
Chapter 13

Non-Discrimination in European Tax Law: General Remarks

13.1. Introduction

13.1.1. Purpose and scope of the study

A first encounter with the ECJ's body of case law in the area of direct taxation may cause a sense of bewilderment. Several judgments seem difficult to reconcile or even contradictory. However, a closer reading often reveals slight distinctions and subtle nuances. Apparent contradictions are frequently reconcilable on the basis of those distinctions and nuances. As Walt Whitman wrote in his seminal poem *Song of Myself*:¹¹⁷³

*Do I contradict myself?
Very well, then, I contradict myself;
(I am large—I contain multitudes.)*

Similarly, the ECJ's body of case law is large, and its apparent contradictions can often be explained by the multitudes contained in that case law. Among these multitudes are the different types of discrimination which have been distinguished in case law and legal literature, which make it difficult to accurately describe the notion of "discrimination" (*see* section 12.2.). Additionally, the apparent contradictions can sometimes be explained by a lack of analytical strictness in the Court's judgments (or in the academic discussion of those judgments). In particular, it seems that the Court sometimes takes arguments into consideration in the wrong step of its decision process. As a result, different judgments sometimes seem irreconcilable because identical arguments are taken into account in different steps of the decision process.

For this reason, a strict division will be endeavoured to be maintained between the different steps of the decision process when discussing ECJ case law. Ultimately, the purpose of this study is to verify whether there is a common idea of non-discrimination underlying ECJ case law in matters of direct taxation. In order to do so, the case law will be discussed from the perspective of, on the one hand, the comparability of the subject and object

1173. W. Whitman, *Leaves of Grass* (1855).

of comparison and, on the other hand, the treatment accorded to the subject of comparison.¹¹⁷⁴ Both of those sections will be subdivided thematically into subsections.

In other words, the purpose of this study is not to expose contradictions in the case law or conflicts between the different decisions. Instead, a common principle will be sought which underlies this case law and which may remove some apparent tensions. As will become apparent throughout the discussion of the Court's decisions, that common principle is the principle of non-discrimination.

13.1.2. The case law of the European Court of Justice on direct taxation

The ECJ's body of case law on direct taxation is steadily expanding.¹¹⁷⁵ However, when discussing this case law, it should be borne in mind that it is part of a much larger body of case law on non-discrimination and the fundamental freedoms that has evolved over the past decades. Direct taxation is, in principle, a matter of the Member States' national sovereignty, but this sovereignty is limited by aspects of EU law, of which the free movement rules and the rules on state aid are the most important. Consequently, even though Member States are, in principle, free to design their tax systems, they must not violate the relevant provisions of EU law.¹¹⁷⁶ This study is concerned only with the compatibility of Member States' tax systems with the free movement provisions.

1174. Given the scope of this study, the author will mainly address the *existence* of a discrimination, rather than the possible justification thereof. Accordingly, the focus will be on the first two steps of the analysis (i.e. the comparability test and the disadvantage test). The third step (the justification test) will be discussed only in so far it has a bearing on the first two steps. For a recent overview of the justification issue in the area of direct taxation, see A. Cordewener, G. Kofler and S. van Thiel, *The Clash between European Freedoms and National Direct Tax Law: Public Interest Defences Available to the Member States*, Common Mkt. L. Rev. (2009), at 1951-2000.

1175. This study is mainly concerned with direct taxation. Case law dealing with other taxes will be addressed in so far as it is relevant for the evolution of the case law on direct taxation.

1176. The ECJ's standard formula in this regard is that "although direct taxation falls within their competence, the Member States must none the less exercise that competence consistently with Community law". See e.g. C-80/94, *Wielockx*, 11 Aug. 1995, ECR (1995), I-2493, para. 16; C-311/97, *Royal Bank of Scotland*, 29 Apr. 1999, ECR (1999), I-02651, para. 19.

In principle, the ECJ's analysis in direct tax cases does not differ from other areas of the law.¹¹⁷⁷ A tax disadvantage is simply another obstacle to individuals and companies wishing to exercise their Treaty freedoms.¹¹⁷⁸ As a result, the general remarks made above with regard to the ECJ case law on discrimination apply to the case law on direct taxation, notwithstanding several specific refinements.¹¹⁷⁹ These refinements will become apparent throughout the discussion of the relevant case law, but it may be advisable to note some important differences.

First, given the specific relationship between a person's nationality and his taxability, the case law has deviated somewhat from the general approach with regard to discrimination. For example in *Gilly*, the Court has held that a Member State did not discriminate directly on grounds of nationality merely because it explicitly based its taxing rights on an individual's nationality. As will be explained in detail in section 17.3., this position should be seen in the context of the distinction between the allocation of taxing powers, and the exercise of these powers. The Member States are free to determine the criteria and connecting factors with respect to direct taxation, but they may not disregard EU law as far as the *exercise* of the power of taxation so allocated is concerned.

Second, in its tax case law on corporate establishment, the ECJ tends to replace references to "indirect discrimination" with "unequal treatment" (or "inequality of treatment"). In its earlier case law, the Court used the traditional notion of indirect discrimination to analyse rules based on a company's seat or residence.¹¹⁸⁰ In more recent cases, however, the Court substituted this notion with "unequal treatment".¹¹⁸¹ As a result, the Court side-steps the difficulty that rules which are based on a company's seat or

1177. E.g. Case 82/71, *Italy v. Società agricola industria latte (SAIL)*, 21 Mar. 1972, para. 5 ("the effectiveness of Community law cannot vary according to the various branches of national law which it may affect"). See also P. Stanley, *Review Essay: Case C-107/94, Asscher v. Staatssecretaris van Financiën*, Common Mkt. L. Rev. (1997), at 713 ("The field of direct taxation is one area where Member States are inclined to be especially protective of their rights. Nevertheless, the Court of Justice has declined to erect a barrier around tax law, and vigorously maintains its insistence that here, as elsewhere, Member States must exercise their powers consistently with the fundamental principles of Community law").

1178. R. Lyal, *Non-discrimination and Direct Tax in Community Law*, EC Tax Rev. (2003), at 68.

1179. The most important of these refinements is that the ECJ has attempted to transpose its restriction-based reading to direct tax cases, but that this attempt has not been entirely successful. See section 13.4.3.

1180. E.g. C-330/91, *Commerzbank AG*, 13 July 1993, ECR (1993), I-4017.

1181. E.g. C-264/96, *ICI v. Colmer*; 16 July 1998, ECR (1998), I-4695; C-307/97, *Saint-Gobain*, 21 Sept. 1999, ECR (1999), I-6161; C-141/99, *Algemene Maatschappij*

residence, technically may amount to direct discrimination on the grounds of nationality, and can therefore be justified only by relying on the grounds provided by the Treaty.¹¹⁸²

Finally, even though the ECJ has attempted to apply the principles developed in its non-tax case law to direct tax cases, this has often proven to be difficult, if not impossible. The most telling example is the evolution in the Court's general tax law from a pure discrimination-based analysis towards a broader, restriction-based reading of the Treaty freedoms. As will become apparent in section 13.4.3., the Court has attempted to transpose this evolution to the field of direct taxation, but this has not been a resounding success.

Even though there are some deviations, the general approach in tax cases and in non-tax cases is the same. As a result, the standard Aristotelian formula applies in tax matters as well: "comparable situations must not be treated differently and different situations must not be treated in the same way unless such treatment is objectively justified".¹¹⁸³ This chapter will be structured along the lines of the different elements of this formula. After a brief general overview of the Court's position on these matters, the case law will be examined against the backdrop of the two constitutive elements of discrimination, namely comparability and difference in treatment. The third element in the ECJ's discrimination analysis, the justification test, will be addressed only in so far as it is relevant to the actual inquiry as to whether discrimination has occurred (i.e. the first two steps).

The general starting point will be that the fundamental freedoms are all based on a common, underlying principle of non-discrimination.¹¹⁸⁴ The purpose of this part of the study is to identify this principle and to compare it to the standard underlying article 24 of the OECD Model Convention, identified in Part II. Consequently, the starting point is the assumption that

voor *Investering en Dienstverlening NV (AMID) v. Belgische Staat*, 14 Dec. 2000, ECR (2000), I-11619.

1182. P. Farmer, *The Court's Case Law on Taxation: A Castle Built on Shifting Sands?*, EC Tax Rev. (2003), at 76.

1183. E.g. C-279/93, *Schumacker*, 14 Feb. 1995, ECR (1995), I-225, para. 30; C-80/94, *Wielockx*, 11 Aug. 1995, ECR (1995), I-2493, para. 17; C-107/94, *Asscher*, 27 June 1996, ECR (1996), I-3089, para. 40; C-311/97, *Royal Bank of Scotland*, 29 Apr. 1999, ECR (1999), I-02651, para. 26.

1184. See also R. Lyal, "EU Report", in IFA, *Cahiers de Droit Fiscal International: Non-discrimination at the Crossroads of International Taxation*, vol. 93a (Amersfoort: Sdu Fiscale & Financiële Uitgevers, 2008), at 64.

the comparability test and the disadvantage test are identical in all four fundamental freedoms.¹¹⁸⁵

In this respect, reference should be made to the Court's case law on the free movement of capital in relation to third countries. In that context, the Court has repeatedly held that:

because of the degree of legal integration that exists between Member States of the Union, in particular by reason of the presence of Community legislation which seeks to ensure cooperation between national tax authorities, [...] the taxation by a Member State of economic activities having cross-border aspects which take place within the Community is not always comparable to that of economic activities involving relations between Member States and non-member countries.¹¹⁸⁶

At first glance, this seems to indicate that the comparability test is affected by the fact that a third country is involved. More specifically, this statement might suggest that the object of comparison is an intra-EU transaction while the subject of comparison is a transaction involving a third country. Given the degree of legal integration in the EU, object and subject of comparison are, in principle, not comparable. However, this interpretation is not entirely convincing, as the ECJ has traditionally held that matters relating to the cooperation between national tax authorities are not a matter of comparability, but of justification.¹¹⁸⁷

A more convincing interpretation of this statement is that *justification grounds* may differ between intra-EU transactions and transactions involv-

1185. According to art. 65 of the TFEU “the provisions of Article 63 shall be without prejudice to the right of Member States to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested”. However, such tax rules “shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 63”. When this provision was introduced, some authors suggested that it would lead to a severe restriction of the free movement of capital. E.g. B. Knobbe-Keuk, *The Ruding Committee Report: An Impressive Vision of European Company Taxation for the Year 2000*, EC Tax Rev. (1992), at 1, 30; B. Gouthière, *Removal of Discrimination: A Never-ending Story*, Eur. Taxn. (1994), at 302). However, it is now generally accepted that art. 65 of the TFEU merely expresses the Court's practice as developed in the context of the other freedoms. E.g. F. Vanistendael, *The Limits To the New Community Tax Order*, Common Mkt. L. Rev. (1994), at 314; J. Englisch, *The European Treaties' Implications for Direct Taxes*, Intertax (2005), at 326; C-35/98, *Verkooijen*, 6 June 2000, para. 43.

1186. E.g. C-446/04, 12 Dec. 2006, *Test Claimants in the FII Group Litigation*, para. 170; C-101/05, 18 Dec. 2007, *Skatteverket v. A*, para. 37; C-201/05, 23 Apr. 2008, *Test Claimants in the CFC and Dividend Group Litigation*, para. 92.

1187. E.g. C-520/04, 9 Nov. 2006, *Turpeinen*, para. 35.

ing a third country. In other words, the statement that the situations are “not always comparable” does not refer to the comparison between object and subject of comparison as the first step of the discrimination analysis, but to the comparison between two bodies of case law. The ECJ has developed a body of case law as regards justification grounds that are accepted in intra-EU situations, and this case law applies irrespective of which freedom is at play. However, this case law cannot simply be transposed to situations where a third country is involved (a situation which, by definition, can only fall within the scope of the free movement of capital). Because of the degree of legal integration in the EU, it is possible for a justification ground to be accepted in a situation involving a third country, even though that justification has been rejected in an intra-EU situation.¹¹⁸⁸ From this perspective, the two bodies of case law are “not always comparable”. However, this does not mean that the discrimination test as such, i.e. comparability and disadvantage, is different in a situation involving a third country. This point will be further addressed in section 14.2.8.2.

