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Abstract

This Essay addresses one of the main issues currently facing the European Community, the problem of discrimination between individuals. Because discrimination on the basis of nationality concerns virtually everybody, this is a sensitive and universal concern. In addition, this Essay examines an area of law in which the applicable law hinges upon the distinction between the terms "at home" and "abroad." I use the expression distinction because not every distinction results in discrimination. Discrimination occurs when a distinction is made between people in comparable situations without sufficient justification. . . . In the *Finanzamt Koln-Alstadt* v. *Roland Schumacker* decision and succeeding cases, the Court has attempted to consider international tax law by confirming, for the first time, the distinction between residents and non-residents as it is recognized in tax law. To do justice to the special features of this case and the legal reasoning it introduces, it is necessary first to consider the situation prevailing before the Schumacker judgment.

THE JURISPRUDENCE OF THE EUROPEAN COURT OF JUSTICE IN TAX MATTERS

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INTRODUCTION

This Essay addresses one of the main issues currently facing the European Community, the problem of discrimination between individuals. Because discrimination on the basis of nationality concerns virtually everybody, this is a sensitive and universal concern. In addition, this Essay examines an area of law in which the applicable law hinges upon the distinction between the terms "at home" and "abroad." I use the expression distinction because not every distinction results in discrimination. Discrimination occurs when a distinction is made between people in comparable situations without sufficient justification.

The Treaty Establishing the European Community[1] ("EC Treaty") does not specifically empower the European Community to legislate in the field of direct taxes. This does not mean, however, that the internal law of Member States can disregard the four freedoms[2] enshrined in the EC Treaty in the field of taxation. While the Council has the power to issue directives for the approximation of tax law under certain conditions, it has not seen fit to do so. Consequently, the individual freedom of people may conflict with the power of Member States to levy taxes upon persons and business activities within the scope of their authority, and, therefore, internal and international tax law must

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1. Treaty Establishing the European Community, Feb. 7, 1992, [1992] 1 C.M.L.R. 573 [hereinafter EC Treaty], *incorporating changes made by* Treaty on European Union, Feb. 7, 1992, O.J. C 224/1 (1992), [1992] 1 C.M.L.R. 719, 31 I.L.M. 247 [hereinafter TEU]. The TEU, *supra*, amended the Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11, 1973 Gr. Brit. T.S. No. 1 (Cmd. 5179-II) [hereinafter EEC Treaty], *as amended by* Singel European Act, O.J. L 169/1 (1987), [1987] 2 C.M.L.R. 741 [hereinafter SEA], *in* TREATIES ESTABLISHING THE EUROPEAN COMMUNITIES (EC Off'l Pub. Off. 1987).

2. The four freedoms are the free movement of goods, EC Treaty, *supra* note 2, arts. 9-37, [1992] 1 C.M.L.R. at 594-606; free movement of persons, *id.* arts. 48-58, [1992] 1 C.M.L.R. at 612-16; free movement of services, *id.* arts. 59-66, [1992] 1 C.M.L.R. at 616-18; and free movement of capital, *id.* arts. 67-73h, [1992] 1 C.M.L.R. at 618-23.

be brought into harmony with Community laws. Meanwhile, the European Court of Justice ("Court") cannot just sit still and respond passively to this development. The Court must ensure that the freedoms guaranteed under the EC Treaty may be exercised without discrimination. Simultaneously, the Court must protect the sovereign rights of the Member States without the guidance of special legislation applicable to the sector. Thus, it is a classic dilemma: whatever the Court does will be criticized for not protecting individual liberty, for not respecting the authority of the Member States, or for failing to act at all. In the *Finanzamt Koln - Alstadt v. Roland Schumacker*[3] decision and succeeding cases, the Court has attempted to consider international tax law by confirming, for the first time, the distinction between residents and non-residents as it is recognized in tax law. To do justice to the special features of this case and the legal reasoning it introduces, it is necessary first to consider the situation prevailing before the *Schumacker* judgment.

