisions allow to better define comparability analysis, in particular, by means of hypothesizing slightly different circumstances of *Schumacker* and *Saint-Gobain*.

In *Schumacker*, Mr Schumacker was held in an objectively comparable situation to resident workers, because he earned almost all of his income in the host-MS (Germany). He had no personal circumstances taken into account there, nor in the MS of residence (Belgium). This was also the consequence of the fact that Belgium applied the exemption method in the relevant DTT entered into with Germany.

The question now is whether *Schumacker* would have had a different outcome, if Belgium had applied the credit method in the DTT with Germany: in order to answer to this question, it is necessary to consider whether Mr Schumacker would still be comparable to a resident worker.

If Belgium had applied the credit method, it would have taxed Mr Schumacker's employment income, and the tax paid in the host-State would have been credited against the tax levied by Belgium. It is very likely that, in this situation, the overall tax base would have been sufficient for personal and family circumstances to be taken into consideration by the MS of residence.

Therefore, it is argued that a DTT applying the credit method would have healed the disparity of treatment between Mr Schumacker and resident workers, allowing sufficient tax base in the MS of residence.

A similar reasoning can be applied to *Saint-Gobain*, where a French company with a German branch claimed that should have received the (national) treatment in respect of some advantages granted to resident companies through DTTs concluded between Germany and non-MSs (Switzerland and United States).

Under the OECD MTC<sup>117</sup>, permanent establishments of non-resident companies qualify for the rights granted by the DTTs entered into by the State of their head-office (*i.e.* State of residence). In the case of Saint-Gobain SA, the relevant DTTs were the ones entered into by France with Switzerland and with the United States.

According to the principles contained in *Bouanich*, even though domestic provisions may have treated the French company with a branch in Germany less favorably than companies resident in Germany for the purposes of dividends taxation, the relevant DTTs may have had the effect of removing the restrictions on EU freedoms which existed according to the purely domestic scenario.

### 3.7. DIFFERENT TREATMENT OF INTEREST PAYMENTS, BASED ON THE RESIDENCE OF THE RECIPIENTS: *TRUCK CENTER* (AS A FOLLOW-UP OF *ACT IV GLO*)

In considering comparability analysis in ECJ's cases, a very significant one is *Truck Center*, which dealt with the taxation of interests paid out by companies resident in Belgium.

According to the relevant Belgian rules, the payment of interests by a Belgian company to another Belgian company was exempt from withholding tax, while interest paid by a resident company to a non-resident company was subject to withholding tax.

Truck Center SA (hereafter "Truck Center"), a Belgian company, paid withholding-free interests to SA Wickler Finances, a Luxembourg company, holding 48% of the shares of Truck Center. The Belgian tax administration claimed that the withholding tax on such payments was due; the taxpayer opposed that the disparity in treatment of interest payments to residents and non-residents was contrary to EU law.

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<sup>117</sup> The OECD Commentary to Art. 1, par. 1, recalls that, unlike Art 1 OECD MTC, some DTTs apply more generally to "taxpayers", notwithstanding their tax residence.

The case was brought before the Tribunal de première instance d'Arlon, which ruled in favor of Truck Center<sup>118</sup>; this latter decision was appealed before the Cour d'appel de Liège, which referred to the ECJ the question whether the relevant Belgian provisions "preclude a legislation (...) which provides for the retention of tax at source on interest paid by a (...) resident (...) to a recipient company resident in another Member State, while exempting from that retention interest paid to a (...) resident"<sup>119</sup> company.

The ECJ took the view that a tax regime as such may give rise to a discrimination "based on the place in which companies have their seat"<sup>120</sup>, as well as to a restriction, by reason of the heavier taxation.<sup>121</sup> Coherently, the ECJ ran both the discrimination and the restriction analysis. Beginning from the former<sup>122</sup>, the ECJ ascertained whether residents and non-residents were comparable, given that, according to settled case law, "a lack of comparability alone may justify the different treatment of the non-resident to the resident."<sup>123</sup>

In respect of companies receiving interest payments, the ECJ found that "the difference in treatment (...) consisting in the application of different taxation arrangements to companies established in Belgium to those established in another Member State, relates to situations which are not objectively comparable"<sup>124</sup> for a number of reasons.

First, if both the paying and recipient companies are resident, Belgium acts as State of residence, while, if the payer is resident and the recipient is non-resident, Belgium acts in its capacity of State of source.<sup>125</sup> Secondly, and partly as a consequence of this first observations, the payment of interest to a resident company

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<sup>118</sup> For instance, on the grounds that Belgian law was incompatible with EU free movement of capital (*Truck Center*, 18). The ECJ, given SA Wickler Finances's 48% shareholding, decided the case on the grounds of freedom of establishment.

<sup>119</sup> *Truck Center*, 21.

<sup>120</sup> *Truck Center*, 32.

<sup>121</sup> *Truck Center*, 33.

<sup>122</sup> In ECJ direct tax cases, discrimination analysis always precedes restriction analysis: this is clear in *Futura*, where discrimination analysis features at 20-22, and restriction analysis at 24-26.

<sup>123</sup> O'SHEA, *Quis Custodiet*, p. 69.

<sup>124</sup> *Truck Center*, 41.