13.2. Comparable situations

As was the case under article 24 of the OECD Model Convention, the comparability analysis is decisive in many cases decided by the ECJ under the fundamental freedoms. Here as well, the determination of the relevant characteristics is of the utmost importance. This issue will be addressed in chapter 14, where the ECJ’s relevant case law will be discussed.

The main issue at stake throughout this case law is the distinction between residents and non-residents of a Member State, a distinction which is vital in international taxation. As a general rule, the ECJ seems to start from the assumption that residents and non-residents are not comparable, unless there are valid reasons for deciding otherwise. In contrast, where the comparison is between two residents, the ECJ started from the assumption that they are comparable, and then determines whether there are valid reasons for incomparability.

The reasons underlying these assumptions and the grounds accepted by the ECJ in order to discard the assumptions will be analysed by discussing the relevant case law, which will be divided thematically for this purpose.

1188. E.g. C-446/04, 12 Dec. 2006, *Test Claimants in the FII Group Litigation*, para. 171; C-101/05, 18 Dec. 2007, *Skatteverket v. A*, para. 37; C-201/05, 23 Apr. 2008, *Test Claimants in the CFC and Dividend Group Litigation*, para. 93.

13.3. Equal treatment

If two situations are comparable, the principle of non-discrimination demands that they be treated equally. The intricacies of this requirement will be addressed by analysing the relevant ECJ case law in chapter 15. However, some general remarks on the Court's interpretation of the equal treatment requirement can be made here.

First, the term “equal treatment” may be somewhat misleading, as it actually concerns a protection from discrimination, i.e. the protected person or situation (the subject of comparison) must not be treated less favourably than the object of comparison. Thus, the test is actually not as strict as requiring “equal” treatment. Rather, it is sufficient that the subject of comparison not be treated less favourably (which is why this test will be referred to as the disadvantage test). If the subject of comparison is treated more favourably than the object of comparison, there is no immediate issue of discrimination. Issues of reverse discrimination, which may arise in such a case, are addressed in section 12.2.3.

Furthermore, there is no *de minimis* exception in the context of the disadvantage test. In other words, as soon as the subject of comparison is treated less favourably, the equal treatment requirement has been violated, regardless of the severity of the disadvantage. It is settled case law that any disadvantage, even minor, can violate the equal treatment test.¹¹⁸⁹

Finally, the Court is reluctant to take account of offsetting advantages which might remove the disadvantage at issue. Particularly, it seems that the Court generally refuses to accept that a disadvantage may be neutralized by advan-

1189. E.g. C-270/83, *Avoir Fiscal*, para. 21 (“it is also not necessary in this context to assess the extent of the disadvantages which branches and agencies of foreign insurance companies suffer as a result of the failure to grant them the benefit of shareholders’ tax credits and to consider whether those disadvantages could have any effect on their tariffs, since Article 52 prohibits all discrimination, even if only of a limited nature”). See also C-49/89, *Corsica Ferries France*, para. 8; C-169/98, *Commission v. France*, para. 46 and C-212/06, *Government of the French Community and Walloon Government v. Flemish Government*, para. 52.

tages granted in the Member State in question¹¹⁹⁰ or in another Member State.¹¹⁹¹

13.4. Types of discrimination

13.4.1. Direct and indirect discrimination

As indicated in section 12.2.2., not only rules which differentiate on the basis of nationality amount to discrimination; rules which apply other differentiating criteria, but in fact lead to the same result as a directly discriminatory rule, are forbidden as well. The same is true in matters of direct taxation, where distinctions are rarely made on the basis of nationality but often on the basis of residence. As indicated above, the situations of residents and non-residents are, normally, not comparable. However, it is possible that no relevant difference exists between both categories. In such a case, different treatment might amount to discrimination. Furthermore, it is clear that a tax rule which differentiates on the basis of residence amounts to indirect discrimination, in so far as the rule mainly burdens nationals of other Member States. It is clear, indeed, that a rule targeting non-residents will often fall heavier on foreign nationals.

For this reason, the Court has affirmed the *Sotgiu* reasoning in direct tax cases as well, starting with the *Biehl* case.¹¹⁹² In *Biehl*, the Court began by repeating the *Sotgiu* formula: “the rules regarding equality of treatment forbid not only overt discrimination by reason of nationality but also all

1190. E.g. C-270/83, *Avoir Fiscal*, para. 21 (“the difference in treatment also cannot be justified by any advantages which branches and agencies may enjoy vis-à-vis companies and which [...] balance out the disadvantages resulting from the failure to grant the benefit of shareholders’ tax credits. Even if such advantages actually exist, they cannot justify a breach of the obligation laid down in Article 52 to accord foreign companies the same treatment in regard to shareholders’ tax credits as is accorded to French companies”); C-307/97, *Saint-Gobain*, para. 53 (“it must be observed that the difference in tax treatment between resident companies and branches cannot [...] be justified by other advantages which branches enjoy in comparison with resident companies and which, according to the German Government, will compensate for the disadvantages of not being allowed the tax concessions in question. Even if such advantages exist, they cannot justify breach of the obligation laid down in Article 52 of the Treaty to accord the same domestic treatment concerning the tax concessions in question”).

1191. E.g. C-294/97, *Eurowings*, para. 44 (“Any tax advantage resulting for providers of services from the low taxation to which they are subject in the Member State in which they are established cannot be used by another Member State to justify less favourable treatment in tax matters given to recipients of services established in the latter State”).

1192. C-175/88, *Biehl*, 8 May 1990, ECR (1990), I-1779.

covert forms of discrimination which, by the application of other criteria of differentiation, lead to the same result”.¹¹⁹³ The Court applied this principle to the residence criterion of the national legislation at issue, and concluded: “even though the criterion of permanent residence in the national territory [...] applies irrespective of the nationality of the taxpayer concerned, there is a risk that it will work in particular against taxpayers who are nationals of other Member States”.¹¹⁹⁴

The same is true for companies. The Court held in *Avoir Fiscal* that, with regard to companies, “it is their registered office [...] that serves as the connecting factor with the legal system of a particular state, like nationality in the case of natural persons”.¹¹⁹⁵ Indirect discrimination may arise if a tax rule differentiates on the basis of other criteria than the seat of the company. For example in *Commerzbank*, the ECJ held that:

the rules regarding equality of treatment forbid not only overt discrimination by reason of nationality or, in the case of a company, its seat, but all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result.¹¹⁹⁶

Applied to the distinguishing criterion at issue in *Commerzbank* (i.e. fiscal residence):

Although it applies independently of a company’s seat, the use of the criterion of fiscal residence within national territory for the purpose of granting repayment supplement on overpaid tax is liable to work more particularly to the disadvantage of companies having their seat in other Member States. Indeed, it is most often those companies which are resident for tax purposes outside the territory of the Member State in question.¹¹⁹⁷

1193. Id. at para. 13.

1194. Id. at para. 14.

1195. Case 270/83, *Avoir Fiscal*, para. 18. The Court referred to the “registered office” as the relevant criterion, but it seems unlikely that it wanted to exclude the two other criteria of art. 54 of the TFEU. Instead, it seems that the reference to the “registered office” is really a mistranslation, as the other language versions of *Avoir Fiscal* all refer to the “corporate seat” (“*siège*” in French, “*Sitz*” in German, “*zetel*” in Dutch), i.e. the generic term to refer to all three criteria of art. 54 of the TFEU. See also J. Wouters and P. de Man, “EC law and residence of companies”, in G. Maisto (ed.), *Residence of Companies under Tax Treaties and EC Law* (Amsterdam: IBFD Publications, 2009), at 73-74.

1196. C-330/91, *Commerzbank*, para. 14.

1197. Id. at para. 15.

13.4.2. Reverse discrimination

With regard to the issue of reverse discrimination, consider what has been said in section 12.2.3: EU law is not concerned with purely internal situations. As a result, the fundamental freedoms may not be invoked in such a situation. However, in cases where nationals of a Member State are, by reason of their conduct, in a situation which can be regarded as equivalent to that of any other person enjoying the rights and liberties guaranteed by the Treaty, the Treaty freedoms apply to such nationals as well. This conclusion is also upheld in tax cases.¹¹⁹⁸

13.4.3. Is ECJ case law in direct tax matters still based on a discrimination analysis, or has it evolved towards a restriction-based reading of the Treaty?

13.4.3.1. Restrictions: a similar evolution in direct tax case law?

Reference was made in section 12.2.4 to the broad interpretation in *Dassonville* of “measures having effect equivalent to quantitative restrictions on imports”. Such measures were defined as “all trading rules enacted by Member States which are capable of hindering, directly or indirectly, actually or potentially, intra-community trade”. As a result, measures applicable without distinction to domestic and imported products were targeted, as well. Thus, the test is no longer whether the national measure distinguishes between domestic and imported products, but whether the measure (directly or indirectly, actually or potentially) is capable of hindering the free movement of goods. There has been some controversy surrounding the question as to whether this approach (and the rule-of-reason doctrine of *Cassis de Dijon*) can also be upheld in direct tax matters.

At first glance, it seems that the ECJ has adopted the restriction approach in its direct tax case law, as well. Starting with *Futura*, in 1997, the Court has struck down more and more national measures that were “liable to hinder or dissuade the exercise of the Treaty freedoms”, without referring to any distinction on the basis of nationality. *Futura* is therefore generally consid-

1198. E.g. C-107/94, *Asscher*, para. 32. As an example of reverse discrimination in the area of direct taxation, reference can be made to expatriate regimes, which grant tax benefits exclusively to, for example foreign managers. See also section 5.6.2.

ered as the first of the so-called second generation cases in the ECJ's body of direct tax case law (*see* section 13.4.3.2.).¹¹⁹⁹

Before analysing the relevant ECJ case law, there are two important remarks to be made. First, the question arises as to whether the *Bosman* reasoning can be transposed to direct tax matters.¹²⁰⁰ What is at stake here is the way in which the Court assesses whether a national measure is restrictive. At first sight, it would seem that measures without distinction which hinder the exercise of the Treaty freedoms must cause a disadvantage *as compared to a comparable internal situation*. In other words, one might think that the ECJ would restrict itself to striking down non-discriminatory restrictions which dissuade cross-border activities as compared to domestic activities. However, *Bosman* seems to indicate that measures having exactly the same effect on domestic situations as on cross-border situations may be struck down as well, if those measures make it virtually impossible to go abroad. The measure at issue in *Bosman* restricted domestic situations in exactly the same manner as cross-border situations.¹²⁰¹ However, given the restrictive

1199. There are also earlier indications that the Court might try to apply a restriction-based reading of the Treaty freedoms. A very early example in the specific context of the free movement of goods is Case 18/84, *Commission v. France*, 7 May 1985. In that case, the Court was called to decide on a provision in the French tax code which granted certain tax advantages to newspaper publishers with regard to publications printed in France. These advantages were not accorded if the publications were printed abroad. Such a rule, which is applicable without distinction between French and foreign publishers, may hamper intra-EU trade, by encouraging French publishers to conclude contracts with French printers and not with printers established in other Member States. The Court concluded that the French provision amounted to a measure having an effect equivalent to a quantitative restriction on imports, as it was likely to restrict imports of publications printed in other Member States. As a result, art. 34 of the TFEU had been violated. The Court set aside the French government's argument that printing is a service and cannot be regarded as a product ("printing work cannot be described as a service, since it leads directly to the manufacture of a physical article which, as such, is classified in the common customs tariff [...]. In any event, Article 60 of the Treaty provides that services shall be considered to be 'services' within the meaning of this Treaty where they are normally provided for remuneration, in so far as they are not governed by the provisions relating to freedom of movement for goods, capital and persons. The case must therefore be considered solely on the basis of Article 30"). However, given the surge in restriction cases in the years following *Futura*, the latter case will be used as the starting point for this second generation of case law.