I. *JURISPRUDENCE BEFORE THE* SCHUMACKER *JUDGMENT*

A. *The* Avoir Fiscal *Judgment (1986): Freedom of Establishment*

The Court's first judgment in the field of direct taxes dates from January 1986 and resulted from an enforcement action of the Commission against France, the *Avoir Fiscal* case.[4] This case touches on significant problems and principles, which are of importance for the subsequent cases in the area of direct taxes. The *Avoir Fiscal* case concerned the freedom of establishment under Article 52 of the EC Treaty.[5] Article 52 "ensure[s] that all nationals of Member States who establish themselves in another Member State, even if that establishment is only secondary, for the purpose of pursuing activities there as a self-employed person receive the same treatment as nationals of that State . . . ."[6] In addition, "it prohibits, as a restriction on freedom of establishment, any discrimination on grounds of nationality resulting from the legislation of the Member State."[7] The Court found,

3. Case C-279/93, [1995] E.C.R. I-225.

4. Commission v. France, Case 270/83, [1986] E.C.R. 273 [hereinafter *Avoir Fiscal*].

5. EC Treaty, *supra* note 2, art 52, [1992] 1 C.M.L.R. at 613-14.

6. *Avoir Fiscal*, [1986] E.C.R. at 303, ¶ 14.

7. *Id.*

"Article 52 expressly leaves traders free to choose the appropriate legal form in which to pursue their activities in another Member State . . . ."[8]

The Court's method of examination in this case has been used in all subsequent cases dealing with direct taxation.[9] Under this method, the Court considers whether or not there has been a violation of Article 52. Such a breach may result both from discrimination on the grounds of nationality and from a restriction on the freedom of establishment. If a violation is found to exist, the Court examines whether such a violation could be justified in certain circumstances.

As far as the first stage of the examination is concerned, the question regarding a violation of Article 52, the Court in the *Avoir Fiscal* case pointed to tax law's distinction between residents and non-residents,[10] which plays a very important role in the more recent direct tax cases. The circumstance that residents and non-residents may not be in a comparable situation, however, is only regarded as a possibility, but by no means as the only possibility, which may not be completely excluded.[11] The Court added that in the case of companies, their registered office is comparable with the nationality of natural persons[12] because they both serve as the connecting factor with the legal system of a particular Member State. The freedom of establishment would be undermined if a Member State in which a company seeks to establish itself may treat this company differently solely because the company's registered office is situated in another Member State.[13] The Court decided, therefore, that rules in the field of direct taxation could contravene Article 52 and that such a violation could not be justified by inadequate harmonization or inconsistent rules in double-taxation conventions.

8. *Id.* at 305, ¶ 22. The Court added that the freedom to choose the appropriate legal forum must not be "limited by discriminatory tax provisions." *Id.*

9. *Id.* at 302-07, ¶¶ 11-28.

10. *Avoir Fiscal*, [1986] E.C.R. at 303-04, ¶¶ 16-17.

11. *Id.* at 304, ¶ 19.

12. *Id.* at 304, ¶ 18.

13. *Id.*

B. *The* Biehl *Judgment (1990): Freedom of Movement for Workers and Covert Forms of Discrimination*

The Court in *Klaus Biehl v. Administration des contributions du grand-duche de Luxembourg*[14] extended the jurisprudence of the *Avior Fiscal* case into the area of workers' freedom of movement under Article 48 of the EC Treaty.[15] Article 48 provides that the "freedom of movement for workers entails the abolition of all discrimination based on nationality between workers of the Member States, particularly with regard to remuneration."[16]

The Court examined a Luxembourg regulation which prohibited a repayment of tax in the event of over-payment if the taxpayer had been a resident for only part of the year.[17] The rule, as such, did not expressly take nationality into account. The Court, however, referred to its case-law, which stated that the rules on equal treatment forbid both overt and covert forms of discrimination.[18] As the Court further explained, the criterion of permanent residence in the national territory carries with it the risk that it "will work in particular against taxpayers who are nationals of other Member States" because "[i]t is often such persons who will in the course of the year leave the country . . . ."[19] The Court, therefore, found that discrimination in the *Biehl* case.

C. *The* Bachmann *Judgment (1992): Fiscal Cohesion as a Ground of Justification*

The *Hanns-Martin Bachmann v. Belgium*[20] judgment also requires consideration (The Court issued another judgment on

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14. Case C-175/88, [1990] E.C.R. I-1779.

15. EC Treaty, *supra* note 2, art. 48, [1992] 1 C.M.L.R. at 612.

16. *Id.*

17. *Id.* at 1791, ¶ 6. The Luxembourg regulation states:

> Amounts duly deducted from capital incomes shall become the property of the Treasury and are not repayable. The same shall apply to the deduction of tax from the salaries and wages of taxpayers resident during only part of the year because they take up residence in the country or leave it during the course of the year.

Id. (quoting loi sur l'impot sur le revenu, art. 154(6)).

18. *Biehl*, [1990] E.C.R. at 1792, ¶ 13 (citing Sotgiu v. Deutsche Bundespost, Case 152/73, [1974] E.C.R. 153, ¶ 11).