<sup>125</sup> *Truck Center*, 42.

is subject to different tax charges than the payment of interest to a non-resident: while in the scenario of payments from a resident to a resident, interest payments are exempted from the withholding tax, and the income related to such payments is taxed in the hands of the recipient company<sup>126</sup>, payments from a resident to a non-resident are subjected to withholding, pursuant to the Belgium-Luxembourg DTT.<sup>127</sup> Finally, a resident and a non-resident are in a different position, for what concerns the recovery of taxes.<sup>128</sup>

Despite some adverse positions in academic literature<sup>129</sup>, comparability analysis run by the ECJ in *Truck Center* is perfectly in line with the principles affirmed in *ACT IV GLO*<sup>130</sup>, with the relevant difference that this latter case concerned disparity in treatment of dividends paid by resident companies to residents *vis-à-vis* to non-residents.<sup>131</sup>

In this latter case, according to the relevant British rules, a UK-resident company receiving dividends from another UK-resident company was entitled to a tax credit for the advance corporation tax (hereafter "ACT") paid by the distributing company, while dividends distributed by a UK-resident company to a non-resident company were exempted from tax, unless this latter company was resident of a State which had concluded a DTT with the UK, providing for such a tax credit. Only in this latter case, non-resident shareholders were also granted the tax credit available to resident shareholders.<sup>132</sup>

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<sup>126</sup> *Truck Center*, 44.

<sup>127</sup> *Truck Center*, 45.

<sup>128</sup> *Truck Center*, 48.

<sup>129</sup> LOZEV, *Bulgaria Three Years after Accession: Net Taxation of Non-Residents and Other Amendments*, in *European Taxation*, 2010, 7 (in IBFD database), refers to the case as "somewhat controversial"; DE BROE-BAMMENS, *Belgian Withholding Tax on Interest Payments to Non-resident Companies Does Not Violate EC Law: A Critical Look at the ECJ's Judgment in Truck Center*, in *EC Tax Review*, 2009-3, pp. 133, maintained that comparability analysis in *Truck Center* was not correct because a "theoretically sound approach requires a comparability analysis without interference from justification arguments" and this would have led the ECJ to set "comparability of the situations like it did in previous judgments on ground that the source state taxes the resident and the nonresident on the same type of income (interest)."

<sup>130</sup> ECJ 12 December 2006, C-374/04.

<sup>131</sup> This means that, while *Truck Center* involved juridical double taxation, *ACT IV GLO* concerned economic double taxation because dividends (unlike interests) are subject to a series of charges, as pointed out by O'SHEA, *Truck Center: A Lesson in Source vs. Residence Obligations in the EU*, in *Tax Notes International*, February 16, 2009, p. 597.

<sup>132</sup> *ACT IV GLO*, 30-32.

At the outset, the ECJ cleared that *ACT IV GLO* was a host-State case (unlike *FII1*, released on the same day, an inbound dividends case from an origin-State perspective).

The ECJ then ran the comparability analysis, and held that no comparability could be set on the grounds that, "in most instances, the U.K. was a source state in relation to dividends paid cross-border; the dividends received from the U.K. company were a U.K. source of income"<sup>133</sup>; as a consequence, the UK was not considered to be "in the same position, as regards the prevention or mitigation of a series of charges to tax and of economic double taxation, as the member state in which the shareholder receiving the distribution is resident."<sup>134</sup>

As a matter of facts, requiring the source State (*i.e.* the UK) to ensure that the non-resident recipient company does not suffer economic double taxation would lead to deem that the source State has no taxing power on a "profit generated through an economic activity undertaken on its territory."<sup>135</sup> This principle, after all, was not new to the ECJ which in *Schumacker* had already highlighted that the State of residence "is best placed to determine the shareholder's ability to pay tax."<sup>136</sup>

However, for sake of completeness, it must be said that the distinction between a resident which is taxed by a MS acting in its capacity of State of residence, and a resident taxed by a MS in its capacity of State of source – accepted by the ECJ– has been first made by AG Geelhoed in his Opinion to *ACT IV GLO*<sup>137</sup>, where he maintained that "the concept of discrimination applies in different ways to States acting in home State and source State capacity. (...) an economic operator subject to home State jurisdiction cannot per se be considered to be in a comparable situation to an economic operator subject to source State jurisdiction."<sup>138</sup>

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<sup>133</sup> O'SHEA, *Dividend Taxation Post-Manninen: Shifting Sands or Solid Foundations?*, in *Tax Notes International*, March 5, 2007, p. 905.

<sup>134</sup> *ACT IV GLO*, 58.

<sup>135</sup> *ACT IV GLO*, 59.

<sup>136</sup> *ACT IV GLO*, 60.

<sup>137</sup> AG's Opinion to *ACT IV GLO*, delivered on 23 February 2006.

<sup>138</sup> AG's Opinion to *ACT IV GLO*, 57.

The impact of this theorization on *ACT IV GLO*<sup>139</sup> is distinct once this latter case is contrasted with *Bouanich*, where the foreign investor was held comparable to a domestic one, and no distinction was made with regard to the capacity in which the host MS acted in respect of the taxation of dividends paid to a foreign investor.

The two cases and *Truck Center*, however, can still be reconciled by bearing in mind that, while in *Bouanich* the host MS subjected the dividends to a series of charges (corporate tax and withholding tax under Sweden-France DTT), such series of charges did not feature in *ACT IV GLO* (the host MS levied corporate tax, but no withholding on outbound dividends, which were completely exempt), nor in *Truck Center*, where the nature of interest payments implied no series of tax charge, even though they were subjected to withholding tax: in fact, interests, unlike dividends, are not taxed in the hands of the company by means of corporate tax, but deducted as business costs by the paying company. This is confirmed by the ECJ which, in this respect, pointed out that, "once a Member State, unilaterally or by a convention, imposes a charge to income tax not only on resident shareholders but also on non-resident shareholders in respect of dividends which they receive from a resident company, the position of those non-resident shareholders becomes comparable to that of resident shareholders."<sup>140</sup>

Therefore, the distinguishing criterion seems to be whether the dividends are subjected to a series of tax charge, namely corporate tax and a tax on dividends: if dividends are not subject to a series of tax charge, they are not comparable to dividends which are taxed in hands of the company and of the shareholders. This never happens, having regard to interests, which are deductible business costs.