1200. C-415/93, *Bosman*, 15 Dec. 1995.

1201. *Id.* at paras. 98-99 ("It is true that the transfer rules in issue in the main proceedings apply also to transfers of players between clubs belonging to different national associations within the same Member State and that similar rules govern transfers between clubs belonging to the same national association. [...] However, [...] those rules are likely to restrict the freedom of movement of players who wish to pursue their activity in another Member State by preventing or deterring them from leaving the clubs to which they belong even after the expiry of their contracts of employment with those clubs").

effect of this measure on cross-border activity, the ECJ considered it to be incompatible with the freedom of movement. Transposed to direct taxation, this would imply that tax measures which restrict cross-border traffic in a non-discriminatory way (e.g. thin capitalization rules, CFC rules) cannot always be made EU-proof by merely making them applicable to domestic situations, as well. Even rules that are completely neutral may be incompatible with the fundamental freedoms if they make it impossible to go to another Member State, regardless of whether the same restriction would exist in a domestic situation.¹²⁰² However, the overview of the restriction-based case law (*see* section 13.4.3.2.) suggests that the Court has refrained from applying a *Bosman*-type reasoning in substantive direct tax matters. Instead, the Court generally assesses whether the measure is restrictive by comparing the cross-border situation to a purely domestic situation. The situation seems to be different in the context of procedural tax law, in that the measure at issue in *Futura* was completely neutral (i.e. applied regardless of the existence of a cross-border element), but was nevertheless held to be restrictive.

Second, it is important to note that the distinctions drawn above are merely tools to structure and classify the Court's vast body of case law. However, the ECJ does not adhere to these distinctions dogmatically, and its case law is subject to constant evolution. Therefore, it is sometimes difficult to reconcile broad statements made in early cases with the evolution seen in later case law. A clear example of this is the statement in *Gebhard* that the rule-of-reason defence could be invoked only if the national measure at issue applied without distinction on the basis of nationality. Similar statements have been made in the area of direct taxation.¹²⁰³ However, it seems that the Court has abandoned this strict dichotomy, by applying the rule-of-reason test in clear discrimination cases. For example in *Lindman*, the Court noted that the Finnish measure at issue was "manifestly discriminatory".¹²⁰⁴ The Finnish government attempted to justify the measure by relying on reasons in the public interest. Even though the measure was discriminatory, the Court did not dismiss the Finnish government's argument on the basis that only measures that apply without distinction can be justified on the basis of the rule-of-reason defence. Instead, the Court noted that the Finnish government did not demonstrate that the measure was appropriate and proportional.¹²⁰⁵ Similarly, in *Wallentin*, the Court did not dismiss the fiscal cohesion justification on the ground that discriminatory measures were not justifiable on

1202. B. Terra and P. Wattel, *European Tax Law* (The Hague: Kluwer Law International, 2005), at 56-57.

1203. E.g. C-270/83, *Avoir Fiscal*, para. 25.

1204. C-42/02, *Lindman*, 13 Nov. 2003, para. 22.

1205. *Id.* at paras. 25-26.

a rule of reason-basis. Instead, the Court rejected the cohesion argument on substantive grounds.¹²⁰⁶ A similar evolution has taken place in non-tax cases.¹²⁰⁷

For the time being, this evolution will be accepted as a given, without questioning its theoretical appropriateness. Accordingly, throughout the discussion of the case law in the remainder of this chapter, no distinction will be drawn between cases on this basis. Instead, it will be assumed that the rule of reason analysis can also be applied to discriminatory measures.¹²⁰⁸

One may wonder, finally, whether the distinction between discrimination and restriction is still valid. On the one hand, the distinction between restriction and indirect discrimination is quite vague, in that they both concern measures which, on the face of things, do not distinguish between situations on the basis of the prohibited criterion, but rather disadvantage the cross-border situation or impede the crossing of borders. On the other hand, the distinction between both concepts at the justification level has apparently been abandoned by the Court, as both discriminatory and restrictive measures may be saved by the rule of reason. In this regard, Advocate-General Geelhoed has suggested that, “in the direct taxation sphere, there is no practical difference between these two manners of formulation, i.e. ‘restriction’ and ‘discrimination’”.¹²⁰⁹ The relationship between both concepts will be considered in the next section, which consists of three parts. First, an overview of the Court’s relevant case law will be provided. In this respect, it will be helpful to draw a distinction between three generations of direct tax cases (*see* section 13.4.3.2.). Next, it will be argued that the restriction-based analysis in many cases is actually a reformulation of the discrimination-based analysis. Even though the Court used language that refers to “restrictions”,

1206. C-169/03, *Wallentin*, 1 July 2004, paras. 21-22. *See also* the Opinion of Advocate-General Maduro in C-446/03, *Marks & Spencer*, para. 33 (“Advocate General Léger has already had occasion to recall that, in the area of tax, the Court accepted that ‘discriminatory national rules may be justified for imperative public-interest requirements other than those set out in the Treaty and in particular in the name of the cohesion of the tax system’. However, those judgments contradict a more general approach taken by the Court which applies also in tax matters whereby it affirms that a discriminatory measure can be justified only on the basis of derogating provisions expressly provided for in the Treaty. It would be useful for the Court to put an end to these uncertainties”).

1207. E.g. C-240/95, *Schmit*, 27 June 1996 and C-120/95, *Decker*, 28 Apr. 1998. *See also* M. Fallon and D. Martin, *Dessine-moi une discrimination*, *Journal de Droit Européen* (2000), at 166-167.

1208. *See also* G. Davies, *Nationality Discrimination in the European Internal Market* (The Hague: Kluwer Law International, 2003), at 37-39.

1209. Opinion of Advocate-General Geelhoed in C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue*, 23 Feb. 2006, ECR (2006), I-11673, para. 36.

the actual analysis in these cases is based on the concept of discrimination (*see* section 13.4.3.3.). The final part is based on the notion that the existence of actual restriction-based cases does not mean that the discrimination standard is redundant. Both concepts are complementary components of the fundamental freedoms (*see* section 13.4.3.4.).

13.4.3.2. From discrimination to restriction and back

13.4.3.2.1. *Introduction: three generations of cases*

The brief overview given above suggests that ECJ case law on direct taxes has evolved along the same path as its Treaty freedom case law in other areas, such that the general prohibition on nationality discrimination has been extended in two directions. First, not only direct discrimination by reason of nationality is forbidden, but also all indirect forms of discrimination. Second, it seems that the Court has gradually evolved from a discrimination-based reading of the Treaty freedoms to a restriction-based reading. However, this extension does not imply that the Treaty freedoms are no longer considered to be founded on the non-discrimination principle.

In legal literature, two generations of ECJ direct tax cases have been identified.¹²¹⁰ The first wave of cases, starting in 1986 with *Avoir Fiscal*, strictly applied the discrimination analysis. Examples in this line of case law include *Schumacker*, *Wielockx* and *Royal Bank of Scotland*. In the second generation, starting in 1997 (*Futura*, later confirmed in e.g. *ICI*, *Baars*, *Saint-Gobain*, *Safir*, *Verkooijen*), the Court has apparently moved towards a restriction analysis. Under this analysis, the Court adopts the language first used in non-tax cases such as *Gebhard* and *Bosman* and verifies whether the national measure at issue “is liable to hinder or make less attractive” the exercise of the Treaty freedoms. However, it seems that the second generation has come to an end and that the Court has shifted away from a simple restriction-based reading to a more nuanced discrimination-based approach (*see* section 13.4.3.2.3.).

1210. E.g. L. Hinnekens, *The Search for the Framework Conditions of the Fundamental EC Treaty Principles as Applied by the European Court to Member States' Direct Taxation*, EC Tax Rev. (2002), at 113 et seq.; A. Zalasinski, *The Limits of the EC Concept of Direct Tax Restriction on Free Movement Rights, the Principle of Equality and Ability To Pay, and the Interstate Fiscal Equity*, Intertax (2009), at 283 et seq. Obviously, these generations overlap to some degree. For example *Royal Bank of Scotland*, a clear example of a discrimination-based approach, was decided in 1999, after the start of the second generation.

The obvious problem with a pure restriction-based reading of the Treaty freedoms is that it is difficult to reconcile with the Member States' sovereignty in direct tax matters. Member States remain free to choose their tax rate, tax base, to what extent they wish to relieve double taxation, etc. As a result of this sovereignty, the different tax systems of the Member States exist side by side. This coexistence of discrete systems is obviously "liable to hinder or make less attractive" the exercise of the Treaty freedoms. For example a higher tax rate in Member State *A* as compared to Member State *B* can be seen as liable to hinder state *B* taxpayers from moving to state *A*. Moreover, Member States are free to assert their taxing jurisdiction on the basis of residence (worldwide taxation) and on the basis of source (limited, territorial taxation). Consequently, cross-border income streams are liable to be taxed twice. Leaving aside the possible impact of tax treaties, there is no obligation for the states involved to remove this double taxation. EU law does not require the home state to grant a relief for tax incurred in the source state.¹²¹¹ Once again, these fundamental aspects of tax sovereignty inevitably lead to "restrictions" on the exercise of the Treaty freedoms.¹²¹²

It was therefore unavoidable that the strict restriction-based reading would prove to be unsuited for direct tax issues and that the Court would run into the limits of this interpretation. Essentially, the Court had two options for dealing with this issue. First, it could consider these impediments resulting from the Member States' fiscal sovereignty to be restrictive (in the first step of its analysis) but justified (in the second step). A second option would be to narrow the concept of "restriction" in direct tax cases. In fact, the Court has applied both of these options in its case law of the last decade, but ultimately, starting with *D* in 2005, it has shown a preference for the second option.

13.4.3.2.2. *The second generation: a restriction-based reading of the Treaty freedoms*

In the late 1990s, the Court took a cue from its case law in non-tax matters and began to apply a restriction-based interpretation of the Treaty, at least on the level of language. Under this approach, the Court first verifies whether the national measure at issue "is liable to hinder or make less attractive" the exercise of the Treaty freedoms. In a second step, the Court analyses whether the measure can be justified. Consequently, instead of the traditional three-

1211. See the discussion of *Kerckhaert-Morres* in section 13.4.3.3.3.

1212. See also P. Farmer and R. Lyal, *EC Tax Law* (Oxford: Clarendon Press, 1994), at 28 ("Taken to its logical conclusion, an approach focusing on the exercise of a restriction rather than on discrimination would bring all charging provisions in national tax legislation within the scope of the Treaty Articles on the freedoms".).

step test of the discrimination analysis, there are only two steps under this restriction-based approach.

The most obvious difference between the discrimination test and the restriction test is the absence of a comparability analysis in the latter. In this sense, restriction could be considered as being an absolute concept that operates independently, meaning that it is independent from the treatment of other situations.¹²¹³ The cross-border situation is assessed in isolation, without taking account of comparable domestic situations. It has been argued that in order to achieve an Internal Market, it is necessary to extend the scope of the fundamental freedoms beyond a mere guarantee of equal treatment, as non-discrimination is insufficient to remove all obstacles to free movement.¹²¹⁴ However, as will become apparent below, the main strength of the restriction-based reading (i.e. that it operates as an absolute concept, without requiring an object of comparison) has also proven to be its weakness, given the particular nature of direct taxation.

In the author's view, the second generation of cases spans from May 1997 (*Futura*) to March 2005 (*Laboratoires Fournier*).¹²¹⁵ In this period, the Court decided 39 direct tax cases on the basis of the free movement provisions.¹²¹⁶

1213. A. Cordewener, "The Prohibitions of Discrimination and Restriction within the Framework of the Fully Integrated Internal Market", in F. Vanistendael (ed.), *EU Freedoms and Taxation* (Amsterdam: IBFD Publications, 2006), at 26.

