

**DIRECT TAXATION  
FALLS WITHIN THE COMPETENCE OF  
THE MEMBER STATES**

**BUT**

**THE MEMBER STATES MUST  
EXERCISE THAT COMPETENCE  
CONSISTENTLY  
WITH COMMUNITY LAW**

# I. « Direct taxation falls within the competence of the Member States »

- Nothing specific in the Treaties about direct taxation
- Only way to act :
  - art. 94 EC
  - small results : 5 directives :
    - \* 77/799 EEC
    - \* 90/434 and 435 EEC
    - \* 2003/48 and 49 EC



- Tax scales, taxation methods, taxable incomes are to be decided by the Member States all the more because the ECJ (**GILLY, 1998**) has distinguished

*the **exercise of fiscal competence** (with the obligation to comply with EC-law)*

*and*

*the **allocation of fiscal competence** (which comes before)*

**SO, NO PROBLEM**  
**FOR NATIONAL SYSTEMS ?**

**II. « But the Member States must exercise that competence consistently with EC-Law »**

Suddenly the taxpayers woke up...  
and  
after more than 30 condemnations  
since 1995,  
the Member States do not seem yet to be  
awake.



With consistency, the ECJ case-law has defined :  
**the obligation to exercise the fiscal competence** consistently with EC-Law  
as the prohibition

in the fields of

**free movement of** - persons  
- services  
- capital  
**freedom of** - establishment

of **ANY DISCRIMINATION OR RESTRICTION (BARRIER)** except if they are justified.

**DE GROOT (2002)** transposed to  
corporate tax (pt 115)

***« Community law contains no specific requirement with regard to the way in which [a Member] State must [deal with corporate tax], provided that the conditions [governing it] do not constitute a discrimination, either direct or indirect, on grounds of nationality or an obstacle to the exercise of a fundamental freedom guaranteed by the EC treaty »***



### III. Natural persons : some principles applicable to corporate tax

1. Residents and non-residents are in principle in comparable situations (and therefore cannot be discriminated) when the applicable rule has nothing to do with the residence
  - Rules of fiscal procedure : **BIEHL (1990), SCHUMACKER (1995)**
  - Rule of progressive scales : **ASSCHER (1996)**
  - Tax advantages deriving from a double taxation convention : **ST GOBAIN (1999)**



2. Even if the text of the Treaty (Art. 58 EC) is different, the rules applicable to freedom of establishment and to freedom to provide services are also applicable to free movement of capital.

**VERKOOIJEN (1999)**

3. Freedom of establishment goes both ways :

- to the Member State of destination
- to the Member State of origin

**BAARS (2000)**

## **IV. Legal persons : corporation tax – tax on dividends**

- A.** Direct or indirect discriminations and barriers are incompatible with EC Law but the Court is more and more reluctant to use the word « discrimination ».



## ■ Freedom of establishment :

- « Discrimination »

**COMMISSION – FRANCE (1986)**

**COMMERZBANK (1993)**

**R. BANK OF SCOTLAND (1999)**

- « Difference of treatment »

**ICI (1998)**

**ST GOBAIN (1999)**

**AMID (2000)**

**METALLGESELLSCHAFT (2001)**

## ■ Freedom to provide services

- « Barrier »

**SAFIR (1998)**

- « Difference of treatment »

**XAB-YAB (1999)**

**VESTERGAARD (1999)**



- Three recent cases :
  - « Difference of treatment constitutes a barrier »

**XY (2002)**

**LANKHORST-HOHORST (2002)**

**BOSAL HOLDING (2003)**

***BUT IS IT NECESSARY TO  
DISTINGUISH  
DISCRIMINATIONS AND  
BARRIERS ?***



In principle, **YES**

- *as barriers can be justified more easily than discriminations*
- *as barriers can be justified by « reasons of overriding general interest » whereas discriminations only by the reasons expressly provided for by the Treaty.*

In practice, ***DOUBTFUL***

- ***SVENSSON (1995)***
- The ECJ avoids the problem
  - by, after the finding of « difference of treatment », examining all justifications put forward;
  - without having to rule whether or not the « difference of treatment » is discriminatory when all the justifications are rejected (95 % of the cases)



## B. JUSTIFICATIONS

### 1. Cohesion of the tax system

always invoked by Member States ...

because the ECJ accepted it ... once in 1992... (**BACHMANN**)

*[Belgian law did not allow the deduction of life insurance premiums paid abroad. The Belgian system gave the choice of either deducting premiums but taxing future benefits or not deducting premiums and having future benefits exempted. The cohesion of the Belgian system required the certainty to tax the benefits if the premiums had been deducted, what was not the case if the benefits were paid abroad.]*



but systematically refused it afterwards for two reasons.