This conclusion seems correct also in light of *Denkavit*<sup>141</sup>, where French rules provided for a 25% withholding tax on dividends paid to non-resident companies and an almost full exemption for domestic dividends. Here, as in *Bouanich*, and

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<sup>139</sup> Which has been underlined by O'SHEA, *EU Tax Law*, pp. 123-124.

<sup>140</sup> *ACT IV GLO*, 68.

<sup>141</sup> ECJ 14 December 2006, C-170/05. On this case, the argument (grounded on *Bouanich*) whether DTTs may heal the restriction is discussed by Prof. Lüdicke, in MUTÉN-LÜDICKE, *Lecture in Honour of Klaus Vogel*, in *Bulletin for International Taxation*, January 2008, p. 10.

differently from *ACT IV GLO*, "dividends paid to non-resident parent companies, unlike those paid to resident parent companies, are subject to a series of charges to tax under French tax legislation."<sup>142</sup>

#### 4. COMPARABILITY IN THE "ORIGIN-STATE" ENVIRONMENT

The decisions which have been considered so far are host-State cases, that can be said the natural environment of EU law: as held in *Daily Mail*, EU law "provisions are directed mainly to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State."<sup>143</sup>

However, as anticipated, EU law applies also to origin-State situations, and cases regarding such situations will be considered in this section.

The ECJ held that EU law provisions "also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation"<sup>144</sup>; otherwise, EU freedoms "would be rendered meaningless if the Member State of origin could prohibit undertakings from leaving in order to establish themselves in another Member State."<sup>145</sup> Consequently, MSs are not in the position of laying down rules which treat less favorably its own nationals who exercise EU freedoms rights *vis-à-vis* nationals who do not exercise such rights.

However, in order for a national to be entitled to national treatment after having operated cross-border, he must be comparable to nationals who operated domestically.

This being premised, from an origin-State perspective, comparability analysis is best showed having regard to three groups of cases, *i.e.* inbound dividend cases, interest deduction cases, and loss-relief cases.

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<sup>142</sup> *ACT IV GLO*, 68.

<sup>143</sup> *Daily Mail*, 16.

<sup>144</sup> *Daily Mail*, 16.

<sup>145</sup> *Daily Mail*, 16.

4.1. INBOUND DIVIDEND CASES: *LENZ*, *MANNINEN*, AND *FII1*

The first group of origin-State cases concerns the treatment of inbound dividends, *i.e.* received by resident of a MS from companies resident in other MSs.

In *Lenz* and *Manninen*, residents of the same MS were treated differently depending upon the residence of the company of which they held shares: in particular, in *Lenz*, Austrian shareholders receiving dividends from companies established in other MSs were denied the benefit of a tax-rate reduced by half (ordinary taxation applied, with maximum tax-rate of 50%), while dividends from Austrian companies were taxed at a 25% tax-rate or lower; in *Manninen*, a Finnish resident who invested in a Swedish company was denied the imputation credit, which was available for dividends from resident companies.

In both cases, MSs of residence maintained that different treatment based upon the place of investment did not constitute restriction on the freedoms of establishment or of movement of capital, because, first of all, residents who invested cross-border were not comparable to residents who invested domestically, being cross-border and domestic dividends "fundamentally different in character."<sup>146</sup> The MSs involved put forward that in both cases domestic tax legislations were "designed to prevent double taxation of company profits by granting to a shareholder who receives dividends a tax advantage linked to the taking into account of the corporation tax due from the company distributing the dividends."<sup>147</sup>

In setting the comparability between the two residents, one investing cross-border and one domestically, the ECJ highlighted that "both revenue from capital of Austrian origin and such revenue originating in another Member State are capable of being the subject of double taxation"<sup>148</sup>, because, "[i]n both cases, the revenue is first subject to corporation tax and then (...) to income tax in the hands of the beneficiaries."<sup>149</sup> In other words, the ECJ held that, if the MS of residence relieves

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<sup>146</sup> *Manninen*, 30. Very similarly *Lenz*, 28.

<sup>147</sup> *Manninen*, 33. Identically *Lenz*, 30.

<sup>148</sup> *Lenz*, 31.

<sup>149</sup> *Manninen*, 35.

economic double taxation domestically, it will have to relief economic double taxation also cross-border, *i.e.* MSs of residence must grant national treatment.

In light of this, and for the purposes of the present research, it is important a further holding of *Manninen*, where the ECJ explained that “the situation of persons fully taxable in Finland might differ according to the place where they invested their capital. That would be the case in particular where the tax legislation of the Member State in which the investments were made already eliminated the risk of double taxation of company profits distributed in the form of dividends, by, for example, subjecting to corporation tax only such profits by the company concerned as were not distributed.”<sup>150</sup>

The principles of *Lenz* and *Manninen* have been later upheld in the answer to the first question referred to the ECJ in *FIII*<sup>151</sup>, which concerned the treatment of inbound dividends, for the purposes of freedom of establishment<sup>152</sup> and free movement of capital.<sup>153</sup>

Pursuant to the relevant British tax system, dividends received by UK companies from UK companies were exempt, while dividends received by UK companies from companies resident in other MSs were subject to UK corporate tax, but a foreign tax credit was granted for the suffered withholding tax, and – provided a minimum 10% shareholding by the recipient company – for any underlying tax.