1214. E.g. M. Boutard Labarde, *Case Note: C-300/90, Commission v Belgium and C-204/90, Bachmann*, *Journal du Droit International (Clunet)* 2 (1992), at 447; E. Steindorff, *EG-Vertrag und Privatrecht* (Baden-Baden: Nomos Verlagsgesellschaft, 1996), at 65; L. Hinnekens, *The Search for the Framework Conditions of the Fundamental EC Treaty Principles as Applied by the European Court to Member States' Direct Taxation*, *EC Tax Rev.* (2002), at 119 (referring to R. Barents).

1215. Any attempt to reduce a living and evolving system such as the ECJ's body of case law to structured categories is artificial, and approximate at best. Nevertheless, the use of these generations facilitates and understanding of the evolution the case law has gone through. The second generation of case law stops with *Laboratoire Fournier* because it was followed by *D*, which paved the way for the third generation.

1216. C-250/95, *Futura*, 15 May 1997; C-118/96, *Safir*, 28 Mar. 1998; C-336/96, *Gilly*, 12 May 1998; C-264/96, *ICI*, 16 July 1998; C-311/97, *Royal Bank of Scotland*, 29 Apr. 1999; C-254/97, *Baxter*, 8 July 1999; C-391/97, *Gschwind*, 14 Sept. 1999; C-307/97, *Saint-Gobain*, 21 Sept. 1999; C-439/97, *Sandoz*, 14 Oct. 1999; C-294/97, *Eurowings*, 26 Oct. 1999; C-55/98, *Vestergaard*, 28 Oct. 1999; C-200/98, *X AB & Y AB*, 18 Nov. 1999; C-251/98, *Baars*, 13 Apr. 2000; C-87/99, *Zurstrassen*, 16 May 2000; C-35/98, *Verkooijen*, 6 June 2000; C-156/98, *Germany v. Commission (tax incentives new Länder)*, 19 Sept. 2000; C-141/99, *AMID*, 14 Dec. 2000; Joined Cases C-397/98 and C-410/98, *Metallgesellschaft and Hoechst*, 8 Mar. 2001; C-17/00, *De Coster*, 29 Nov. 2001; C-431/01, *Mertens*, 12 Sept. 2002; C-136/00, *Danner*, 3 Oct. 2002; C-436/00, *X & Y*, 21 Nov. 2002; C-324/00, *Lankhorst-Hohorst*, 12 Dec. 2002; C-385/00, *De Groot*, 12 Dec. 2002; C-234/01, *Geritse*, 12 June 2003; C-422/01, *Skandia*, 26 June 2003; C-168/01, *Bosal*, 18 Sept. 2003; C-209/01, *Schilling*, 13 Nov. 2003; C-42/02, *Lindman*, 13 Nov. 2003; C-364/01, *Barbier*,

The starting point is *Futura*, or at least the part of that decision that dealt with the accounting obligation imposed on non-resident taxpayers.¹²¹⁷ The Luxembourg measure at issue in *Futura* concerned non-resident taxpayers with a permanent establishment in Luxembourg. In order to carry forward losses suffered by the Luxembourg PE, these taxpayers were required to keep “proper accounts” in Luxembourg, i.e. accounts that complied with the relevant Luxembourg accounting rules. Luxembourg residents wishing to carry forward losses were also required to keep proper accounts during the financial year in which the losses were incurred. The measure at issue was therefore applicable without distinction, but it was nevertheless liable to hinder cross-border activities, as the non-resident taxpayer was already required to keep accounts in its home state. The Luxembourg obligation to keep separate accounts for the PE resulted in a double burden for non-residents carrying out their activities in Luxembourg through a PE.¹²¹⁸ The Court concluded that this restriction was in principle prohibited, but that it could be justified on the basis of reasons of public interest.

Thus, *Futura* was the first (and, possibly, the last; *see* section 13.4.3.3.) direct tax case in which an actual restriction approach was followed. Even though the measure applied without any distinction, the Court considered that the resulting obstacle was, in principle, contrary to EU law. This approach was also reflected in the language used by the Court (“Such a condition may constitute a restriction [...] on the freedom of establishment” and “the effectiveness of fiscal supervision constitutes an overriding requirement of general interest capable of justifying a restriction on the exercise of fundamental freedoms”).¹²¹⁹ Subsequent judgments also used language referring to “restrictions”. Of the 39 judgments rendered during this period, 20 used

11 Dec. 2003; C-334/02, *Commission v. France (fixed levy)*, 4 Mar. 2004; C-9/02, *de Lasteyrie*, 11 Mar. 2004; C-268/03, *De Baeck*, 8 June 2004; C-169/03, *Wallentin*, 1 July 2004; C-315/02, *Lenz*, 15 July 2004; C-242/03, *Weidert*, 15 July 2004; C-319/02, *Maninen*, 7 Sept. 2004; C-219/03, *Commission v. Spain*, 9 Dec. 2004; C-39/04, *Laboratoires Fournier*, 10 Mar. 2005.

1217. C-250/95, *Futura*, para. 23 et seq. The other aspect of the case, which was decided on the basis of the traditional discrimination analysis, will be discussed in section 14.1.1.3.

1218. C-250/95, *Futura*, paras. 24-25 (“Such a condition may constitute a restriction, within the meaning of Article 52 of the Treaty, on the freedom of establishment of a company or firm [...] where that company or firm wishes to establish a branch in a Member State different from that in which it has its seat. It means in practice that if such a company or firm wishes to carry forward any losses incurred by its branch, it must keep, in addition to its own accounts which must comply with the tax accounting rules applicable in the Member State in which it has its seat, separate accounts for its branch’s activities complying with the tax accounting rules applicable in the State in which its branch is established. Furthermore, those separate accounts must be held, not at the company’s seat, but at the place of establishment of its branch”)(emphasis added).

1219. C-250/95, *Futura*, paras. 24 and 31 (emphasis added).

language referring to a restriction-based reading of the Treaty.¹²²⁰ However, as will become apparent in section 13.4.3.3., many of these cases were, in substance, discrimination cases.

As mentioned before, the requirement that a measure might be “liable to hinder or dissuade” free movement is very easily fulfilled in the context of direct taxation. Accordingly, it should come as no surprise that a restriction was found to exist in all of the 20 cases referred to above in which the decision was framed in restriction language. Consequently, in each of these cases the burden was shifted to the Member State in question to prove that the restriction was justified. Due to the Court’s reluctance to accept justification grounds in the context of direct tax, these arguments failed in the vast majority of cases (more specifically, in 18 of the 20 cases).¹²²¹

1220. C-250/95, *Futura*, paras. 24 and 31; C-118/96, *Safir*, paras. 22-23 and 30; C-439/97, *Sandoz*, paras. 18-20; C-55/98, *Vestergaard*, paras. 20-21; C-35/98, *Verkooijen*, paras. 34-36 and 46; C-17/00, *De Coster*, para. 26 et seq.; C-136/00, *Danner*, paras. 29-30; C-436/00, *X & Y*, paras. 35-39 and 67-70; C-324/00, *Lankhorst-Hohorst*, paras. 27-32; C-385/00, *De Groot*, paras. 77-80 and 95; C-422/01, *Skandia*, paras. 25-28; C-168/01, *Bosal*, para. 27; C-209/01, *Schilling*, paras. 24-26 and 37; C-364/01, *Barbier*, para. 63; C-334/02, *Commission v. France (fixed levy)*, paras. 23-25; C-9/02, *de Lasteyrie*, paras. 39-48; C-268/03, *De Baeck*, paras. 20-26; C-315/02, *Lenz*, paras. 20-22; C-242/03, *Weidert*, paras. 13-15; C-319/02, *Manninen*, paras. 20-24. Several other judgments handed down during this period, such as *AMID* and *Mertens*, contain less obvious references to the concept of restriction, such as the observation that national measures must not “dissuade taxpayers from exercising their fundamental freedoms”. However, the remainder of those judgments is framed in clear discrimination language (unequal treatment, differentiation on the basis of the taxpayer’s place of residence, etc.). Nevertheless, it is often difficult to determine whether the Court intended to decide a case under the restriction standard or the discrimination standard. Take for example *Lankhorst-Hohorst*, in which the Court looks for an “obstacle” to the freedom of establishment in paras. 27-32 and refers to the national measure as a restriction in para. 27, while at the same time noting that the “restriction introduces a difference in treatment between resident subsidiary companies according to whether or not their parent company has its seat in Germany”. Given this ambiguous use of language, it might seem difficult to categorize cases as being applications of either discrimination or restriction. As will become apparent in section 13.4.3.3., however, the vast majority of these cases are clear discrimination cases, despite their confusing use of words.

1221. The only two cases in which the justification grounds were accepted, were *Futura* and *Sandoz*. On *Futura*, see section 13.4.3.3.3. *Sandoz* was actually a disparity case (see section 13.4.3.3.2.), which means that the justification issue should not have come up for discussion.

13.4.3.2.3. *The third generation: the return to discrimination*

Starting with its judgment in *D*, the Court seems to have abandoned its attempts to apply a restriction-based reading of the Treaty in direct tax matters.¹²²² The *D* case, which will be discussed extensively in section 14.2.1.1.9., concerned a tax-free allowance under the Dutch wealth tax.¹²²³ This allowance was granted only to residents of the Netherlands and, pursuant to the tax treaty between the Netherlands and Belgium, Belgian residents. The Court rejected the taxpayer's claim, thereby firmly establishing its reasoning in a discrimination analysis. Referring to its traditional discrimination case law, particularly *Schumacker*, the Court made a lengthy comparability analysis and decided that German residents were not comparable to Dutch residents.¹²²⁴ As to the comparison with Belgian residents, the Court once again applied its traditional discrimination analysis, and held that German residents were not comparable to Belgian residents because of the specific nature of tax treaties.¹²²⁵ Under a pure restriction-based analysis, the line of reasoning would have been fundamentally different. The limitation of the tax allowance to Dutch and Belgian residents was undoubtedly restrictive for German residents owning real estate in the Netherlands. Ultimately, the case would then have to be decided on the basis of the asserted justification grounds.

The next important step was taken in *Marks & Spencer*, a case involving the UK system of loss deductibility.¹²²⁶ The applicable UK measure allowed resident parent companies to offset losses incurred by their resident subsidiaries against their own profits. In contrast, resident parent companies with non-resident subsidiaries could not offset the losses incurred by their subsidiaries against their own profits, because such non-resident subsidiaries were subject to UK tax on their profits only in so far as these had been earned in the United Kingdom. The taxpayer, a UK resident parent company, sought to deduct from its own profits the losses incurred by its Belgian, French and

1222. Similarly S. Kingston, *A Light in the Darkness: Recent Developments in the ECJ's Direct Tax Jurisprudence*, Common Mkt. L. Rev. (2007), at 1335, who refers to the period starting with *D* as "a coming of age in the Court's direct tax case law", characterized by a shift away from a simple restriction-based reading of the Treaty towards a more nuanced, sophisticated approach, grounded on discrimination. See also S. Kingston, *The Boundaries of Sovereignty: The ECJ's Controversial Role Applying Internal Market Law To Direct Tax Measures*, 9 Cambridge Y.B. Eur. Legal Stud. (2007), at 303.

1223. C-376/03, *D v. Inspecteur van de Belastingdienst*, ECR (2005), I-05821, 5 July 2005.

1224. *Id.* at paras. 26-38.

1225. *Id.* at paras. 52 and 58-62.

1226. C-446/03, *Marks & Spencer*, ECR (2005), I-10837, 13 Dec. 2005. This case will be addressed in more detail in section 14.2.4.4.

German subsidiaries. In order to achieve this result, the taxpayer argued that the limitation of the tax benefit to resident parent companies with resident subsidiaries violated the freedom of establishment. Under a pure restriction-based approach, the measure would most likely be considered as liable to hinder the freedom of establishment of UK resident parent companies with non-resident subsidiaries. Accordingly, the focus would shift to the justification test.¹²²⁷ However, the Court decided to take a more nuanced approach.