- a. Either, because according to the ECJ, the cohesion of the tax system was realized, under a double taxation convention, at the level of the global relationships between the two countries, which implied to waive the right to ensure it at individual level.

**WIELOCKX (1995)**

**XY (2002)**

b. Or, because the concerned national system did not fulfil the conditions imposed by the definition of the ECJ

Cohesion of a tax system may only be invoked when :

1) One taxpayer only is concerned (difficult to meet this criterion for groups of companies, when parent companies and subsidiaries are concerned)

**ICI (1998)**

**METALLGESELLSCHAFT (2001)**

**BOSAL HOLDING (2003)**



2) One taxation is concerned (not possible to « compensate » corporation tax and income tax or corporation tax and wealth tax)

**ASSCHER (1996)**

**BAARS (2000)**

**VERKOOIJEN (2000)**

3) There is a direct link between a tax relief and a taxation.

**DANNER (2002)**

**BOSAL (2002)**

**LANKHORST-HOHORST (2002)**

**SKANDIA (2003)**



## **2. Loss of tax revenue**

(or « aim of avoiding an erosion of the tax base going beyond...mere diminution of tax revenue »)

**NEVER !**

**ICI (1998)**

**ST GOBAIN (1999)**

**DANNER (2002)**

**SKANDIA (2003)**

**BOSAL (2002)**

### **3. Territoriality**

Here also, the ECJ has closed in **XY (2002)** and **BOSAL (2003)** the door that had been slightly opened in **FUTURA PARTICIPATIONS (1997)**.

## 4. Increasing the effectiveness of fiscal supervision

In principle YES

but never accepted (with one exception)

because « Directive 77/799 concerning mutual assistance in the field of direct taxation provides adequate means... »

**SCHUMACKER (1995)**

**BAXTER (1999)**

**VESTERGAARD (1999)**



## 5. Preventing the risk of tax avoidance

In principle YES

but only when the national legislation has the specific purpose of preventing wholly artificial arrangements to circumvent national tax legislation,

what cannot be presumed for :

- the establishment of a subsidiary abroad

**ICI (1998)**

- any situation in which a mother company, for any reason, has its seat abroad

**LANKHORST - HOHORST (2002)**

- the establishment of the mother company or of a subsidiary abroad.

**XY (2002)**



# V. Double taxation conventions

## A. Primary law

*« If the Member States are free to define the criteria for allocation their powers of taxation as between themselves, »*

**GILLY (1998)**

the simple existence of a double taxation convention does not exempt them from complying with EC law (single market + primacy)

**SAINT GOBAIN (1999)**

**DE GROOT (2002)**



## **B. Secondary legislation : directive parent companies – subsidiaries**

Art. 4 the State of the parent company may either refrain from taxing dividends paid by the subsidiary or tax them while authorizing the parent company to deduct the fraction of the corporation tax paid by the subsidiary related to these dividends.

Art. 5 : these dividends shall be exempt from withholding tax (temporary derogations for Germany, Portugal, Greece)

**BUT**

Art. 7 §2 : « This directive shall not affect the application of... agreement-based provisions designed to eliminate or reduce economic double taxation of dividends... »



***Can art. 7 § 2 (i.e. a double taxation convention) be considered as an exception to art. 5 (no withholding tax) ?***

***Or is art. 7 § 2 inconsistent with the aim of the directive ?***

## OCE VAN DER GRINTEN (2003)

- ✓ No problem of validity of art 7 § 2
- ✓ **BUT** it implies that :  
the withholding tax (as the UK 5 % in this case) is part of a double taxation convention which does not have as effect a (even partial) double taxation of the dividends (in other words, Member States can allocate between themselves the power of taxation but if one taxes them, the other must compensate...)