

---

## Chapter 5

### The Relevance of Residence Under EC Tax Law

by Luc De Broe<sup>1</sup>

This chapter does not aim at exhaustively discussing the Community law aspects of residence of individuals in the field of direct taxation. It instead focuses on two selected topics: (1) the use of the “residence” criterion by Member States as a factor to allocate taxing jurisdiction between themselves, and (2) certain Community law aspects of transfers of residence by individuals.

#### 5.1. The use of the “residence” criterion by Member States as a factor to allocate taxing jurisdiction

##### 5.1.1. The basic principles

Apart from the few EC Directives that provide for substantive tax provisions (Merger Directive, Parent-Subsidiary Directive, Interest and Royalty Directive, and Savings Directive), there are no Community law rules in direct taxation. Save for those limited fields in which tax law has been harmonized within the Community by way of directives, direct taxation therefore falls within the competence of the Member States. Against this finding, it comes as no surprise that it is established case law of the ECJ that, in the absence of any unifying or harmonizing measures adopted in the Community context, it is within the Member States’ sovereign taxing powers to define unilaterally<sup>2</sup> or in tax treaties designed to avoid double taxation<sup>3</sup> the criteria for allocating their powers of taxation. In certain cases involving

---

1. Professor of Tax Law, KU Leuven (Belgium); Senior of Counsel, Stibbe Brussels.

2. ECJ, 23 February 2006, C-513/03, *Van Hilten*, § 47.

3. See in particular: ECJ, 12 May 1998, C-336/96, *Gilly*, § 30; ECJ, 21 September 1999, C-307/97, *Saint Gobain*, § 56; ECJ 12 December 2002, C-385/00, *De Groot*, § 93; ECJ, 5 July 2005, C-376/03, *D*, § 52; ECJ, 19 January 2006, C-265/04, *Bouanich*, § 49; ECJ, 7 September 2006, C-470/04, *N*, § 44; ECJ, 12 December 2006, *ACT GLO*, C-374/04, § 81; ECJ 14 December 2006, C-170/05, *Denkavit Internationaal*, § 43; ECJ, 8 November 2007, C-379/05, *Amurta*, § 17; ECJ, 20 May 2008, C-194/06, *Orange Smallcap*, § 32; ECJ, 16 July 2009, C-128/08, *Damseaux*, § 30.

the allocating of taxing powers under a tax treaty, the ECJ sometimes adds the Member States' sovereign power to decide on the allocation criteria is done "with a view to eliminating double taxation".<sup>4</sup> It follows that Community law – and consequently also the ECJ – must respect the choices made by Member States, either in their domestic laws or their tax treaties, to determine the criteria for the levy of taxes. The ECJ therefore accepts that Member States allocate tax jurisdiction amongst themselves on the basis of "residence" – with the resulting consequence that residents are subject to worldwide taxation in the Member State of residence (unlimited tax liability) – and of "source" – the consequence of which is that in the Member State of the source of the income, non-residents are subject to tax only on that income (limited tax liability).<sup>5</sup> Also, the ECJ accepts the various allocation criteria laid down to that effect in tax treaties (situs of real property, Member State of residence of payer or beneficiary of the income, Member State where employment is exercised, etc.). It equally accepts that Member States in their domestic laws or tax treaties divide their taxing powers on the basis of nationality of the taxpayer and that this does not amount to discrimination.<sup>6</sup> In summary, using the expression of S. Van Thiel, Member States may "shape inter-jurisdictional equity in any way Member States see fit and, therefore, regulate relations between Member States by establishing an agreed balanced allocation of taxing powers".<sup>7</sup>

In early cases like *Gilly* and *Saint Gobain*, and a number of subsequent cases, the ECJ observed that in the allocation of fiscal jurisdiction, it is "not unreasonable" for the Member States to base their agreements on international practice and on the OECD Model Convention for the avoidance of double taxation (hereafter "OECD MC") and the Commentaries published

---

4. See e.g. ECJ, 12 May 1998, C-336/96, *Gilly*, § 30; ECJ, 8 November 2007, C-379/05; ECJ, 12 December 2006, *ACT GLO*, C-374/04, § 81; *Amurta*, § 17; ECJ, 16 July 2009, C-128/08, *Damseaux*, § 30.

5. ECJ, 15 May 1997, C-250/95, *Futura*, § 22; ECJ, 13 December 2005, C-446/03, *Marks & Spencer*, § 39; ECJ 29 March 2007, C-347/07, *Rewe*, § 69; Lenaerts, K., Bernardeau, L., "L'encadrement communautaire de la fiscalité directe", *Cahiers de droit européen* (2007), at 61.