19. *Id.* at 1793, ¶ 14.

20. Case C-204/90, [1992] E.C.R. I-249.

the same day concerning the same legal regulation[21]). The question in *Bachmann* was whether contributions to insurance companies of other Member States were deductible. The judgment is important because the Court upheld the concept of fiscal cohesion as a ground of justification notwithstanding other possible grounds of justification.[22]

The disputed Belgian regulation connected the deductibility of sickness and invalidity insurance contributions or pension and life assurance contributions with the tax liability of sums payable by the insurers under such assurance contracts.[23] There was concern regarding how such taxation could be guaranteed if the payments are subsequently paid out in another Member State. In the absence of a bilateral convention or a harmonization measure of the Council, the Court concluded, "as Community law stands at present, it is not possible to ensure the cohesion of such a tax system by means of measures which are less restrictive than those at issue in the main proceedings . . . ."[24] In the framework of the *Bachmann* judgment, the Court also considered, but rejected, consumer protection as a justification for the discrimination.[25]

Finally, the effectiveness of fiscal controls as a ground of justification requires consideration. In the *Bachmann* judgment, as well as in subsequent cases, the Court rejected such a justification. The Court observed that Member States may invoke Council Directive 77/799 of December 19, 1977[26] concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation to verify that payments have been made in another Member State.[27]

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21. Commission v. Belgium, Case C-300/90, [1992] E.C.R. I-305.

22. *Bachmann*, [1992] E.C.R. at 283-84, ¶¶ 27-28.

23. *Id.* at 283, ¶ 27. The Belgian regulation "provide[d] that only voluntary sickness and invalidity insurance contributions paid to a mutual insurance company recognized by Belgium and pension and life insurance contributions paid in Belgium may be deducted from occupational income." *Id.*

24. *Bachmann*, [1992] E.C.R. at 283, ¶ 27.

25. *Id.* at 281, ¶ 16.

26. Council Directive No. 77/799, O.J. L 336/15 (1977).

27. *Bachmann*, [1992] E.C.R. at 281, ¶ 18.

D. *The* Werner *Judgment (1993): Discrimination Within the Same Group of Nationals*

In *Hans Werner v. Finanzamt Aachen-Innenstadt,*[28] a German national appealed the decision of the German tax authority that found him subject to limited taxation. The Court decided that there was no contravention of Article 52 of the EC Treaty when a Member State imposed a heavier tax burden "on its nationals who carry on their professional activities within its territory and who earn all or almost all of their income there or possess all or almost all of their assets there a heavier tax burden if they do not reside in the state than if they do."[29] Thus, the Court considered this discrimination within the same group of nationals for which the Community was not held responsible although the taxpayer was a resident abroad.

II. *THE* SCHUMACKER *JUDGMENT (1995)*

In the previous judgments, the Court examined whether or not there was discriminatory treatment on the basis of nationality or, in the case of covert disrimination, on the basis of residence and whether there were circumstances in which this could be justified. The *Schumacker*[30] judgment rounded off this approach in many ways. This case concerned the taxation of a Belgian national, whose income derived from employment in Germany.[31] Lacking a permanent residence in Germany, the Belgian national was classified as being subject to limited taxation.[32] In Germany, for married couples, the so-called splitting-regime had been "introduced to mitigate the progressive nature of the income tax rates."[33] Pursuant to Germany's so called splitting regime, which is applied under unlimited taxation, the income of each spouse is combined, apportioned equally between the

28. Case C-112/91, [1993] E.C.R. I-429. By way of concluding my observations on the decisions of the Court prior to the *Schumacker* judgment, I would like to consider this decision which falls somewhat outside the scope of my reflections up to this point, but which will be of importance in relation to the later decisions.

29. *Id.* at 470, ¶ 17.

30. Case C-279/93, [1995] E.C.R. I-225.

31. *Id.* at 254-55, ¶¶ 15-17.