At first glance, the starting point of the ECJ's analysis seems to be the restriction concept, as the Court concluded in a first step that the UK measure was liable to hinder the exercise by UK resident parent companies of their freedom of establishment by deterring them from setting up subsidiaries in other Member States.¹²²⁸ The Court then went on to apply its traditional three-step justification test, i.e. whether the measure pursued a legitimate objective in the public interest, whether it was appropriate to attain that objective and whether it was proportional, but not before addressing the comparability of the situations.¹²²⁹ In doing so, the Court took a similar approach as that taken in *D*.

In respect of the comparability test, the UK government had argued that it was in accordance with the principle of territoriality that the Member State of establishment of the parent company has no tax jurisdiction over non-resident subsidiaries. Tax competence over non-resident subsidiaries belongs in principle to the state where they are established. In response to this argument, the Court first confirmed that residence may constitute a valid distinguishing factor in tax matters. However, the ECJ immediately added that "residence is not always a proper factor for distinction". Referring to *Avoir Fiscal*, the Court emphasized that acceptance of the proposition that Member States may apply different treatment solely because a company's registered office is in another Member State, would deprive the freedom of establishment of all meaning. It is therefore necessary in each specific situation to consider whether the fact that a tax advantage is available only to residents "is based on relevant objective elements apt to justify the difference in treatment". In the case at hand, the ECJ held that:

1227. Advocate-General Maduro apparently took this approach in his Opinion in *Marks & Spencer*. See particularly paras. 25-35 of the Opinion, which concludes with the observation that it is necessary "to retain in tax matters the same concept of restriction on freedom of establishment which is applicable in the other areas. Thus 'all measures which prohibit, impede or render less attractive the exercise of that freedom' must be regarded as restrictions".

1228. C-446/03, *Marks & Spencer*, paras. 28-34.

1229. *Id.* at paras. 35-39.

by taxing resident companies on their worldwide profits and non-resident companies solely on the profits from their activities in that State, the parent company's Member State is acting in accordance with the principle of territoriality enshrined in international tax law and recognised by Community law.¹²³⁰

However, this fact in itself was not sufficient to render the situations incomparable in respect of the measure at issue. Unfortunately, the Court did not state why the situations *are* comparable; it simply rejected the UK government's argument that they are incomparable because the national measure was in accordance with the principle of territoriality. In the author's opinion, the fact that the Court rejected this argument and immediately went on to the justification test, can mean two things. Either the Court implicitly accepted the situations at issue to be comparable unless the government argues convincingly that they are not, or the comparability test is controlled by the justification test (i.e. when the justification grounds are convincing, the situations are incomparable). This question will be discussed in section 14.2.4.4.

The Court then went on to identify three justification grounds for the measure, namely the need to protect a balanced allocation of the power to impose taxes between Member States, the danger that losses would be used twice and the risk of tax avoidance. Ultimately, the Court concluded from this analysis that the freedom of establishment did not preclude a measure such as the UK measure at issue. However, the Court added an important exception to this on the basis of the proportionality requirement, specifically that it is contrary to the freedom of establishment to prevent the resident parent company from deducting the losses of its non-resident subsidiary where that subsidiary has exhausted the possibilities available in its state of residence of having the losses taken into account for past, present or future accounting periods.¹²³¹

It may not be immediately apparent from the ECJ's choice of words, but it seems that *Marks & Spencer* is a confirmation of the renewed emphasis on comparability that began with *D*, and more particularly the influence of the territoriality principle on this assessment of comparability.¹²³² In other words, it seems that a pure restriction approach has been abandoned in these judgments, in favour of a more nuanced approach. Judging from the reasoning followed by the Court in these two decisions, it seems that this "new" approach consists of three steps. First, the Court assesses whether the

1230. *Id.* at 39.

1231. *Id.* at paras. 55-56 and 59.

1232. This issue will be addressed in detail in section 14.2.4.

measure is liable to hinder the exercise of Treaty freedoms. Next, the Court considers whether the situations are comparable, having regard, in particular, to the influence of the territoriality principle. Finally, the Court analyses whether the measure is justified. This is essentially the traditional three-step discrimination analysis, in which the comparability test is determined by the influence of the territoriality principle, and the disadvantage test consists of verifying whether the exercise of the Treaty freedoms may be hindered.

This approach was subsequently confirmed in cases such as *ACT*, *FII*, *Thin Cap GLO* and *Denkavit*. *ACT*¹²³³ and *FII*,¹²³⁴ the facts of which will be discussed at length in section 14.2.6., both concerned the UK system of dividend taxation. While *ACT* concerned the tax treatment of outbound dividends (i.e. dividends paid by a UK subsidiary to a non-resident parent), *FII* dealt with the tax treatment of inbound dividends. The Court's starting point in both judgments is that comparable situations must receive the same treatment. For reasons set out in section 14.2.6., the Court ultimately decided that the domestic and cross-border situation were incomparable as regards outbound dividends (meaning that the difference in treatment did not give rise to discrimination),¹²³⁵ while the domestic and cross-border situations were comparable as regards inbound dividends (meaning that the difference in treatment gave rise to discrimination).¹²³⁶ Instead of merely pointing out that the legislation at issue may cause restrictions, the Court examined extensively whether the situations are comparable. If so, the Member State must refrain from treating the cross-border situation less favourably.¹²³⁷ In *Denkavit* (which will also be discussed in section 14.2.6.), the Court took the same approach.¹²³⁸

13.4.3.3. Most restriction cases are actually discrimination cases in disguise

13.4.3.3.1. *Discrimination on the basis of the exercise of the free movement provisions*

The evolution described above implies that the Court has not abandoned the discrimination approach for a restriction-based reading of the Treaty. On the

1233. C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*, 12 Dec. 2006.

1234. C-446/04, *Test Claimants in the FII Group Litigation*, 12 Dec. 2006.

1235. C-374/04, *ACT*, paras. 55-58 and 68.

1236. C-446/04, *FII*, paras. 86-91.

1237. See also C-524/04, *Test Claimants in the Thin Cap Group Litigation (Thin Cap GLO)*, 13 Mar. 2007, para. 90.

1238. C-170/05, *Denkavit Internationaal*, 14 Dec. 2006, para. 35.

contrary, recent case law suggests a return to the traditional discrimination approach. Moreover, many cases that are traditionally perceived as being applications of the restriction-based approach (i.e. the so-called second generation cases), are actually discrimination cases in disguise.¹²³⁹

The majority of this body of case law is composed of so-called outbound cases. When comparing the Court's case law in this era to its very early decisions, there is a noticeable trend of extending the Treaty freedoms to outbound situations.¹²⁴⁰ As mentioned before, the traditional view was that the freedoms were mainly aimed at host state restrictions, thereby aiming to provide foreign nationals protection from discrimination when they moved to another Member State. However, the Court has evolved towards a broader understanding of the freedoms, and also considers home state restrictions on the freedoms.¹²⁴¹ Even though the analysis of home state restrictions are

1239. This section is concerned only with the 20 cases identified in n. 1220, in which the Court's use of language seems to indicate that a restriction test has been applied. Other second-generation cases, such as *ICI, X AB & Y AB, Baars*, etc. deal with similar issues, but the language used in those cases makes it clear that the Court carried out a discrimination analysis. On the idea that many of the Court's direct tax cases that, due to the language used, give the impression that a restriction analysis is carried out, are nevertheless applications of the non-discrimination test, see also K. Banks, *The Application of the Fundamental Freedoms to Member State Tax Measures: Guarding against Protectionism or Second-guessing National Policy Choices*, 33 Eur. L. Rev. 4 (2008), at 482-506; J. Snell, *Non-discriminatory Tax Obstacles in Community Law*, 56 Intl. & Comp. L.Q. 2 (2007), at 339-370, J. Englisch, *Taxation of Cross-border Dividends and EC Fundamental Freedoms*, Intertax (2010), at 202-203.

1240. E.g. C-141/99, *AMID*, para. 21 ("even though, according to their wording, the provisions concerning freedom of establishment are mainly aimed at ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation which comes within the definition contained in Article 58 of the Treaty"). Obviously, this idea was not entirely new, as there had been similar statements in earlier cases (e.g. 81/87, *Daily Mail*, para. 16). Nevertheless, there is a remarkable number of such cases in this second generation of case law.

1241. The distinction between home state restrictions and host state restrictions is not the same as the distinction between "active" and "passive" market participants (who form both ends of an economic relationship). It has been very clear from the beginning that both active (e.g. employees) and passive (e.g. employers) market participants are protected by the fundamental freedoms. See e.g. in respect of the free movement of goods, Case 18/84, *Commission v. German*, para. 16 (the reservation of tax advantages to French newspaper publishers that had their newspapers printed by domestic printers violated art. 34 of the TFEU, as it encouraged newspaper publishers to have publications printed in German rather than other Member States); in respect of the freedom to provide services, C-353/91, *Commission v. German*, para. 23 (art. 56 of the TFEU was violated by the obligation for German broadcasters to make use only of technical resources offered by domestic undertakings, as it prevented them from using the services of undertakings established in other Member States or, in any event, limited their opportunities of doing so); in respect

well suited for a pure restriction-based reading of the Treaty, it is remarkable that the Court, in substance, applies a discrimination-based reading in such cases. For example in *Safir*, the Court compared the situation of Swedish resident taxpayers who had taken out capital life assurance with companies established in other Member States with the situation of Swedish resident taxpayers who had taken out capital life assurance with companies established in Sweden.¹²⁴² Similarly, in *Verkooijen*, the Court compared the situation of Dutch resident taxpayers in receipt of dividend income from shares in companies established in another Member State with that of Dutch resident taxpayers in receipt of dividend income from shares in companies established in the Netherlands.¹²⁴³ In both cases, the ECJ clearly compared

of the free movement of capital, C-484/93, *Svensson and Gustavsson*, para. 10; in respect of the free movement of workers, C-350/96, *Clean Car Autoservice*, para. 20. On the “passive” aspect of the freedom of establishment, see A. Cordewener, “The Prohibitions of Discrimination and Restriction within the Framework of the Fully Integrated Internal Market”, in F. Vanistendael (ed.), *EU Freedoms and Taxation* (Amsterdam: European Publications, 2006), at 20-21.

