“Dancing with Mr D”: The ECJ’s Denial of Most-Favoured-Nation Treatment in the “D” case

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1. INTRODUCTION

The “D" case concerned not only the issue of national treatment in respect of the tax-free allowance with regard to Netherlands wealth taxation, but also the question of whether or not horizontal discrimination between non-residents due to different tax treaties is prohibited by the fundamental freedoms contained in the EC Treaty. A positive conclusion regarding the latter would inevitably have led to a situation that is commonly referred to as “inbound most-favoured-nation treatment”. Under this, a non-resident taxpayer could have invoked the most favourable tax treaty that the source Member State had concluded with any other Member State. Despite the Advocate General’s sympathetic approach in the “D” case, the much-anticipated decision of the Grand Chamber of the European Court of Justice (ECJ), given on 5 July 2005, adopted such an obligation with regard to comparability. Specifically, the ECJ concluded that bilateral tax treaties by their nature only cover residents of the two contracting states and that the ECJ concluded that bilateral tax treaties by their nature only cover residents of the two contracting states and that non-residents residing in different Member States are generally not in comparable situations from the perspective of the source Member State for the purposes of the discrimination test under EC law. As a result, not unlike the 1972 Rolling Stones song “Dancing with Mr D”, the “D” case unleashed the “grave digging” power of the ECJ with regard to EU most-favoured-nation (MFN) treatment. This article is intended to provide an initial analysis of the

1. ECJ, 5 July 2005, Case C-376/03, D. v. Inspecteur van de Belastingdienst/Particulier/Ondernemingen buitenland te Heerlen.
ECJ’s decision, and a consideration of its likely effects on pending cases and the possible future developments.4

2. BACKGROUND TO THE “D” CASE

Despite of the lack of the harmonization of direct taxation in the European Union, several landmark decisions of the ECJ in recent years have clearly put the focus on the far-reaching effect of the fundamental freedoms of the EC Treaty with regard to direct taxation. This is because, in the absence of political solutions, taxpayers have been compelled to make recourse to the ECJ to overcome discriminatory rules and other obstacles. Consequently, the ECJ has developed a large body of case law on the compatibility of national tax rules with the EC Treaty. The basis of this case law is that, although the Member States retain their competence in direct tax matters, they must exercise this power consistently within EC law and avoid any overt or covert discrimination on the grounds of nationality.5 The four fundamental freedoms (i.e., the free movement of persons, goods and capital and the freedom to provide services) cover all forms of cross-border economic activity and investment and, in conjunction with another principle central to the acquis communautaire, that of equal treatment, prohibit tax provisions that may create discriminatory obstacles to cross-border economic activities. Based on these principles of non-discrimination, the ECJ has consistently held that the disadvantageous unequal treatment of resident and non-resident taxpayers in comparable situations is a violation of EC law, unless the treatment is justified by the “rule of reason”. Whilst such cases of vertical discrimination between a non-resident and a resident taxpayer have frequently been decided by the ECJ, an open issue was, and still is, whether or not the EC Treaty also prohibits horizontal discrimination between non-residents, which may arise from different tax treaties. The latter is usually referred to as the question of “most-favoured-nation treatment” within the European Union.

In the absence of a multilateral tax treaty under Art. 293 of the EC Treaty,6 the Member States have concluded a multitude of different bilateral tax treaties between each other and with third countries. Inter alia, these tax treaties basically distribute taxing rights between the tax treaty partners and grant mutual benefits for the residents of the contracting states. It is the rule rather than the exception that these benefits vary from tax treaty to tax treaty. This may, of course, result in a situation in which one Member State grants a certain beneficial treatment to a resident of another Member State, but, due to a different tax treaty, not to a resident of a third Member State. Accordingly, a highly disputed issue is whether or not an EU Member State is required under EC law to treat non-resident taxpayers equally. In other words, whether or not an EU taxpayer is eligible for the benefit of the most favourable tax treaty concluded by the Member State from which he derives income.7 This notion may be categorized as “inbound most-favoured-nation-treatment”. Until the “D” case, the ECJ had, due to judicial self-restraint or hesitation, left this issue open in several cases.8