32. *Id.* at 252, ¶ 5. Pursuant to "Paragraph 1(4) of the Einkommensteuergesetz natural persons with no permanent residence or usual abode in Germany are subject to tax only on the part of their income arising in Germany ('limited taxation')." *Id.*

33. *Id.* at 253, ¶ 7. The "splitting-regime" is located in paragraph 26b of the Einkommensteuergesetz, the German law on income taxation.

two spouses, and then taxed according to the apportionment.[34] The Court noted, "[i]f the income of one spouse is high and that of the other low, 'splitting' makes their taxable amounts the same and palliates the progressive nature of the income tax rates."[35] Additionally, persons subject to unlimited taxation[36] have available to them annual adjustments of wage tax to recover over payments of tax.[37] Moreover, "in the case of persons subject to unlimited taxation, tax is assessed according to overall ability to pay, that is to say having regard to all the other income received by such taxpayers and to their personal and family circumstances."[38] In comparison, the German Government withholds these benefits from those employed persons who are subject to limited taxation.[39]

In the *Schumacker* case, Mr. Schumacker, a Belgian national who had always lived in Belgium and been employed in Germany, was subject to German taxation and was treated as a single person for purposes of tax-splitting because he was classified as being subject to limited taxation.[40] He appealed this treatment. The second stage of his appeal went to the *Bundesfinanzhof*, Federal Tax Court, which requested a number of preliminary rulings from the European Court of Justice.[41] The first question concerned the powers of the Community in the field of direct taxation. The *Bundesfinanzhof* asked whether Article 48 of the

34. *Id.*

35. *Id.*

36. *Id.* at 252, ¶ 4. According to Paragraph 1(1) of the Einkommensteuergesetz, "natural persons who have their permanent residence or usual abode in Germany are subject there to tax on all their income", i.e., they are subject to unlimited taxation. *Id.*

37. *Id.* at 253, ¶ 9. Paragraph 46 of the Einkommensteuergesetz grants this procedure. *Id.*

38. *Schumacker*, [1995] E.C.R. at 253, ¶ 10. Personal and family circumstances include, "family expenses, welfare expenses and other outgoings which in general give rise to tax relief and rebates." *Id.*

39. *Id.* at 254, ¶ 11.

40. *Id.* at 255, ¶¶ 17-18.

41. *Id.* at 255-56, ¶ 19. A preliminary ruling is a procedure employed by European courts to ensure that "Community law will remain uniform in all Member States." Carl Otto Lenz, *The Role and Mechanism of the Preliminary Ruling Procedure*, 18 FORDHAM INT'L L.J. 388, 391 (1994). The process allows national courts to:

> refer questions on the interpretation and validity of Community law to the Court of Justice for a binding determination. If a question of Community law needs to be answered in order to determine a case before a court of last instance, that court is obliged to submit a reference for a preliminary ruling.

Id. at 390.

EC Treaty has the effect of limiting the right of Member States, in this case the German Federal Republic, to establish the conditions concerning the tax liability of a national of another Member State and the manner of levying tax on the income received by that national within its territory.[42] In response to this, the Court determined, "[a]lthough, as Community law stands at present, direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law."[43]

The Court decided by reference to the earlier *Biehl* judgment:

> Article 48 of the [EC] Treaty must be interpreted as being capable of limiting the right of a Member State to lay down conditions concerning the liability to taxation and the manner in which tax is to be levied on the income received within its territory, since that article does not allow a Member State, as regards the collection of direct taxes, to treat a national of another Member State in the exercise of his right of freedom of movement less favourably than one of its own nationals in the same situation.[44]

In determining whether there may have been discrimination, the Court, for the first time in the field of direct taxes, referred to a well-established doctrine. That doctrine states, "discrimination can arise only through the application of different rules to comparable situations or the application of the same rule to different situations."[45] The Court then applied a new approach stating, "[i]n relation to direct taxes the situations of residents and of non-residents are not, as a rule, comparable."[46] Only in the *Avoir Fiscal* judgment had the Court considered the possibility that residents and non-residents could be treated differently because they were not in comparable situations.[47] In subsequent judgments, there has been no further discussion of this question. When the Court stated in *Schumacker* that residents and non-resi-

42. *Schumacker*, [1995] E.C.R. at 255-56, ¶ 19.

43. *Id.* at 257, ¶ 21 (citing Commission v. United Kingdom, Case C-246/89, [1991] E.C.R. I-4585, ¶ 12).

44. *Id.* at 258, ¶ 24.

45. *Id.* at 259, ¶ 30.

46. *Id.* at 260, ¶ 31.

47. *Avoir Fiscal*, [1986] E.C.R. at 304, ¶ 19.

dents are as a rule not in comparable situations, it overtook the normal distinction drawn on the basis of residence in tax law. This could imply that the Court is attempting to integrate international tax law principles with the Community law prohibition of discimination.