The taxpayers involved argued that applying an imputation method for dividends received from companies resident in other MSs, and the exemption method to dividends received from resident companies determined a less favorable treatment of the residents which exercised freedom of establishment and free

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<sup>150</sup> *Manninen*, 34. This clarification should be considered when looking at the so-called “always somewhere principle”, expressed by TERRA-WATTEL, *European*, p. 62-63, according to which – having regard to *Bosal*, *Manninen*, and *Schumacker* – the ECJ would have maintained that the taxpayer who exercised EU freedoms *always* “is able to deduct his cost *somewhere*, to get his imputation credit *somewhere*, and to benefit from personal tax allowances *somewhere*.” It is respectfully submitted that this is not true, in light of the fact that the ECJ requires comparability of residents and non-residents in order to allow national treatment. From *Manninen*, 34, for instance, flows that comparability is not set if economic double taxation does not occur.

<sup>151</sup> *FIII*, 33-74.

<sup>152</sup> *FIII*, 33-57.

<sup>153</sup> *FIII*, 58-74.

movement of capital, in regard of which the 10% minimum shareholding was also questioned.

In respect of the first issue (*i.e.* application of two different methods of relief of economic double taxation), the ECJ held that, in mitigating a series of charges, MSs are in the position to “choose between a number of systems”<sup>154</sup>: such systems may lead to different results, and this is acceptable under EU law. However, this choice must comply with the principles of *Lenz* and *Manninen* according to which – when a series of charges applies, *i.e.* comparability of the migrant and the non-migrant occurs<sup>155</sup> – EU freedoms “preclude a Member State from treating foreign-sourced dividends less favorably than nationally-sourced dividends.”<sup>156</sup>

This means that comparability does not require the MS of residence to provide exactly the same treatment. On the contrary, that MS is entitled to treat them differently, as far as the migrant is granted national treatment. To this extent, the ECJ further cleared that, in a legislation such as the one considered in *FIII*, national treatment is granted “provided that the tax rate applied to foreign-sourced dividends is not higher than the rate applied to nationally-sourced dividends and that the tax credit”<sup>157</sup> given is an ordinary tax credit.

According to this system, it is possible that, depending upon the circumstances, the migrant is worse off than the non-migrant, but this is not a consequence of a less favorable treatment applied by the MS of residence, but of lack of harmonization and, similarly to *Gilly*<sup>158</sup>, “of differences in tax rate”<sup>159</sup>: as a matter of facts, the migrant will suffer a tax disadvantage insofar the MS of the dividend-paying company levies more burdensome taxation than the MS of the shareholding company.

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<sup>154</sup> *FIII*, 43.

<sup>155</sup> For the purposes of the free movement of capital, see *FIII*, 62.

<sup>156</sup> *FIII*, 46.

<sup>157</sup> *FIII*, 57.

<sup>158</sup> ECJ 12 May 1998, C- 336/96.

<sup>159</sup> O’SHEA, *Dividend*, p. 891.

On these grounds, the ECJ held that the UK could treat differently domestic-sourced and foreign-sourced dividends for the purposes of freedom of establishment<sup>160</sup> and of free movement of capital<sup>161</sup>, but nevertheless – for the purposes of free movement of capital – had to grant the credit for the underlying tax also to shareholders with less than 10% of the share capital.<sup>162</sup> Otherwise, if the underlying credit were not given, national treatment would not be granted.

The principles affirmed in the dividend cases are confirmed in the interest deduction cases, which will be next analyzed.

#### 4.2. INTEREST DEDUCTION CASES: *BOSAL* AND *KELLER*

*Bosal*<sup>163</sup> and *Keller*<sup>164</sup> are two origin-State cases, concerning the prohibition of interest deduction for parent companies, which – directly or indirectly – took up loans in order to acquire shares in foreign companies. While *Keller* can be considered a natural follow-up of *Bosal*, this latter case is of particular importance because it represents – to a certain extent – an anticipation of *Marks & Spencer*.

Both cases were concerned with the freedom of establishment and the free movement of capital: this feature was particularly significant in *Keller*, because the restriction at stake regarded two financial years, and, during the first one (1994), Austria had not joined the EC yet, and accordingly only free movement of capital applied.

In *Bosal*, a Dutch-resident company, having subsidiaries in nine different MSs, was refused the deduction of costs borne in connection with the holding in the capital of its subsidiaries, because such costs should have been “indirectly instrumental in making profits which are taxable”<sup>165</sup> in the Netherlands, and the profits of the subsidiaries were not taxable there.

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<sup>160</sup> *FIII*, 57.

<sup>161</sup> *FIII*, 73.

<sup>162</sup> *FIII*, 74.

<sup>163</sup> ECJ 18 September 2003, C-168/01.

<sup>164</sup> ECJ 23 February 2006, C-471/04.

<sup>165</sup> *Bosal*, 12.

The Netherlands maintained that such rules were not prohibited by EU law on the grounds that “the subsidiaries of parent companies established in the Netherlands which do make taxable profits in that Member State and those which do not are not in an objectively comparable situation.”<sup>166</sup>

In rejecting this argument<sup>167</sup>, the ECJ cleared that comparing a resident and a non-resident subsidiary is not correct, while Bosal’s correct comparator is a parent company having subsidiaries within the same MS: “The difference in tax treatment (...) concerns parent companies according to whether or not they have subsidiaries making profits taxable in the Netherlands, even though those parent companies are all established in that Member State.”<sup>168</sup> By means of this statement, the ECJ cleared that a comparison between resident subsidiaries and non-resident subsidiaries is not suited for origin-State cases, where parent companies are to be compared.<sup>169</sup>

This point must be underlined because shows how comparability analysis changes in origin-State cases *vis-à-vis* host-State cases: in facts, in the former, the resident which has exercised EU freedoms must be compared to a resident of the same MS which has undertaken the same actions domestically.

A similar analysis was conducted in *Keller*, where, under German rules, financing costs incurred by a resident parent company in connection with an indirect holding in an Austrian subsidiary could not be deducted “to the extent that they relate to dividends paid by the latter and redistributed to the parent company under the tax-free scheme.”<sup>170</sup>

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<sup>166</sup> *Bosal*, 18.