1242. C-118/96, *Safir*, para. 24 et seq.

1243. C-35/98, *Verkooijen*, para. 34 et seq. Similar comparisons were also made in C-55/98, *Vestergaard*, paras. 21-22 (comparison between Danish resident taxpayers participating in professional training courses organized in other Member States and Danish resident taxpayers participating in professional training courses organized in Denmark), C-136/00, *Danner*, paras. 29-30 (comparison between Finnish resident taxpayers paying voluntary pension scheme contributions to pension providers established in other Member States and Finnish resident taxpayers paying voluntary pension scheme contributions to pension providers established in Finland), C-436/00, *X & Y*, paras. 35-39 and 67-70 (comparison between Swedish resident taxpayers transferring shares at undervalue to a company established in another Member State (or to a Swedish company with owners established in another Member State) and Swedish resident taxpayers transferring shares at undervalue to a Swedish company (or to a Swedish company with owners established in German)), C-324/00, *Lankhorst-Hohorst*, paras. 27-32 (comparison between German resident companies making repayments in respect of loans obtained from a shareholder established in another Member State and German resident companies making repayments in respect of loans obtained from a shareholder established in German), C-385/00, *De Groot*, paras. 81-95 (comparison between German resident employees exercising part of their activities in other Member States and German resident employees exercising all their activities in the German), C-422/01, *Skandia*, paras. 26-28 (comparison between Swedish resident employers taking out occupational pension insurance with institutions established in other Member States and Swedish resident employers taking out occupational pension insurance with institutions established in German), C-168/01, *Bosal*, paras. 12-13 (comparison between German resident parent companies with a subsidiary in another Member State and German resident parent companies with a subsidiary in the German); C-209/01, *Schilling*, paras. 33-37 (comparison between German residents who employ a household assistant for whom they pay contributions to the social security system of another Member State (their work State), and German residents who employ a household assistant for whom they pay contributions to the German social security system), C-364/01, *Barbier*, paras. 27 and 76 (comparison in the German inheritance tax between the situation where the deceased was a resident of another Member State and where the deceased was a resident of the German), C-334/02, *Commission v. German*

the situation of the protected category of taxpayers with the purely domestic situation in order to assess whether the national measure was compatible with the EU Treaty. This is not a pure restriction analysis, but a discrimination analysis. As will be discussed below, the only difference with a traditional analysis of discrimination on the basis of nationality, is that the comparison is no longer between nationals and non-nationals but between a person exercising his Treaty freedoms and a person not exercising those freedoms. This is also clear in *de Lasteyrie*, in which the ECJ compared the situation of a French resident taxpayer wishing to transfer his residence to another Member State with that of a French resident taxpayer who stays in France.¹²⁴⁴ Finally, in *Lenz*, the Court compared the situation of Austrian resident investors holding shares in companies established in other Member States with that of Austrian resident investors holding shares in companies established in Austria.¹²⁴⁵

Consequently, even though these cases are at first glance applications of a restriction-based reading, they are actually discrimination cases in disguise. In other words, even in outbound situations, which are perfectly suited for a pure restriction-based reading, the Court has not shifted towards a restriction-based analysis, but rather seems to adhere to the idea that the Internal Market requires equal treatment between cross-border situations and purely internal

(*fixed levy*), paras. 23-25 (comparison between French resident taxpayers in receipt of interest paid by a debtor resident in another Member State and French resident taxpayers in receipt of interest paid by a debtor resident in German), *C-268/03, De Baeck*, paras. 20-26 (comparison between German resident taxpayers securing gains in value on the transfer of shares in a German company to a company established in another Member State and German resident taxpayers securing gains in value on the transfer of shares in a German company to a company established in German), *C-242/03, Weidert*, paras. 13-15 (comparison between Luxembourg resident taxpayers holding shares in a company established in another Member State and Luxembourg resident taxpayers holding shares in a company established in Luxembourg) and *C-319/02, Manninen*, para. 20 (comparison between Finnish resident taxpayers in receipt of dividends from a company established in another Member State and Finnish resident taxpayers in receipt of dividends from a company established in Finland).

1244. *C-9/02, de Lasteyrie*, para. 46 (“a taxpayer wishing to transfer his tax residence outside French territory, in exercise of the right guaranteed to him by Article 52 of the Treaty, is subjected to disadvantageous treatment in comparison with a person who maintains his residence in German. That taxpayer becomes liable, simply by reason of such a transfer, to tax on income which has not yet been realised and which he therefore does not have, whereas, if he remained in German, increases in value would become taxable only when, and to the extent that, they were actually realised”).

1245. *C-315/02, Lenz*, para. 21 (“to the extent that revenue from capital originating in another Member State receives less favourable tax treatment than revenue from capital of Austrian origin, the shares of companies established in other Member States are, for investors living in German, less attractive than the shares of companies established in that Member State”).

situations. This is, in substance, a discrimination analysis. However, the comparison is no longer between nationals and non-nationals (or, indirectly, between residents and non-residents), but between a person exercising his fundamental freedoms and a person not exercising those freedoms (e.g. a self-employed person working in another Member State as compared to a self-employed person working in his home state, an investor investing in another Member State as compared to an investor investing in his home state).¹²⁴⁶

In this respect, reference should be made to what was said in section 2.1. regarding the elements of discrimination. As noted there, one of the four components of discrimination is that the rule at issue must distinguish on the basis of a prohibited criterion. In ECJ case law, criteria are prohibited when they distinguish on the basis of a cross-border element, such as the fact that services are obtained from a service provider established in another Member State. This is a preliminary issue to be addressed before the Court assesses comparability and the existence of a disadvantage. If the rule at issue makes no distinction on the basis of a prohibited criterion, there can be no discrimination.

1246. See also P. Farmer, *The Court's Case Law on Taxation: A Castle Built on Shifting Sands?*, EC Tax Rev. (2003), at 77 (noting that such outbound cases are not concerned with discrimination on grounds of nationality "but discrimination against the exercise of the Treaty freedoms"). And further, at 81 ("Except for [the accounting requirement in Futural], all the obstacles which the Court had to consider could be said to be discriminatory"). Similarly, R. Lyal, "EU Report", in IFA, *Cahiers de Droit Fiscal International: Non-discrimination at the Crossroads of International Taxation*, vol. 93a (Amersfoort: Sdu Fiscale & Financiële Uitgevers, 2008), at 66 ("in determining whether a measure can be said to deter someone from making use of a Treaty freedom the Court essentially engages in a comparative exercise, assessing whether national legislation makes outbound movement less attractive than simply staying at home. For this reason it seems legitimate to regard the Court's interpretation of the freedoms as tantamount to a rule prohibiting discrimination against cross-border transactions or movement in comparison with purely domestic situations. It is true that for some years now the Court's case law on direct taxation, following the trend in its general case law on the freedoms, has adopted the language of restriction in describing the criteria which govern their interpretation. [...] Nevertheless, the Court's logic does not correspond to its language. In determining the existence of an obstacle to free movement, it consistently focuses on the existence of a difference in treatment between domestic and cross-border situations. [...] It is clear, therefore, that what is in issue is not some abstract or inherent character of restrictiveness to be found in the legislation but a difference in treatment which is not justified. That is the logic of discrimination"). Similarly, M. Lang, *Recent Case Law of the ECJ in Direct Taxation: Trends, Tensions and Contradictions*, EC Tax Rev. (2009), at 99 and 113 ("in the freedoms cases, it is always possible to identify comparable situations, even in situations that, at first sight, give the impression that a mere 'restriction approach' is required").

In *Eurowings* (see section 15.4.1.), for example the German government argued that there was no discrimination because the add-backs were applied when the lessor was not liable to trade tax, regardless of whether it was established in Germany or in another Member State.¹²⁴⁷ In other words, the German government argued that no distinction was made on the basis of a cross-border element, as the distinction being made was solely on the basis of liability to trade tax. However, the Court rejected this argument and noted that the add-backs *always* applied when German taxpayers leased goods from lessors established in another Member State, as those lessors are never liable to trade tax, while that obligation did not apply, in most cases, when the lessors were established in Germany, as they were generally liable to trade tax.¹²⁴⁸ Therefore, the rule did in fact distinguish on the basis of a cross-border element, albeit indirectly, by referring to liability to trade tax.

As mentioned above, non-discrimination is essentially the prohibition to treat a protected category less favourably, i.e. the prohibition to distinguish on the basis of a specific criterion. In contrast, non-restriction is an absolute analysis, one that seeks to ascertain free movement without verifying whether a distinction has been made on the basis of a prohibited criterion.¹²⁴⁹ Therefore, when a national tax measure distinguishes on the basis of a prohibited criterion, it should be analysed under the discrimination test. Only when there is no distinction (or no distinction on the basis of a prohibited criterion) should the restriction test be applied. In the author's opinion, the EU Treaties protect EU citizens from discrimination not only on the basis of nationality. The wording and structure of the free movement provisions demonstrate that free movement as such is a protected activity. That is to say, the Treaty seeks to protect EU citizens exercising their free movement from less favourable treatment as compared to EU citizens not exercising those freedoms.¹²⁵⁰ If not, the freedoms would be devoid of any practical

1247. C-294/97, *Eurowings*, 26 Oct. 1999, paras. 24-25.

1248. *Id.* at paras. 35-36.

1249. For example in *Futura*, there was no distinction at all. The restriction resulted from the cumulative application of different systems. Of course, the restriction becomes visible only by comparing it to a situation in which it does not exist, particularly the situation of a taxpayer subject to a single set of rules. However, the measure at issue did not make any distinction on the basis of a prohibited criterion; it was completely neutral in every respect.

1250. See also C-224/98, *D'Hoop*, 11 European 2002, paras. 30-31 (on citizenship) ("In that a citizen of the Union must be granted in all Member States the same treatment in law as that accorded to the nationals of those Member States who find themselves in the same situation, it would be incompatible with the right of freedom of movement were a citizen, in the Member State of which he is a national, to receive treatment less favourable than he would enjoy if he had not availed himself of the opportunities offered by the Treaty in relation to freedom of movement. Those opportunities could not be fully effective if a

meaning. Accordingly, EU citizens exercising their Treaty freedoms constitute a protected category under the Treaty, and should therefore be protected from discrimination on the basis of their defining criterion (the exercise of the freedoms). In other words, national measures that make a distinction on the basis of the exercise of a Treaty freedom should be analysed under the discrimination test, rather than the restriction test.¹²⁵¹

Consequently, these outbound cases are not concerned with issues of restriction, but with issues of discrimination, the comparison being made between economic actors pursuing cross-border transactions and economic actors engaged in equivalent activities within one Member State.¹²⁵² From a substantive perspective, the analysis to be applied is exactly the same as in traditional discrimination cases (i.e. unfavourable treatment of non-nationals in the host state), but the difference lies in the object and the subject of comparison.¹²⁵³

The question thus arises as to whether this difference at the level of object and subject of comparison warrants a fundamentally different analysis. As noted above, the main difference between a discrimination analysis and a restriction analysis is the absence of any reference to comparability in the latter. Non-restriction requires that the exercise of the fundamental freedoms not be hindered (disadvantage test), unless it is justified (justification test). Thus, a restriction analysis is not based on a comparison with the domestic situation, as it only verifies whether the cross-border activity is hindered. The reason why there is no comparability test in a pure restriction-based

national of a Member State could be deterred from availing himself of them by obstacles raised on his return to his country of origin by legislation penalising the fact that he has used them"). Similarly, C-224/02, *Pusa*, 29 Apr. 2004, paras. 18-19.

1251. See also R. Lyal, *Non-discrimination and Direct Tax in Community Law*, EC Tax Rev. (2003), at 74 ("we should not take too narrow a view of the concept of discrimination on the basis of nationality: we should be willing to regard as discriminatory all measures which give less favourable treatment to a trans-frontier situation than to a purely domestic situation, whether that relates to incoming or outgoing movement of workers, capital, services, establishment of business").

1252. Similarly, J. Englisch, *The European Treaties' Implications for Direct Taxes*, Intertax (2005), at 314.

1253. Once again, the vague wording of the Treaty has been said to cause this dichotomy in the Court's case law. In particular, it seems that the ECJ's reluctance to use the term "discrimination" in outbound situations may be explained by the lack of reference to "discrimination" in the Treaty as regards outbound situations. The guarantee of "national treatment" makes sense only in inbound situations, and the only clauses that could be considered to cover outbound situations are those prohibiting "restrictions" or guaranteeing "free movement". See A. Cordewener, "The Prohibitions of Discrimination and Restriction within the Framework of the Fully Integrated Internal Market", in F. Vanistendael (ed.), *EU Freedoms and Taxation* (Amsterdam: European Publications, 2006), at 17.

case, is that restriction is an absolute concept, which does not require any comparison to be made. Clearly, that is not what was at issue in the outbound cases referred to here. In those cases, the restriction was caused by the less favourable treatment as compared to the domestic situation. The restriction was never assessed in a vacuum, as it existed only because the domestic situation received more favourable tax treatment. As mentioned above, the reason why the Court is reluctant to call this “discrimination” is the vague wording of the Treaty, but substantively, these are clearly discrimination cases. As the cases referred to here are not actual restriction cases, it is questionable whether the comparability test should be left aside.