In international tax law, the distinction is drawn between taxation based on residence and source taxation. Taxation based on residence concerns cases of unlimited taxability and includes the taxpayer's worldwide income. It is applied to resident taxpayers taking into account their personal circumstances. By contrast, source taxation is applied to non-residents. In other words, taxation based on residence is made by reference to the taxpayer's personal characteristics, foremost his personal ability to pay tax, whereas source taxation is based on the fact that income is obtained in a particular state. Unlike the state of residence, the source state may not refer to the taxpayer's personal circumstances and his ability to pay tax.

The Court referred to these principles in the *Schumacker* judgment.[48] The Court explained that the total income is concentrated at the place of residence of the taxpayer and that the non-resident's personal ability to pay tax, which is determined by reference to his aggregate income and his personal circumstances, is easier to assess at the place where his personal and financial interests are centered.[49] In general, that is the place where the taxpayer has his usual abode. Examining international tax law and the Organization for Economic Cooperation and Development ("OECD") Model Double Taxation Treaty,[50] the Court stated, "the overall taxation of taxpayers, taking account of their personal and family circumstances, is a matter for the state of residence."[51] The major part of a resident's income is normally concentrated in the state of residence, which has all the information needed to assess the taxpayer's overall ability to pay, including personal and family circumstances.[52]

If the Court proceeds from the assumption that residents

48. *Schumacker*, [1995] E.C.R. at 257-67, ¶¶ 20-59.

49. *Id.* at 260, ¶ 32.

50. Organization for Economic Cooperation and Development, Comm. on Fiscal Affairs, Model Double Taxation Convention on Income and Capital (1977) [hereinafter 1977 OECD Treaty].

51. *Schumacker*, [1995] E.C.R. at 260, ¶ 32.

52. *Id.* at 260, ¶ 33.

and non-residents are not in a comparable situation, there will be no discrimination if a Member State denies certain tax privileges to a non-resident which it grants to a resident. This constitutes a limitation on the prohibition of discrimination.

The Court must ascertain, however, in every particular case, whether or not residents and non-residents are genuinely in a different situation. According to the reasoning of the Court in the *Schumacker* case, this will not be the case where the non-resident receives no significant income in the Member State of his residence "with the result that the State of residence is not in a position to grant him the benefits resulting from the taking into account of his personal and family circumstances."[53] A non-resident who essentially earns his taxable income from work in the Member State where he is employed and whose income in the Member State of residence is too small to absorb the tax benefits which are due to him on the basis of his personal and family circumstances finds himself in a similar situation with a resident engaged in comparable employment. In other words, there is no objective difference which could justify a different treatment.[54] The discrimination against Mr. Schumacker arises from the fact that neither the Member State of residence nor the Member State of employment could take into account his personal and family circumstances.[55]

According to the standard method of examination the question is then asked, whether this discrimination may be justified. Once again, the question of cohesion of tax rules is raised, which in the *Bachmann* judgment was recognized as a factor providing justification.[56] In the *Schumacker* case, it was submitted that there was a link between the taking into account of the personal and family circumstances and the right to tax worldwide income.[57] The taking into account of personal circumstances is the matter for the Member State of residence, which alone is entitled to tax worldwide income.[58] The Member State, on whose territory the

53. *Id.* at 261, ¶ 36.

54. *Id.* at 261, ¶ 37.

55. *Id.* at 261, ¶ 38.

56. *See Bachmann*, [1992] E.C.R. at 283-84, ¶ 28 (holding "in the field of pensions and life insurance, provisions such as those contained in the Belgian legislation at issue are justified by the need to ensure the cohesion of the tax system . . . .").

57. *Schumacker*, [1995] E.C.R. at 261-62, ¶ 40.

58. *Id.*

non-resident works, does not have to take account of his personal circumstances. In the *Schumacker* case, the Court did not find a justification on the basis of the fiscal cohesion. The Member State of residence cannot take account of the taxpayer's personal situation because the tax payable there is insufficient to enable it to do so.[59] The Court posited, "[w]here that is the case, the Community principle of equal treatment requires that, in the [Member] State of employment, the personal and family circumstances of a foreign non-resident be taken into account in the same way as those of resident nationals and that the same tax benefits should be granted to him."[60] The denial of the advantage of tax-splitting for married couples in the case of a non-resident accordingly contravenes Article 48, because the person concerned "obtains his income entirely or almost exclusively from the work performed in the [other Member] State and does not receive in the [State of residence] sufficient income to be subject to taxation there in a manner enabling his personal and family circumstances to be taken into account."[61]

This is the first case in which the Court considered the personal circumstances which must be taken into account in imposing taxation in the Member State of residence. If this is not possible in the Member State of residence, then it must at least be undertaken in the Member State in which the income is obtained. In a given case, this leads to a situation in which the tax relief a Member State grants to residents on the basis of personal circumstances must also be applied to non-residents.