<sup>167</sup> *Bosal* is criticized by ZALASIŃSKI, *The Limits of the EC Concept of ‘Direct Tax Restriction on Free Movement Rights’, the Principles of Equality and Ability to Pay, and the Interstate Fiscal Equity*, in *Intertax*, 2009-5, p. 293-294, who deems it an application of the “always somewhere principle” and points out that “the costs were also not deductible in the State of the subsidiary. In that state, there were taxable profits related to subsidiary, but it was not the subsidiary who incurred the holding costs.”

<sup>168</sup> *Bosal*, 39.

<sup>169</sup> This clears the doubt raised by TERRA-WATTEL, *European*, p. 150: “It puzzles us why the Court applies an economic approach, disregarding legal personality by equating branches and subsidiaries, where host measures are at issue, and shifts to a legal approach, *comparing foreign subsidiaries (...) to domestic subsidiaries*, where *origin State* measures are at issue” (emphasis added).

<sup>170</sup> *Keller*, 33.

Germany maintained that a parent company with an indirect subsidiary in another MS is not comparable to a parent having a subsidiary established in the same MS, pointing to the fact that, while “dividends paid by a national indirect subsidiary are included in the basis of assessment of the parent company, dividends paid by an Austrian indirect subsidiary are exempt from tax”<sup>171</sup> in Germany.

The ECJ rejected this argument and highlighted that the parent investing cross-border is comparable to a parent investing domestically because, “[i]n both cases, the dividends received by the parent company are, in reality, exempt from tax”<sup>172</sup>, by means of an imputation credit available to parent companies.<sup>173</sup> Accordingly, as far as the relevant tax rules affected only investments in other MSs, non-deductibility could not be considered “the corollary of the non-taxable nature of dividends from abroad.”<sup>174</sup>

From these cases consistently derives that MSs are required to apply national treatment to residents which invested cross-border, once they are found to be comparable to resident which made similar investment within the MS of origin. This is visible also in loss-relief cases.

#### 4.3. LOSS-RELIEF CASES: *MARKS & SPENCER AND X HOLDING*

In *Marks & Spencer* UK group relief rules were considered.<sup>175</sup> Marks & Spencer plc (hereafter “Marks & Spencer”), a company resident in the UK, was the parent of several companies, some of them being resident in the UK, some in other MSs. The subsidiaries established in Germany, France and Belgium reported losses, and – while Marks & Spencer managed to sell the French subsidiary – the German and Belgian ones ceased trading.

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<sup>171</sup> Keller, 36.

<sup>172</sup> Keller, 37.

<sup>173</sup> Keller, 34.

<sup>174</sup> Keller, 36.

<sup>175</sup> Literature on the case is very extensive. For a list of articles, O’SHEA, Marks and Spencer v Halsey (HM Inspector of Taxes): *restriction, justification and proportionality*, in *EC Tax Review*, 2006-2, p. 66, fn. 3.

Marks & Spencer sought relief from the losses incurred by its subsidiaries applying to the UK group tax relief, which was denied by the HMRC, "on the ground that group relief could only be granted for losses recorded in the United Kingdom."<sup>176</sup>

Marks & Spencer appealed against the refusal: while the Special Commissioners of Income Tax dismissed the appeal, the High Court of Justice, Chancery Division, decided to stay proceeding and referred the question whether the UK provisions constituted a restriction, and, if so, whether the restriction could be justified. In addition, it was also referred the question whether there may be a difference, in answering the first question, if relief had already been granted or obtained in the subsidiary's MS of residence.

For the purposes of the present research<sup>177</sup>, it is interesting to note how the ECJ dealt with comparability.

After stating that the UK relevant provisions constituted a restriction, the ECJ considered the observation submitted by the United Kingdom, according to which, having regard to the group relief system in the proceeding, "resident subsidiaries and non-resident subsidiaries are not in comparable tax situations", in light of the principle of territoriality.<sup>178</sup>

In rejecting this argument, at the outset the ECJ repeated the reasoning that tax residence may justify different treatment, but it is not always a proper factor of distinction.<sup>179</sup> The ECJ went on by pointing out that "it is necessary to consider whether the fact that a tax advantage is available solely to resident taxpayers is based on relevant objective elements apt to justify the difference in treatment."<sup>180</sup> In this respect, the ECJ cleared that the fact that the MS of residence of the parent does not

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<sup>176</sup> *Marks & Spencer*, 24.

<sup>177</sup> The outcome of the decision was that the ECJ held that the UK group tax relief rules at stake constituted a restriction, such a restriction was justified by the need to ensure balanced allocation of taxing rights, to prevent double use of losses and to prevent tax avoidance, taken together, but that restriction was disproportionate if final losses occurred.

<sup>178</sup> *Marks & Spencer*, 36.

<sup>179</sup> *Marks & Spencer*, 37.

<sup>180</sup> *Marks & Spencer*, 38.

tax the profits of the subsidiaries, relying on the principle of territoriality, “does not in itself justify restricting group relief to losses incurred by resident companies.”<sup>181</sup>

This conclusion echoes the previous *Lenz* and *Manninen*, where the ECJ had held that “the principle of territoriality cannot justify different treatment of dividends distributed by companies established in Finland and those paid by companies established in other Member States, if the categories of dividends concerned by that difference in treatment share the same objective situation.”<sup>182</sup> In other words, the ECJ had already made it very clear that the simple fact that a MS does not tax the profits in relation to which an imputation credit is given does not allow MSs to deny national treatment. Analogously, the fact that a MS does not tax profits of non-resident subsidiaries is not by itself a reason for denying the offset of losses reported by foreign subsidiaries, as comparability between the their parent company and a parent company with resident subsidiaries can still be set.