6. ECJ, 12 May 1998, C-336/96, *Gilly*, § 30 (under a tax treaty); ECJ, 23 February 2006, C-513/03, *Van Hilten*, § 47 (under domestic law).

7. Van Thiel, S., "Justifications in Community Law for Income Tax Restrictions on Free Movement: Acte Clair Rules That Can Be Readily Applied by National Courts – Part 2", *European Taxation* (2008), at 342. Van Thiel's position only deals with the allocation of taxing rights in tax treaties; however, such allocation may also be achieved through domestic law and to the extent that such law follows a general international practice in this field "inter-jurisdictional equity is [also] shaped by establishing an agreed balanced allocation of taxing powers".

by the OECD in relation to that MC (hereafter “OECD MC Commentary”).<sup>8</sup> It also took that position in the *Van Hilten* case (an inheritance tax case, see 5.2.2.) with respect to the OECD Double Taxation Model Convention on Inheritances and Gifts and the Commentary thereto.<sup>9</sup> This case law suggests that when Member States conform to this OECD soft law, Member States will generally be protected from interference by the ECJ in the division of their taxing jurisdiction on grounds of alleged incompatibility with the TEC freedoms.<sup>10</sup>

The choice of the allocating factor may be advantageous or disadvantageous for the taxpayer depending upon whether as a consequence of that factor the taxpayer pays tax in the Member State levying the lower or the higher tax. However, this follows from a disparity between the tax laws of the Member States that is a matter of national sovereignty unaffected by Community law. Community law does not require harmonization or equation of tax rates, nor does it require Member States to prevent double taxation in such a way that income is always taxed at the lowest tax rate of the two Member States involved.<sup>11</sup>

However, although Member States have the sovereign power to determine the connecting factors for delineating their tax jurisdiction, Member States may not infringe the TEC freedoms when exercising their taxing rights once they have been allocated. In *Saint Gobain* and a number of subsequent judgments, the ECJ said:

Member States are at liberty in the framework of bilateral agreements concluded in order to prevent double taxation to determine the connecting factors for the purposes of allocating powers of taxation as between themselves.... As far as the exercise of the power of taxation so allocated is concerned, the Member States nevertheless may not disregard Community rules. According to the settled case-law of the Court, although direct taxation is a matter for the

---

8. ECJ, 12 May 1998, C-336/96, *Gilly*, § 31; ECJ, 21 September 1999, C-307/97, *Saint Gobain*, § 57; ECJ, 7 September 2006, C-470/04, *N*, §§ 44-46; ECJ, 8 November 2007, C-379/05, *Amurta*, § 17; ECJ, 20 May 2008, C-194/06, *Orange Smallcap*, § 32; ECJ, 16 July 2009, C-128/08, *Damseaux*, § 33.

9. ECJ, 23 February 2006, C-513/03, *Van Hilten*, § 48.

10. Terra, B., Wattel, P., *European Tax Law*, 5th edn., Kluwer, 2008, p. 771.

11. ECJ, 12 May 1998, C-336/96, *Gilly*, § 34. And specifically in case of residence transfers: ECJ, 15 July 2004, C-365/02, *Lindfors*, § 34; ECJ, 29 April 2004, C-387/01, *Weigel*, § 55; ECJ, 12 July 2005, C-403/03, *Schempp*, §§ 45-46. Van Thiel, S., “Justifications in Community Law for Income Tax Restrictions on Free Movement: Acte Clair Rules That Can Be Readily Applied by National Courts – Part 2”, op. cit., p. 344.

Member States, they must nevertheless exercise their powers consistently with Community law....<sup>12</sup>

Although in practice it is not always easy to determine when a Member State is merely allocating taxing powers and when it is exercising the powers so allocated,<sup>13</sup> and that even tax treaty provisions may reach beyond the mere allocation of taxing rights,<sup>14</sup> it is clear that in the exercise of the allocated powers of taxation Member States have to comply with the imperatives set by the TEC freedoms and remain subject to scrutiny of the ECJ. As stated earlier, Community law does not require harmonization or equation of tax rates, nor does it prevent double taxation in such a way that income is always taxed at the lowest tax rate of the two Member States involved. However, it does require equal treatment (national treatment) of residents and non-residents and equal treatment (national treatment) of foreign and domestic income. National treatment here means equal exercise of national taxing powers by the host state in so far as non-residents are taxed on items of income on which residents are taxed and in so far as residents are taxed by the home state on foreign source income.<sup>15</sup>

The ECJ, however, has denied most-favoured-nation (MFN) treatment as regards tax treaty benefits for Community residents. In the *D* case, the ECJ decided that Member State A should not extend the benefits granted to a resident of Member State B under the A/B tax treaty to residents of Member State C with which Member State A also has entered into a tax treaty that provides, however, lesser benefits to Member State C residents. The ECJ observed that the question of MFN treatment has nothing to do with

---

12. ECJ, 21 September 1999, C-307/97, *Saint Gobain*, §§ 56-57, ECJ 12 December 2002, C-385/00, *De Groot*, §§ 93-94; ECJ 14 December 2006, C-170/05, *Denkavit Internationala*, § 44.