After the examination of material discrimination, the Court considered discrimination at the procedural level and found it to be present, in the form of the denial of the annual adjustment of wages tax, as the consideration of special circumstances is only compulsorily required for residents.[62]

59. *Id.* at 263, ¶ 47.
60. *Id.* at 262, ¶ 41.
61. *Id.* at 263, ¶ 47.
62. *Id.* at 264-66, ¶¶ 49-58. It seems that the German Government has transposed the *Schumacker* judgment into German tax law in the Jahressteuergesetz of 1996.

III. *JURISPRUDENCE AFTER THE* SCHUMACKER *JUDGMENT*

A. *The* Wielockx *Judgment (1995): The Question of Fiscal Cohesion as a Problem of Bilateral Conventions*

In 1995, the Court transferred the *Schumacker* doctrine to the situation of the self-employed in *G.H.E.J. Wielockx v. Inspecteur der Directe Belastingen*.[63] For the self-employed, Article 52 of the EC Treaty lays out the freedom of establishment and provides the norm.[64]

Mr. Wielockx, a Belgian national resident in Belgium, worked in the Netherlands as a physiotherapist and received his entire income there. He was also liable to pay tax in the Netherlands. In the absence of a place of residence in the Netherlands, he was regarded as a foreign taxpayer. Under Dutch law, a voluntary pension-reserve tax scheme for self-employed persons had been established.[65] Under that scheme, part of the profits of a business could be allocated to form a pension reserve, the amounts set aside each year remaining in the business. This pension reserve is to be liquidated when the taxpayer reaches the age of 65. The Netherlands Government then treats it as income and taxes it either on the total capital or when periodic payments are made from that capital.[66] Contrary to the position which applied to national taxpayers, this pension reserve could not be deducted from the taxable income.

The OECD Model Double Taxation Treaty provides that "pensions and other similar remuneration paid to a resident of Contracting State in consideration of past employment, shall be taxable only in that State."[67] There was a double taxation convention between the Netherlands and Belgium.[68]

Based on the *Schumacker* judgment, the Court decided that a non-resident taxpayer who receives all of his income in the Member State "where he works but who is not entitled to set up a pension reserve qualifying for deductions under the same tax conditions as a resident taxpayer suffers discrimination."[69]

63. Case C-80/94, [1995] E.C.R. I-2493.
64. EC Treaty, *supra* note 2, art. 52, [1992] 1 C.M.L.R. at 613-14.
65. Wet op de Inkomstenbelasting of 16 November 1972 (*Staatsblad* 612), art. 44d(1).
66. *Id.*, art. 44f(1)(e).
67. OECD Treaty, *supra* note 51, art. 18.
68. *Tractatenblad*, 1970, no. 192, art. 14(1).
69. *Wielockx*, [1995] E.C.R. at 2516, ¶ 22.

Of great importance in *Wielockx* is the subsequent examination of the justification for tax discrimination. Here, the Court scrutinized the principle of fiscal cohesion which it considered in *Bachmann*.[70] The Netherlands Government submitted that a correlation existed between the sums which are deducted from the taxable income and the sums which are subject to tax.[71] If a non-resident could set up a pension reserve in the Netherlands and, thus, secure a right to a pension, that pension would not be taxed in the Netherlands by virtue of the double-taxation convention between Belgium and the Netherlands, as such income is taxed in the State of residence, in this case in Belgium.[72]

In examining the question of cohesion, the Court went into the problem of double-taxation conventions. It stated that on the basis of double-taxation conventions, which follow the OECD model, a "[s]tate taxes all pensions received by residents in its territory, whatever the State in which the contributions were paid . . . ."[73] Conversely, it "waives the right to tax pensions received abroad even if they derive from contributions paid in its territory which it treated as deductible."[74] The Court regarded fiscal cohesion as established not only in relation to one and the same person, but also on the level "of the reciprocity of the rules applicable in the Contracting States",[75] *i.e.*, on the level of the bilateral conventions. As the Court further explained, in a case where fiscal cohesion is secured at the level of bilateral convention, that principle may not be invoked, in order to justify the disadvantageous treatment of a foreign taxpayer.[76] The possibility of justifying discrimination on the basis of the principle of fiscal cohesion is, thereby, notably restricted.