In light of this, it is argued here that, despite some adverse academic opinion<sup>183</sup>, ECJ’s comparability analysis is extremely consistent in applying a teleological interpretation of the relevant provisions.<sup>184</sup>

*Marks & Spencer* is also clear in explaining how to identify the correct comparator from the origin-State perspective.

In this latter scenario, the resident of the origin-MS, who exercised EU freedoms, must be compared with a resident of the same MS, who did not exercise EU freedoms. Accordingly, the right comparator for a resident which established foreign subsidiaries is a resident which opens resident subsidiaries, and not a resident with a foreign branch. This point however was discussed at the hearing before the Special Commissioners, where significant debate was committed to treatment of a company

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<sup>181</sup> *Marks & Spencer*, 40.

<sup>182</sup> *Manninen*, 39.

<sup>183</sup> ENGLISH, *HMRC v Philips Electronics UK Ltd: another contribution to EU law jurisprudence on loss relief*, *British Tax Review*, 2012, 5, p. 589, in commenting *Philips Electronics* (ECJ 6 September 2012, C-18/11), criticized ECJ’s comparability analysis as “erratic and inconsistent.”

<sup>184</sup> Consistency of comparability analysis is found, for instance, in loss-relief cases: *X Holding*, 22-24; *OyAA* (ECJ 18 July 2007, C-231-05), 38; *Philips Electronics*, 19; *A Oy* (ECJ 21 February 2013, C-123/11), 34-35.

resident in the UK creating foreign branches<sup>185</sup>, and featured also in the Special Commissioners' decision<sup>186</sup> and in the Opinion of AG Maduro to *Marks & Spencer*.<sup>187</sup>

The identification of the correct comparator is made clear by the ECJ, where it highlighted that precluding group tax relief to a parent company on the grounds that its subsidiaries are non-resident "is of such a kind as to hinder the exercise of that parent company of its freedom of establishment by deterring it from setting subsidiaries in other Member States."<sup>188</sup>

This statement echoes the principles affirmed in *Bosal* where the ECJ had already held that the "difference in tax treatment in question concerns parent companies (...) all established in that Member State"<sup>189</sup>, while subsidiaries, being them resident or non-resident, are not involved.<sup>190</sup>

This explains also the outcome of *X Holding*, where the taxpayer – a Dutch parent company – claimed that the domestic treatment of losses recorded by its Belgian subsidiary was incompatible with EU law, because received a less favorable treatment than if it had created a foreign permanent establishment, instead of establishing a non-resident subsidiary: as a matter of facts, a Dutch company with a permanent establishment abroad was allowed to temporary deduct the foreign losses from the domestic profits.

The ECJ held that the Netherlands were not obliged to extend the (more favorable) treatment of losses incurred by permanent establishments to subsidiaries, because "[p]ermanent establishments situated in another Member State and non-resident subsidiaries are not in a comparable situation with regard to the allocation of the power of taxation"<sup>191</sup>, as provided by a DTT. Even though the ECJ had held

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<sup>185</sup> As reported by O'SHEA, *EU Tax Law*, p. 221.

<sup>186</sup> Decision SpC 00352, [2003] STC (SCD) 70, 90-91.

<sup>187</sup> AG's Opinion to *Marks & Spencer*, 37-55.

<sup>188</sup> *Marks & Spencer*, 33.

<sup>189</sup> *Bosal*, 39.

<sup>190</sup> This is in open contrast with the Special Commissioners' decision, which – in holding that foreign subsidiaries are not comparable to UK subsidiaries – placed "too much emphasis on the subsidiaries (...) rather than on the decision taken by (...) the UK parent company to establish subsidiaries or branches in the first place." (O'SHEA, *Marks*, pp. 67 and 72).

<sup>191</sup> *X Holding*, 38.

that “the second sentence of the first paragraph of Article 43 EC leaves traders free to choose the appropriate legal form in which to pursue their activities”<sup>192</sup>, the MS of origin “remains at liberty to determine the conditions and level of taxation for different types of establishments chosen by national companies operating abroad, on condition that those companies are not treated in a manner that is discriminatory in comparison with comparable national establishments.”<sup>193</sup>

*X Holding* explains paradigmatically how the comparator differs in origin-State and host-State perspectives: while in the latter a host-State company is compared to a non-national company (with a permanent establishment in the host-State), in the origin-State perspective “the comparator is not between a PE and a resident company; rather it is between a resident company exercising a fundamental freedom and a resident company conducting a similar operation domestically.”<sup>194</sup> Thus, being a foreign permanent establishment and a non-resident subsidiary not comparable, the origin-MS remains free to apply two different (national) treatment to residents who are not in comparable situations, having chosen two different forms of establishment.

#### 5. “HOST-STATE” VS. “ORIGIN-STATE”: (DIRECT AND INDIRECT) DISCRIMINATION AND RESTRICTION

From previous sections it is clear how comparability plays a key-role from both host-State and origin-State perspectives, given that discrimination and restriction occur only to the extent that the migrant is in a comparable situation to the non-migrant.

In this section, cases will be further categorized, starting from host-State cases.

From the analysis conducted here, host-State’s provisions are capable to treat the non-national/resident differently by discriminating him or by restricting his exercise

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<sup>192</sup> *X Holding*, 39.

<sup>193</sup> *X Holding*, 40.

<sup>194</sup> O’SHEA, *News Analysis: Dutch Fiscal Unity Rules Receives Thumbs up From ECJ*, in *Tax Notes International*, March 8, 2010, p. 835.

of EU freedoms; in addition, both discrimination and restriction by the host-State can be grounded on nationality or on other criteria (e.g. tax residence). Thus, there is a combination of possibilities for the host-MS to apply different treatment than its own nationals/residents.