13.4.3.3.2. *Examples*

In *Sandoz*, the Court had to deal with an Austrian stamp duty on loans contracted by resident borrowers.¹²⁵⁴ Even though this was an indirect tax case, it illustrates the confusion and contradictions that characterize this era of the Court’s tax case law. The Austrian duty applied to all Austrian residents who entered into a contract for a loan irrespective of the nationality of the contracting parties or of the place where the loan was contracted. Nevertheless, the Court held that the levy of the duty on loans contracted with a non-resident lender constituted a restriction on the free movement of capital. According to the Court, the measure deprived Austrian residents:

of the possibility of benefiting from the absence of taxation which may be associated with loans obtained outside the national territory. Accordingly, such a measure is likely to deter such residents from obtaining loans from persons established in other Member States.¹²⁵⁵

At first glance, this seems to be an application of the restriction approach. However, it is not clear to the author why this is not a disparity. The mere observation that the Austrian measure deprived residents of the possibility of tax-neutral treatment, even though other Member States do not levy a similar duty, does not elevate this case above a disparity issue.¹²⁵⁶ There is

1254. C-439/97, *Sandoz*, 14 Oct. 1999. *Sandoz* also concerned another aspect of the Austrian tax treatment of loans. Loans contracted by residents with a non-resident lender were subject to tax in circumstances where a loan contracted with a resident lender would not be subject to tax. This difference in treatment clearly amounted to discrimination, and the Court’s use of words leaves no doubt that the analysis carried out in this respect was an application of the discrimination test (*see in particular*, paras. 30-31).

1255. *Id.* at para. 19.

1256. *See also* A. Cordewener, “The Prohibitions of Discrimination and Restriction within the Framework of the Fully Integrated Internal Market”, in F. Vanistendael (ed.), *EU Freedoms and Taxation* (Amsterdam: European Publications, 2006), at 28.

no restriction if there is a national tax that does not exist in other Member States. The disadvantage stemming from the fact that some taxpayers are subject to that tax while others are not, is simply the result of the existence of 27 discrete national tax systems.

Moreover, the Court ultimately considered the Austrian measure to be justified because it was necessary to prevent infringements of national law. The Austrian government had argued that the measure was “justified by the need to observe the principle that residents should be treated equally for tax purposes”.¹²⁵⁷ The idea behind this argument seems to be that the Austrian government sought to ensure that every Austrian resident paid the duty, even if the loan were contracted in another Member State or with a non-resident lender. The ECJ agreed, observing that the main objective of the measure was to ensure equal tax treatment for all Austrian residents. The Court went on to state, “since the effect of such a measure is to compel [resident borrowers] to pay the duty, it prevents taxable persons from evading the requirements of domestic tax legislation through the exercise of freedom of capital”.¹²⁵⁸ This line of reasoning is quite remarkable. In effect, the Court first decided that a neutral measure is, *prima facie*, contrary to EU law, only to decide that it is justified *because it was neutral*, with the additional argument that its effect was “to compel resident borrowers to pay it” thereby preventing tax evasion. In other words, the Court concluded that a measure that treats domestic and cross-border situations equally is restrictive, but that it is ultimately justified because it is intended to ensure equal treatment of domestic and cross-border situations. Such an interpretation would in fact be able to justify all neutral tax measures.¹²⁵⁹ Perhaps this strained reasoning can be explained by what has been suggested above, namely that the restrictive effect identified by the Court was nothing more than the result of the interplay of different tax systems, and should therefore fall outside the scope of the Treaty freedoms.¹²⁶⁰

Another indirect tax case that is sometimes referred to as an example to demonstrate the Court’s willingness to apply a restriction approach in tax

1257. C-439/97, *Sandoz*, 14 Oct. 1999, para. 23.

1258. *Id.* at para. 24.

1259. See also J. Snell, *Non-discriminatory Tax Obstacles in Community Law*, 56 *Intl. & Comp. L. Q.* 2 (2007), at 345-346.

1260. See also K. Banks, *The Application of the Fundamental Freedoms to Member State Tax Measures: Guarding against Protectionism or Second-guessing National Policy Choices*, 33 *Eur. L. Rev.* 4 2008, at 493-493, who notes that “this somewhat tortured approach is evidence of the fact that the drafters of the Treaty provisions on free movement of capital never envisaged entirely neutral tax measures being treated as restrictions, and therefore provided no suitable ‘let-out’ clause for them”.

matters is *De Coster*.¹²⁶¹ That case concerned a Belgian municipal tax on satellite dishes, a measure which applied without any distinction on the basis of nationality. The Court concluded that the measure constituted a restriction on the freedom to provide services because it had the effect of a charge on the reception of television programmes transmitted by satellite which did not apply to the reception of programmes transmitted by cable. However, the reasoning of the Court was based on a discrimination analysis rather than a restriction analysis. The reason why the measure was incompatible with the freedom to provide services was that broadcasters established in Belgium enjoyed unlimited access to cable distribution for their programmes in that Member State, while broadcasters established in other Member States generally did not. As a result, the measure at issue was likely to dissuade the recipients of the television broadcasting services established in the municipality in question from seeking access to television programmes broadcast from other Member States, as the reception of such programmes was subject to a charge which did not apply to the reception of programmes coming from broadcasters established in Belgium.

In other words, the Court concluded that the measure was more disadvantageous to foreign service providers than it was to Belgian service providers:

the tax on satellite dishes introduced by the tax regulation *is liable to impede more* the activities of operators in the field of broadcasting or television transmission established in Member States other than the Kingdom of Belgium, while

1261. C-17/00, *François De Coster v. Watermaal-Bosvoorde*, 29 Nov. 2001. For a similar case, see Joined Cases C-544/03 and 545/03, *Mobistar SA v. Commune de Fléron, Belgacom Mobile SA v. Commune de Schaerbeek*, concerning local taxes on transmission pylons, masts and antennae for GSM. Two German mobile telephony operators argued that these taxes constituted a restriction contrary to the freedom to provide services. The Court first noted that “measures, the only effect of which is to create additional costs in respect of the service in question and which affect in the same way the provision of services between Member States and that within one Member State, do not fall within the scope of Article [49] of the Treaty”. As to the case at hand, the Court noted that the taxes at issue applied “without distinction to all owners of mobile telephone installations within the commune in question, and that foreign operators are not, either in fact or in law, more adversely affected by those measures than national operators. Nor do the tax measures in question make cross-border service provision more difficult than national service provision. Admittedly, introducing a tax on pylons, masts and antennae can make tariffs for mobile telephone communications to German from abroad and vice versa more expensive. However, national telephone service provision is, to the same extent, subject to the risk that the tax will have an impact on tariffs”. Finally, the Court did not address the double burden issue because there was “nothing in the file to suggest that the cumulative effect of the local taxes compromises freedom to provide mobile telephony services between other Member States and the Kingdom of German”. Joined Cases C-544/03 and 545/03, *Mobistar*, paras. 31-34.

giving an advantage to the internal Belgian market and to radio and television distribution within that Member State (emphasis added).¹²⁶²

Clearly, that is a discrimination analysis.

13.4.3.3.3. Futura

Ultimately, there are very few real restriction cases in the field of direct taxation.¹²⁶³ The most obvious example is *Futura*, a rare instance where the mutual recognition doctrine was applied in direct tax matters. As mentioned above, the concept of mutual recognition has mainly been applied in the context of the free movement of goods and services.¹²⁶⁴ The basic idea underlying that concept is the following. When a good is put on the market in a Member State (the origin state), that State may apply its own rules. If the good is later exported to another Member State, that state (the host state) is required to recognize the rules of the origin state, unless there is a justification for not doing so. Dual burdens are therefore prohibited, unless they can be justified. In *Futura*, the Court held that the host state (Luxembourg) was in principle required to recognize the accounting rules imposed by the origin state (France), unless there was a justification for refusing to do so.

As regards the justification, the Court also addressed some aspects that were relevant for the determination that there was a restriction. After establishing that the Luxembourg measure constituted a restriction because it imposed a double burden on non-residents with a PE in Luxembourg,¹²⁶⁵ the Court

1262. C-17/00, *De Coster*, para. 35 (emphasis added).

1263. Similarly, S. van Thiel, “The Future of the Principle of Non-discrimination in the EU: Towards a Right To Most Favored Nation Treatment and a Prohibition of Double Burdens?”, in R. Avi-Yonah, J. Hines and M. Lang (eds.), *Comparative Fiscal Federalism* (Alphen aan den Rijn: Kluwer Law International, 2007), at 394 (“in its general case law the Court has gradually moved from a discrimination-based to a restriction-based reading of the Treaty, at least as regards market access (not necessarily as regards market exit. [...] In the tax area a similar approach was followed for indirect taxes and social security contributions, but not (yet) for income taxes. In fact the Court has been reluctant to prohibit non-discriminatory access taxes explicitly in its income tax case law (except in *Futura*)”).

1264. Applications in the field of other freedoms are quite rare. It could be argued that *Centros*, *Inspire Art* and *Überseering* were applications of mutual recognition in the field of the freedom of establishment. In those cases, the ECJ concluded that the host state is required to recognize companies that are formed under the law of another Member State, without imposing additional national requirements.

1265. C-250/95, *Futura*, paras. 23-25 (“Such a condition may constitute a restriction, within the meaning of Article 52 of the Treaty, on the freedom of establishment of a company or firm [...] where that company or firm wishes to establish a branch in a Member State different from that in which it has its seat. It means in practice that if such a company or

verified whether it pursued a legitimate aim compatible with the Treaty. The aim pursued by the Luxembourg accounting requirement was to make sure that the losses in question did in fact arise from Luxembourg activities, that the amount of the losses corresponded, under Luxembourg rules on the calculation of income and losses, to the amount of losses actually incurred by the taxpayer and, finally, to enable the Luxembourg tax authorities to inspect the accounts at any time.¹²⁶⁶

The Court recognized that, as the effectiveness of fiscal supervision may justify a restriction, a Member State is allowed to apply measures that enable the amount of the income taxable in that state and the losses which may be carried forward there to be ascertained clearly and precisely. On the one hand, the Court then pointed out that the objectives pursued by the Luxembourg measure would not be attained if the Luxembourg authorities had to refer to accounts kept by the non-resident taxpayer pursuant to another Member State's rules. As there was no EU harmonization on the determination of the taxable base, each Member State has its own rules governing the determination of profits and losses. As a result, there was no guarantee that a company's accounts drawn up for the purpose of determining the taxable base in its home state would provide relevant figures concerning the amount of taxable income and of the losses which could be carried forward in the PE state.

On the other hand, the Court examined whether the requirement of keeping separate accounts in Luxembourg *goes beyond what is necessary* to enable the amount of losses that may be carried forward to be ascertained. In this respect, the Court observed that, under Luxembourg law, non-resident taxpayers are not, as a rule, obliged to keep proper accounts relating to their Luxembourg activities. As a result, the Luxembourg authorities are unable to inspect the accounts. It is only when a non-resident taxpayer asks to be allowed to carry forward losses that it is obliged to show that it kept proper accounts relating to its activities in Luxembourg. However, once such a request is made, the sole concern of the Luxembourg authorities is to ascertain clearly and precisely that the amount of losses to be carried forward corresponds, under the Luxembourg rules on the calculation of income and

firm wishes to carry forward any losses incurred by its branch, it must keep, in addition to its own accounts which must comply with the tax accounting rules applicable in the Member State in which it has its seat, separate accounts for its branch's activities complying with the tax accounting rules applicable in the State in which its branch is established. Furthermore, those separate accounts must be held, not at the company's seat, but at the place of establishment of its branch".).