In a further judgment of 1995, *Peter Svensson v. Ministre du Logement et de l'Urbanisme*,[77] the possibility of justification by reference to the fiscal cohesion was further restricted at the level of the individual person. The problem in *Svensson* related to interest rate subsidies in regard to housing construction, which were

70. *See Bachmann*, [1992] E.C.R. at 282-84, ¶¶ 20-28; *Wielockx*, [1995] E.C.R. at 2516-17, ¶¶ 23-27.

71. Wielockx, [1995] E.C.R. 2516, ¶ 23.

72. *Id.*

73. *Id.* at 2516, ¶ 24.

74. *Id.*

75. *Id.*

76. *Id.*

77. Case C-484/93, [1995] E.C.R. I-3955.

only granted to persons who had taken out a loan from a credit institution approved in Luxembourg.[78] The Government of the Grand Duchy of Luxembourg submitted that the policy of supporting housing construction would be a failure without the contested rule, as a large portion of the interest rate subsidies paid out are recovered through a profit tax on financial establishments.[79] The Court did not allow pursuit of this objective because there was no direct link "between the grant of the interest rate subsidy to borrowers on the one hand and its financing by means of the profit tax on financial establishments on the other."[80] Moreover, economic aims could not be called up to provide a justification on the grounds of the general interest.[81]

B. *The* Asscher *Judgment (1996): Economic Activity in Several Member States*

The last case to be considered refers to the argument adopted in the *Schumacker* and *Wielockx* judgments prohibiting that personal circumstances not be taken into account in the state of employment where a taxpayer obtains his income almost exclusively but is not a resident. Accordingly, the taxpayer's personal circumstances must be taken into account in the state where he is a non-resident but obtains his income.[82] This doctrine has been much discussed and, in part, criticized.[83] On the one hand, it is regarded as problematic to exclude from this treatment someone who does not obtain his whole income in another Member State. This would mean that a taxpayer, who obtained his income in a number of Member States, could be treated less favorably in terms of taxation than a resident. On the other hand, the question is raised as to how the formulation "almost all of his worldwide income" can be defined and whether it could be fixed at a certain percentage. The *Asscher v.*

78. *Id.* at 3973,75, ¶¶ 2-9. These restrictions were imposed pursuant to Article 1(3) of the Grand-Ducal Regulation of 17 June 1991. *Id.* at 3973, ¶ 3.

79. *Svensson*, [1995] E.C.R. at 3976, ¶13.

80. *Id.* at 3977, ¶ 18.

81. *Id.* at 3976-77, ¶ 15.

82. *See supra* notes 54-56 and accompanying text (stating that Mr. Schumacker's discrimination resulted from fact that neither Member State of residence nor employment could take into account his personal and family circumstances).

83. Peter J. Wattel, *The EC Court's attempts to reconcile the treaty freedoms with international tax law*, [1996] C.M.L.R. 33 at 223.

Staatssecretaris va Financien[84] judgment of 1996 addresses these problems.

Mr. Asscher, a Dutch national resident in Belgium, pursued a self-employed activity both in the Netherlands and in Belgium. Under Dutch law, a non-resident taxpayer can only be accorded equivalent status to a resident taxpayer, if he shows that all or almost all, that is to say at least ninety percent, of his worldwide income is taxable in the Netherlands.[85] This did not apply to Mr. Asscher, who was, therefore, subject to a higher rate of tax. The Court repeated the formulation it used in *Schumacker.*[86] It added that, where a non-resident taxpayer does not receive all or almost all of his income in the Member State in which he works but does not reside, he can be denied benefits in the Member State of employment if a comparable benefit is granted in the Member State of residence.[87]

The Netherlands Government had submitted that it intended the higher rate of tax to offset the fact that certain non-residents escape the progressive nature of the tax. The Court referred in this regard to the Convention for the avoidance of double taxation between Belgium and the Netherlands and to the OECD Model Convention, which provided that income received in a state in which the taxpayer pursues an economic activity but does not reside is taxable exclusively in that state and exempt in the state of residence.[88] In this connection, however, in order to apply the rule of progressivity, *inter alia*, it is important that the Member State of residence remains entitled to take into account such income in calculating the amount of tax on the remaining income. Consequently, a non-resident would not escape the application of the rule of progressivity in the case under consideration and would be in a situation comparable to that of a resident. On this basis, the Court found that there was indirect discrimination.[89]

84. Case C-107/94, [1996] E.C.R. I-3089.

85. This condition is deemed to be fulfilled if the taxpayer is subject in the Netherlands to contributions under the national compulsory social insurance scheme.