13. Wattel, P., "EC Treaty freedoms, tax treaties and national courts", in Maisto, G., ed., *Courts and Tax Treaty Law*, Amsterdam: IBFD Publications BV, 2007, Vol. 3 EC and International Tax Law Series, p. 125; Weber, D., "In Search of a (New) Equilibrium Between Tax Sovereignty and the Freedom of Movement within the EC", *Intertax* (2006), at 586.

14. *Saint Gobain* is a case in point. The ECJ ruled that Germany had to extend the treaty benefits offered in connection with dividends received by German resident companies to branches of non-resident companies receiving dividends under the same circumstances (ECJ, 21 September 1999, C-307/97, *Saint Gobain*). On the other hand, the allocating factor used in a tax treaty together with the maximum rate set by the treaty at which income may be taxed in the source state may eliminate a discrimination of a non-resident (see ECJ, 19 January 2006, C-265/04, *Bouanich*, §§ 48-56).

15. Terra, B., Wattel, P., *European Tax Law*, 5th edn., Kluwer, 2008, pp. 728 and 778; Weber, D., "In Search of a (New) Equilibrium Between Tax Sovereignty and the Freedom of Movement within the EC", op. cit., p. 586.

the consequences of allocating taxing powers in relation to nationals or residents of Member States that are party to a tax treaty, but deals with the question of drawing a comparison between the situation of a person resident in a state not party to a tax treaty and a person who is a party to the treaty. Residents of Member States B and C are not comparable for the purposes of tax treaty negotiations by Member State A. Tax treaties are the result of negotiations between two Member States with different national tax systems. The benefits which a Member State offers under a tax treaty to a (non-) resident of the other contracting Member State form part of a bundle of reciprocal rights and obligations reserved only to the taxpayers protected by the treaty. Separating the specific treaty benefits from the remainder of the treaty would upset the carefully negotiated overall balance of the treaty.<sup>16</sup> The ECJ has extended this *D*-case law to the question whether limitation on benefits clauses included in tax treaties are in accordance with Community law and answered that question affirmatively.<sup>17</sup> In this writer’s opinion, the ECJ was wrong in doing so and it should reconsider its position.<sup>18</sup>

### 5.1.2. Dual residence

Most tax treaties entered into by Member States follow Art. 4 OECD MC. Those treaties use the residence of a taxpayer as one of the connecting factors to allocate taxing jurisdiction. However, tax treaties following Art. 4 OECD MC do not provide for an autonomous definition of residence but refer to the criteria set out in the domestic laws of the State concerned to ascertain a person’s tax residence. Art. 4 OECD MC limits such criteria, however, to “domicile, residence, place of management or any other criterion of a similar nature”. The choice of the residence criterion in

---

16. ECJ, 5 July 2005, C-376/03, *D*, §§ 52–63. Authors continue to criticise this judgment, see, e.g., Cordewener, A., Kofler, G., Van Thiel, S., “The Clash between European Freedoms and National Direct Tax Law: Public Interest Defences Available to Member States”, *CML Review* (2009), at 1984 et seq.; Van Thiel, S., “Justifications in Community Law for Income Tax Restrictions on Free Movement: Acte Clair Rules That Can Be Readily Applied by National Courts – Part 2”, op. cit., pp. 342–345.

17. ECJ, 12 December 2006, *ACT GLO*, C-374/04, §§ 81–94.

18. De Broe, L., *International Tax Planning and Prevention of Abuse*, Amsterdam: IBFD Publications BV, 2008, pp. 1048–1056. For other criticisms of this judgment, see Cordewener, A., Kofler, G., Van Thiel, S., “The Clash between European Freedoms and National Direct Tax Law: Public Interest Defences Available to Member States”, op. cit., p. 1985.; Van Thiel, S., “Justifications in Community Law for Income Tax Restrictions on Free Movement: Acte Clair Rules That Can Be Readily Applied by National Courts – Part 2”, op. cit., p. 343.