First of all, discrimination on the grounds of nationality (direct discrimination)<sup>195</sup> may occur: paradigmatic cases are *Avoir fiscal* and *Royal Bank of Scotland*.<sup>196</sup>

In *Avoir fiscal*, the ECJ held that, even though nationality generally refers to natural persons, “[w]ith regard to companies, (...) their registered office (...) serves as the connecting factor with the legal system of a particular state, like nationality in the case of natural persons.”<sup>197</sup> Accordingly, also companies can be discriminated on the grounds of nationality, if difference in treatment relates to the State of the seat, as in *Avoir fiscal*, where companies having their registered seat in another MS than France were denied the tax advantage available to French companies.

A similar situation featured in *Royal Bank of Scotland*, where Greek rules provided for different tax-rates, depending upon whether companies had their seat in Greece (35% tax-rate applied) or in another MS (40% tax-rate applied). However, since national and foreign companies were found to be comparable given that the tax due was “calculated, in the case of both Greek and foreign companies, on net income (...), this being determined according to that method both for Greek companies and for foreign companies”<sup>198</sup>, direct discrimination occurred.

Discrimination on the grounds of nationality is not the only possibility of different treatment by host-MSs. In this respect, the ECJ also held that “[t]he rules regarding equality of treatment (...) forbid also all covert forms of discrimination.”<sup>199</sup> Cases where covert or indirect discrimination featured are e.g. *Biehl*, *Commerzbank*, and *Schumacker*.

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<sup>195</sup> Also a restriction can be based upon nationality: if so, it is usually referred to as “discriminatory restriction” and is equated to direct discrimination. Paradigmatic case is *Commission v. Spain (“Lotteries”)* (ECJ 6 October 2009, C-153/08).

<sup>196</sup> ECJ 29 April 1999, C-311/97.

<sup>197</sup> *Avoir fiscal*, 18. Identically, *Royal Bank of Scotland*, 23.

<sup>198</sup> *Royal Bank of Scotland*, 28.

<sup>199</sup> *Sotgiu*, 11.

In *Biehl*, Luxembourg rules which provided for that tax deducted from salaries of taxpayers, resident during only a part of the year, were not repayable. Mr Biehl, resident and employed in Luxembourg until the end of October 1983, moved his residence to Germany and applied for refund. Luxembourg tax authority denied it, and maintained that the rules at stake “did not constitute discrimination prohibited by Community law.”<sup>200</sup> In rejecting this argument, the ECJ applied the principle affirmed in *Sotgiu* and held that “[e]ven though the criterion of permanent residence (...) applies irrespective of the nationality of the taxpayer concerned, there is a risk that it will work in particular against (...) nationals of other Member States. It is often such persons who will in the course of the year leave the country (...).”<sup>201</sup>

An analogous conclusion was reached in *Commerzbank*, where, under the relevant UK rules, a permanent establishment of a German bank was denied repayment supplement of overpaid tax “on the ground that the company was not resident in the United Kingdom.”<sup>202</sup> The ECJ maintained that the criterion of tax residence was likely to affect mainly non-resident and constituted indirect discrimination.

In addition, in *Commerzbank*, the ECJ cleared also how company’s seat and tax residence relate to direct and indirect discrimination, by stating that, “[a]lthough it applies independently of a company’s seat, the use of the criterion of fiscal residence within national territory (...) is liable to work more particularly to the disadvantage of companies having their seat in other Member States.”<sup>203</sup>

This point is extremely important because the difference between direct and indirect discrimination is of extreme relevance when justifications come into play. While only an express Treaty derogation (e.g. public policy, public security or public

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<sup>200</sup> *Biehl*, 8.

<sup>201</sup> *Biehl*, 14.

<sup>202</sup> *Commerzbank*, 8.

<sup>203</sup> *Commerzbank*, 15.

health provided for by Art. 52 TFEU) may justify direct discrimination<sup>204</sup>, indirect discrimination can be justified by imperative reasons in the public interest.<sup>205</sup>

Coherently, in *Royal Bank of Scotland*, the ECJ stated that, “according to settled case law, only an express derogating provision, such as Article 56 of the EC Treaty, could render such discrimination compatible with Community law.”<sup>206</sup> Similarly, in *Avoir fiscal* the ECJ had held that the risk of tax evasion cannot be relied upon as justification, because “Article 52 of the EEC Treaty does not permit any derogation (...) on such a ground.”<sup>207</sup>

On the other hand, having regard to indirect discrimination, in *Schumacker* – where again the ECJ maintained that “tax benefits granted only to residents of a Member State may constitute indirect discrimination by reason of nationality”<sup>208</sup> – the ECJ did not require TFEU derogations.<sup>209</sup> In fact, although in rejecting them in the specific case, the ECJ analyzed whether the need to ensure cohesion of the tax system<sup>210</sup> or administrative difficulties in ascertaining the income retrieved by the non-resident in his State of residence<sup>211</sup> may justify the difference in treatment.

In third instance, beside constituting direct and indirect discrimination, provisions laid down by host-MSS may also restrict, *i.e.* hinder, discourage, render less attractive, the exercise of EU freedoms.<sup>212</sup>

An example of restriction from the host-State perspective is certainly *Futura*<sup>213</sup>: according to the relevant Luxembourg rules, whereas a non-resident company

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<sup>204</sup> This applies also to discriminatory restrictions: “(...) although a certain number of overriding reasons in the public interest have indeed been recognized by the Court’s case-law (...), (...) those objectives cannot be relied upon to justify discriminatory restrictions” (*Lotteries*, 36).

<sup>205</sup> For a thorough analysis of justifications, O’SHEA, *EU Tax Law*, pp. 115-158; ID., *A British-Dutch Debate*, p. 122.