86. *Schumacker*, [1995] E.C.R. at 261, ¶ 37.

87. *Asscher*, [1996] E.C.R. at 3126, ¶ 44.

88. *Id.* at 3126, ¶¶ 46-47; Article 24(2)(1) of the Convention of 19 October 1970 between Belgium and the Netherlands for the avoidance of double taxation of income and property and for the regulation of certain other taxation matters (*Tractatenblad* 1970, no. 192); OECD Treaty, *supra* note 51, arts. 23A(1), 23A(3).

89. *Asscher*, [1996] E.C.R. at 3126, ¶¶ 47-48.

The Court did not limit itself to the application of the criterion of whether the whole income is obtained in a Member State which is not the Member State of residence, but instead considered also with regard to bilateral conventions, whether, in the particular case, residents and non-residents were in a comparable situation.

As far as the justification of this discrimination was concerned, the Netherlands Government had submitted that the abolition of the right to deduct social security contributions has entailed for residents an increase in taxable income and, concomitantly, in the amount of tax payable. This would have led to a disadvantaging of residents in the absence of a higher taxation of non-residents.[90] The Court did not accept this submission. In the particular case in which Mr. Asscher is properly insured with the Belgian social security scheme, there can be no question of penalizing him by means of a tax differential for not paying social security contributions in the Netherlands.[91]

Finally, the Court once more raised the question of fiscal cohesion.[92] The Court rejected a justification by pointing out that there was no direct link between the application of a higher rate of tax and the fact no social security contributions were levied on the income earned in the Netherlands.[93] The application of a higher rate of tax did not provide any social security protection. In addition, the non-participation in the Netherlands social security system derives from the application of the corresponding Community law, which the Member States had to observe. In other words, the Member States are not entitled to determine the extent to which their own legislation is applicable. They were, therefore, also not entitled to use tax measures to make up for the fact that a taxpayer is not insured with and does not pay contributions to its social security scheme.[94]

Asscher also raises the question of how far a national may complain against his own tax administration of inequality of treatment as compared with the treatment of residents. The Court conceded that the provisions of the EC Treaty relating to freedom of establishment may not be applied to situations which

90. *Id.* at 3127, ¶ 51.
91. *Id.* at 3128, ¶ 54.
92. *Id.* at 3128, ¶ 55.
93. *Id.* at 3129, ¶ 59.
94. *Id.* at 3129-30, ¶¶ 59-61.

are purely internal to a Member State. Nevertheless, the Court explained that it is settled law that Article 52 may not be interpreted in such a way as to exclude a given Member State's own nationals from the benefit of Community law where by reason of their conduct they are, with regard to their Member State of origin, in an equivalent situation to that of any other person enjoying the rights and liberties guaranteed by the EC Treaty.[95] For this reason, Mr. Asscher may, as a Netherlands national, complain to the Netherlands authorities about discrimination which he suffers as a non-resident.[96]

CONCLUSION

As appears, in particular from the *Asscher* judgment, it will be necessary in the future to ask in every individual case whether non-residents and residents find themselves in a comparable situation. In this process, it will also be necessary to take account of bilateral double-taxation conventions. As far as the area of double-taxation conventions is concerned, the problem has been discussed whether a bilateral treaty granting advantages to only one Member State must be applied to all other Member States or whether a favorable treaty rule with a third state must also be applied to Member States. The Court has so far not been confronted with this problem, and I, accordingly, do not wish to consider it further. It remains to be seen whether or not the Court will be confronted with this problem in the future. Further questions about the unequal treatment in the taxation of natural and legal persons may be expected with certainty. For example, the Court had to decide whether the carrying forward of losses may be made subject to the condition that accounts should be duly made up and kept within the Member State of the company's residence by a permanent establishment of a foreign company or whether this constitutes a limitation on the freedom of establishment. The Court decided that the Member State may require the non-resident taxpayer to demonstrate clearly and precisely that the amount of the losses which he claims to have incurred corresponds to the amount of the losses actually incurred in that Member State by the taxpayer. Article 52 of the EC Treaty precludes, however, the carrying forward of

95. *Id.* at 3122, ¶ 32.
96. *Id.*

losses from being made subject to the condition that the taxpayer must have kept and held in that Member State accounts relating to his activities carried on there which comply with the relevant national rules, because such a condition constitutes a restriction on the freedom of establishment.[97]

97. Futura Participations S.A., Singer v. Administration des Contributions, Case C-250/95.