1266. C-250/95, *Futura*, paras. 28-29.

losses, to the amount of losses actually incurred in Luxembourg by the taxpayer.¹²⁶⁷ Consequently:

provided that the taxpayer demonstrates, clearly and precisely, the amount of the losses concerned, the Luxembourg authorities cannot refuse to allow him to carry them forward on the ground that in the year concerned he had not kept and not held in Luxembourg proper accounts relating to his activities in that State.¹²⁶⁸

The Court therefore held that it is not essential that the means by which the non-resident taxpayer may demonstrate the amount of the losses it seeks to carry forward be limited to those provided for by Luxembourg law. Additionally, the Mutual Assistance Directive allows the Luxembourg tax authorities to request the competent authorities of another Member State to provide them with all the information enabling them to ascertain, in relation to the legislation which they must apply, the correct amount of revenue tax payable by a taxpayer having its residence in that other Member State.¹²⁶⁹

In other words, for *the existence* of a restriction, the Court apparently considers it sufficient that there be a double burden, without ascertaining whether the aim pursued by the measure imposing the double burden is actually achieved by the legislation of another Member State. For *the justification* of that restriction, the Court did consider whether the other state's legislation does in fact achieve the same objective (e.g. because the relevant legislation has been harmonized). This is an interesting distinction, but it is not immediately clear what the underlying reason is. As will be discussed below, the application of a restriction approach is not possible with respect to matters of substantive domestic tax law. Only other matters, i.e. what will be called procedural tax law, are suited for a restriction analysis.

It should be emphasized at this point that the aspect of *Futura* discussed here was not of a substantive nature. The accounting rules to which the Court applied the concept of mutual recognition were elements of procedural law. It is very doubtful whether the Court would extend such a pure restriction-based approach to cases involving substantive tax matters, as mutual recognition of substantive tax rules is quite far-reaching, given the tax sovereignty

1267. This seems to be a rebuttal of the argument of Luxembourg that the measure was necessary to enable the Luxembourg tax authorities to inspect the accounts at any time. According to the Court, there was no need to inspect the accounts of a non-resident taxpayer at any time. Only when such a taxpayer applies for a loss carry-forward, is it necessary to inspect his accounts. And at that time, the only concern of the tax authorities is to ascertain clearly and precisely the amount of losses to be carried forward.

1268. C-250/95, *Futura*, para. 39.

1269. *Id.* at paras. 31-41.

of Member States.¹²⁷⁰ The Court considered disadvantages arising from the fact that a taxpayer is subject to another (i.e. a second) tax system, with its own substantive rules, to be an allowed disparity (*see* chapter 17).

Accordingly, double burdens in substantive tax matters resulting from being subject to more than one tax system do not come within the scope of the Treaty freedoms.¹²⁷¹ The mere fact that the different substantive tax rules of the Member States exist side-by-side cannot give rise to a breach of the Treaty freedoms, even though a taxpayer may be “restricted” from exercising its treaty freedoms as a result of this coexistence. An obvious example of this position is *Kerckhaert-Morres*.¹²⁷² In that case, the Court concluded that Belgium did not breach the Treaty freedoms by applying a neutral tax measure to all income, regardless of the fact that the same income had already been taxed in another Member State. The Belgian measure at issue did not make any distinction between dividends from companies established in Belgium and dividends from companies established in another Member State. Both categories of dividends were taxed by way of income tax at an identical rate of 25%. Consequently, the Belgian measure was truly even-handed. However, it was clearly liable to dissuade cross-border investment, as the dividends that the taxpayer received from a French company had already been taxed in France. Nevertheless, the Court did not consider this double burden to fall foul of the Treaty. According to the Court, the adverse consequences which might arise from the application of the Belgian law “result from the exercise in parallel by two Member States of their fiscal sovereignty”. From this refusal to recognize the existence of a restriction, one could infer that the Court considered substantive direct tax measures to

1270. *See also* M. Aujean, “The Future of Non-discrimination: Direct Taxation in Community Law”, in R. Avi-Yonah, J. Hines and M. Lang (eds.), *Comparative Fiscal Federalism* (Alphen aan den Rijn: Kluwer Law International, 2007), at 324 (“In its non-tax case law the Court has repeatedly held that non-discriminatory restrictions to the free movement of goods are impermissible unless justified by imperative requirements of public interest. In the direct tax sphere the Court has so far only applied this analysis unequivocally to compliance issues (*see* Case C-250/95, *Futura Participations*)”).

1271. *See also* P. Farmer, *EC Law and National Rules on Direct Taxation: A Phoney War?*, *EC Tax Rev.* (1998), at 27, who noted shortly after the *Futura* judgment that a dual approach could arise in the Court’s case law, based on discrimination in relation to tax burden and restriction in regard to compliance. Limiting the analysis in relation to tax burden to discrimination avoids bringing restrictions arising from the mere exercise of tax jurisdiction or from conflicts of jurisdiction within the scope of the Treaty freedoms. On the other hand, compliance issues, such as the accounting obligation in *Futura*, lend themselves more readily to a restriction-based approach.

1272. C-513/04, *Kerckhaert-Morres*, 14 Nov. 2006. This case will be addressed in more detail in section 14.2.6.2.5.

be unsuited for a restriction analysis.¹²⁷³ If the Court had applied its mutual recognition doctrine, as it did to the procedural rules of *Futura*, Belgium would have had to recognize the taxation in France and refrain from further taxation.

The Court took the same position in *CIBA*,¹²⁷⁴ which concerned the Hungarian vocational training levy. Companies established in Hungary were subject to a tax, calculated on the basis of their wage costs, which was intended to finance a fund that served to increase the number of trained specialists in Hungary and to develop their professional skills. The taxpayer was a company established in Hungary with a PE in the Czech Republic. In the latter state, the taxpayer paid taxes and social security contributions in respect of the workers employed in the PE, including contributions relating to public policy on employment, as laid down in Czech domestic law. The taxpayer argued that the Hungarian measure infringed the freedom of establishment because the basis of assessment for the vocational training levy was the taxpayer's total wage cost, including the wages incurred in the Czech PE. Because the Hungarian measure applied to the total wage cost, the taxpayer was subject to a double obligation to pay such a contribution in respect of its workers employed in the Czech Republic.

Referring to *Kerckhaert-Morres*, the ECJ rejected the taxpayer's claim. The Court held that the disadvantage suffered by the taxpayer (i.e. the double burden of paying similar contributions in Hungary and the Czech Republic with respect to the workers employed in the Czech PE) resulted "from the exercise in parallel by two Member States of their fiscal sovereignty". As there are no harmonization measures to eliminate double taxation at the EU level, the Member States enjoy a certain autonomy in this area, meaning that they are not obliged to adapt their own tax systems to the different tax systems of the other Member States in order to eliminate the double taxation arising from the exercise in parallel by those states of their fiscal sovereignty. Therefore, the double taxation incurred by the taxpayer was not contrary to the Treaty freedoms.¹²⁷⁵

1273. Similarly C-298/05, *Columbus Container Services*, 6 Dec. 2007, paras. 43-45, which will be discussed in section 15.2.2.

1274. C-96/08, *CIBA Speciality Chemicals Central and Eastern German Szolgáltató, Tanácsadó és Kereskedelmi Kft*, 15 Apr. 2010.

1275. *Id.* at paras. 25-29. Similarly, C-67/08, *Block*, 12 Feb. 2009, para. 28, concerning the European inheritance tax on capital assets invested with financial institutions in European. Double taxation arose because European made capital claims subject to European inheritance tax if the creditor were resident in European, while European made such claims subject to European inheritance tax if the debtor were established in European. The ECJ held that the refusal by the European tax authorities to grant a credit for

It has been suggested that the Court's refusal to apply the mutual recognition doctrine in *Kerckhaert-Morres* is inconsistent with its earlier case law, notably *Marks & Spencer* and *Manninen*.¹²⁷⁶ In *Marks & Spencer*, the Court required the home state to consider the deductions available in the host state when deciding whether to allow a deduction under domestic law.¹²⁷⁷ This is quite similar to requiring a Member State to consider the taxation in another state when deciding on the imposition of a tax under domestic law (i.e. mutual recognition). In *Manninen*, the Court required a Member State that granted resident shareholders in receipt of domestic dividends a tax credit corresponding to the domestic corporate tax on the profits, to extend that credit to foreign dividends. One could argue that this entails the mutual recognition of a foreign tax for the purpose of granting a tax credit.

However, it should be emphasized here that the measure at issue in *Kerckhaert-Morres* applied without any distinction, while the national measures in *Marks & Spencer* and *Manninen* distinguished on the basis of the subsidiaries' state of residence and the source of the dividends, respectively. Accordingly, *Kerckhaert-Morres* required a restriction analysis, which explains why the Court verified whether the mutual recognition doctrine could be applied. As argued above, this proved to be impossible because it concerned substantive tax rules. In contrast, *Marks & Spencer* and *Manninen* concerned discriminatory rules, which means that the mutual recognition doctrine was irrelevant. In those cases, the taking into account of the taxation in the other Member State was part of the disadvantage test of the discrimination analysis. In particular, in order to verify whether the subject of comparison was being treated less favourably (and in order to assess the extent of that

the tax paid in European was not contrary to the free movement of capital because the disadvantage resulted from the exercise in parallel by the two Member States concerned of their fiscal sovereignty. Reference should also be made to C-234/99, *Nygård*, 23 Apr. 2002, concerning the free movement of goods. When discussing whether a Danish (non-discriminatory) charge on the slaughter of pigs was compatible with art. 90 of the EC Treaty (current art. 110 of the TFEU), the ECJ held that it was irrelevant that the Member State of importation also levied a similar charge, even though this resulted in a double burden. C-234/99, *Nygård*, para. 38 ("As it stands at present, Community law does not contain any provision designed to prohibit the effects of double taxation occurring in the case of charges, such as that in issue in the main proceedings, which are governed by independent national legislation, and, while the elimination of such effects is desirable in the interests of the free movement of goods, it may none the less result only from the harmonisation of national systems"). Similarly, C-517/04, *Koornstra*, 8 European 2006, concerning a European charge on the landing of shrimp.

1276. E.g. J. Snell, *Non-discriminatory Tax Obstacles in Community Law*, 56 Intl. & Comp. L.Q. 2 (2007), at 361-362.

1277. See *Marks & Spencer*, para. 55. (the denial of deduction by the resident parent is disproportionate if it was impossible to take the losses into account in the subsidiary's state of establishment).

disadvantage, which determined the proportionality of the measure), the Court verified in *Marks & Spencer* whether there was a possibility to deduct the losses in the subsidiary's state of residence. Similarly, in *Manninen*, the disadvantage suffered by the subject of comparison was the double taxation which was relieved for domestic dividends but not for cross-border dividends (and which, in the latter case, required the taking into account of the taxation in the other Member State).

This is not the same as recognizing that the tax measure in the other Member State already fulfils the objective sought by the measure under scrutiny, and therefore refraining from further taxation. There is an important difference between mutual recognition of substantive tax measures (which goes beyond the scope of the Treaty freedoms) and taking account of what happens in another state when assessing the existence and extent of a disadvantage.

Ultimately, this is the reason why the evolution perceived in the Court's general body of case law, from discrimination to restriction, cannot be transposed to substantive direct tax matters. Non-discriminatory restrictions resulting from the cumulation of the substantive tax laws of different Member States hinder the development of the Internal Market, but they go beyond the scope of the Treaty freedoms as they are the result of disparities. In order to reduce or eliminate the distortive effects of these restrictions, Member States have two options. Either they replace the national systems with one uniform or harmonized system in which cumulation of burdens is avoided (which is unlikely, given the procedural requirements for direct tax harmonization in the EU), or they choose one of the substantive systems to be applicable to a particular situation (whether it be that of the home state or the host state). The latter option is, to some extent, developed in international tax law, where tax treaties designate which state has the power to tax a certain element of income. However, this allocation of taxing powers is an element of the Member States' sovereignty, and therefore not a matter of EU law.

Moreover, one should keep in mind that the mutual recognition doctrine, as developed in *Cassis de Dijon*, is based on the idea that a Member State may not apply its own rules because the interests it seeks to protect by the application of those rules are already protected by the rules of another Member State. More specifically, the idea underlying mutual recognition is that a Member State is not allowed to impose its product requirements that are intended, for example to protect public health, if that objective is already safeguarded by the product requirements that are applicable in the Member State of origin. This idea cannot be transposed to the field of substantive direct taxation. The interest protected by the application of a Member State's