<sup>206</sup> *Royal Bank of Scotland*, 32.

<sup>207</sup> *Avoir fiscal*, 25.

<sup>208</sup> *Schumacker*, 29.

<sup>209</sup> This is confirmed by O’SHEA, *A British-Dutch Debate*, p. 122, and FARMER-LYAL, *EC Tax Law*, 1994, p. 330, who – having regard to *Bachmann* (ECJ 28 January 1992, C-204/90) – highlighted that “*Bachmann* indicates that covertly discriminatory tax rules can sometimes be justified by imperative requirements.”

<sup>210</sup> *Schumacker*, 40-41.

<sup>211</sup> *Schumacker*, 43-46.

<sup>212</sup> The reasoning behind restrictions on EU freedoms has been first stated by the ECJ in *Dassonville* (ECJ 11 July 1974, 8-74).

<sup>213</sup> As reported by GAMMIE, *The Role of the European Court of Justice in the Development of Direct Taxation in the European Union*, in *IBFD Bulletin*, March 2003, p. 91, fn. 39, the UK Court of Appeal in *Professional*

“wishes to carry forward any losses incurred by its branch, it must keep (...) separate accounts for its branch’s activities complying with the tax accounting rules”<sup>214</sup> of the host-MS, where such separate accounts must also be held. The ECJ highlighted that “such a condition may constitute a restriction (...) on the freedom of establishment.”<sup>215</sup> In holding that the conditions laid down by Luxembourg constituted a restriction, the ECJ stated that such provisions may be justified by reasons of public interest, and applied the principles affirmed in *Gebhard*, namely that the provisions “have to be of such a nature as to ensure achievement of the aim in question and not go beyond what was necessary for that purpose.”<sup>216</sup> *Futura* confirms that provisions constituting a restriction do not require Treaty justifications, but can be justified by “pressing reasons of public interest.”<sup>217</sup>

This being said with reference to host-State cases, origin-State environment greatly differs for what concerns discrimination and restriction.

From *Daily Mail*<sup>18</sup>, MSs are not in the position of laying down rules which treat its own nationals who exercised EU freedoms rights less favorably than its own nationals who did not. In the origin-State environment two nationals/residents, of the same MS are to be compared, and comparability analysis must ascertain whether the cross-border exercise of EU freedoms places the migrant in a different situation than the non-migrant.

Once borne in mind that in the origin-State scenario nationality and residence of the subjects to be compared, *i.e.* the migrant and the non-migrant, do not differ, it is clear that in origin-State cases discrimination never features.

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*Contractors* had held that a restriction can fall into two categories, namely “dislocation” (depending upon the interaction of the different tax systems of MSs) and “neutral” (not constituting discrimination nor dislocation, but having a demonstrable inhibiting effect). Critical towards *Professional Contractors*, O’SHEA, Marks, pp. 71-72. On “dislocation”, also TERRA-WATTEL, *European*, pp. 58-59, who refer to it also as “Tax Base Fragmentation”. According to this categorization, *Futura* is a case of dislocation.

<sup>214</sup> *Futura*, 25.

<sup>215</sup> *Futura*, 24.

<sup>216</sup> *Futura*, 26.

<sup>217</sup> *Futura*, 26.

<sup>218</sup> *Daily Mail*, 16.

Indeed, having regard to *Deutsche Shell*<sup>219</sup>, it has been cleared that, from the origin-MS perspective, “comparison is always between two nationals of that Member State and, as such, discrimination on the grounds of nationality does not enter the picture.”<sup>220</sup>

## 6. CONCLUSIONS

Different treatment is always admitted once different rules apply to different situation, or the same rules apply to similar situations.

Within the direct tax field, the main distinguishing criterion is between the situations of residents and non-residents for tax purposes.

This research proved that this is true also under EU law, whereas the ECJ has abundantly made it clear that, “[i]n relation to direct taxes, the situations of residents and of non-residents are not, as a rule, comparable.”<sup>221</sup>

However, a distinction solely on the grounds of tax residence may allow MSs to discriminate nationals of other MSs or to restrict the exercise of EU freedoms.

Thus, the ECJ – although recognizing the general principle of non-comparability – has identified to what extent comparability of residents and non-residents could be set.

In doing so, the ECJ has focused its attention to the aim pursued by provisions laid down by MSs: this research has cleared that the ECJ conducted no comparability analysis without a teleological interpretation of the various rules at stake.

This awareness allowed to reconcile a number of host-State cases, which at first glance may have seemed inconsistent, such as *Schumacker*, *Gschwind*, *Asscher*, and *Gerritse*, and *ACT IV GLO*, *Denkavit*, and *Truck Center*.

Comparability was considered also from the origin-State perspective: in this scenario as well, an approach which took into account the goal-oriented interpretation adopted by the ECJ led the research to reconcile a number of origin-

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<sup>219</sup> ECJ 28 February 2008, C-293/06.

<sup>220</sup> O’SHEA, *Quis Custodiet*, p. 44.

<sup>221</sup> *Schumacker*, 31.

State cases dealing with dividends taxation, interest deduction, and cross-border loss-relief.

Analysis of cases as host-State and origin-State cases proved to be essential in identifying the correct comparator and in highlighting how the comparator changes from the host-State and origin-State perspectives. On these grounds, *Bosal*, *Marks & Spencer*, and *X Holding* were reconciled.

Furthermore, the results of the research on comparability led to categorize the different treatments between the migrant and the non-migrant that MSs may apply, from both host-State and origin-State perspectives.

The final outcome of this research is that the ECJ showed extreme consistency of analysis in setting comparability between migrants and non-migrants, thus fulfilling its role of ensuring uniform interpretation of EU law, provided for by Art. 234 TFEU.

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