As a result of its potentially very significant effects, the issue of MFN treatment has been the subject of intense discussion in legal writing. At the outset, a conflict of principles is clear. Specifically, the judicial application of the MFN doctrine to tax treaties would undoubtedly ensure full compatibility with EC law and the concept of a Single Market, although, conversely, it would clearly impair the reciprocity of tax treaties and domestic law. From a policy perspective, it has been argued that “such a most favoured nation effect would really ruffle settled international tax law”,9 that MFN treatment “would result in the abolition of the principle of reciprocity which, however, forms the backbone of bilateral agreements”10 or that, as a result of MFN treatment, “one of the pillars of tax treaty law, the reciprocity principle, would have been demolished”.11 Those supporting an MFN doctrine argue that the judicial application of MFN treatment, and, therefore, a loss in revenue, would be a powerful motivation for the Community and the Member States to harmonize international tax law on the EC level.12 Although it may be true that the judicial imposition of MFN treatment, and, therefore, “negative harmonization”, cannot be a surrogate for the positive Community harmonization of tax treaties, it should nevertheless be noted that, to date, the ECJ has not hesitated to challenge long-standing principles of internal tax systems or the international tax policies of the Member States13 and is clearly not impressed by the fiscal consequences of a judgment.14 An analysis of the scholarship on the MFN issue, however, reveals that opinions range from those in favour of an obligation of the Member States for

4. For comprehensive coverage of the MFN issue, see the forthcoming article to be published in European Taxation by Axel Cordewener and Frank Engelen. “‘Most-Favoured-Nation’ Treatment in EC Tax (Treaty) Law after D-Day – Did the ECJ Pull the Emergency Brake without Real Need?”
such treatment in their bilateral tax treaties, through sympathetic views, neutral and antipathetic statements, to the vehement rejection of such a conclusion. The arguments of both sides of the spectrum of opinions are, at first glance, equally persuasive.

Briefly, those against MFN treatment rely on the textual argument that the EC Treaty prohibits “any discrimination on grounds of nationality”, and that does not explicitly provide for multiple non-taxation. The sovereignty of the Member States in direct tax matters, the reciprocity of bilateral tax treaties and the “chaos” that MFN treatment could cause are some of the reasons why those against MFN treatment have placed the principle of non-discrimination on grounds of nationality in the background.


create. This conclusion has also been reached by a number of national courts that have dealt with the issue. Conversely, the proponents of MFN treatment cite Art. 14 of the EC Treaty, which foresees an Internal Market that functions as a national market, and Art. 12, which prohibits “any discrimination on grounds of nationality”, including discrimination between non-residents. The proponents also argue against the “sovereignty” contention in respect of the obligation to exercise powers in compliance with EC law and reason that EC obligations are unconditional and do not depend on “reciprocity”.

Recent scholarship has favoured a differentiated view based on the Gilly case, by taking into account the specific tax treaty rule in question, and has concluded that only provisions conferring a “unilateral” benefit, and not those providing for an allocation of taxing rights, result in horizontal discrimination and thereby require MFN treatment. The Commission also supports this position and, as a result, has put the focus on whether or not a tax treaty provision is allocative in nature. Consequently, in most recent discussions, the pivotal question has been whether or not a specific tax treaty rule can be considered to be a mere allocation of taxing powers.

3. THE “D” CASE

3.1. The facts

On 24 July 2003, the Court of Appeal of ’s-Hertogenbosch, the Netherlands, put various questions (see 3.2.) to the ECI in a case regarding, inter alia, the unequal treatment of non-resident taxpayers within the European Union and, therefore, in respect of the differences in tax treaties in the Union. The facts of this MFN case are straightforward. A resident and national of Germany, for privacy reasons referred to as Mr D, who owned property in the Netherlands appealed against the refusal of the Netherlands authorities to grant him the tax benefit. The base case concerned an assessment of wealth tax for the year 1998, in which it was assumed that 10% of Mr D’s property consisted of immovable property in the Netherlands and that 90% of the property was invested in Germany.

For the year 1998, Mr D, under the Netherlands Law on Wealth Tax 1964 (Wet op de vermogensbelasting 1964), was subject to wealth tax as a non-resident taxpayer. According to this law, resident taxpayers have always had the right to deduct the basic allowance. Non-resident taxpayers are not entitled to do so, unless 90% or more of their capital is invested in the Netherlands. Non-resident taxpayers, who are resident in Belgium, have, however, had the right to deduct the basic allowance under Art. 25(3) of the 1970 Belgium–Netherlands tax treaty, without reference to the property actually invested in the Netherlands. The Germany–Netherlands tax treaty does not provide for this. Accordingly, Mr D did not qualify for a basic allowance either under Netherlands national tax law or under the Germany–Netherlands tax treaty. In 1998, neither Germany nor Belgium imposed a wealth tax.

3.2. The questions

Based on the facts in 3.1. it was, inter alia, argued that taxpayers were treated unequally within the European Union, work conditions of the fundamental EC Treaty principles as applied by the European Court to Member States’ direct taxation”, 11 EC Tax Review (2002), p. 114. See also Peter J. Wattel, “The EC Court’s Attempts to Reconcile the Treaty Freedoms with International Tax Law”, 33 Common Market Law Review (1996), p. 252 et seq. In general, see Hans van den Hurk, “The European Court of Justice knows its limits – A discussion inspired by the Gilly and ICI cases”, 8 EC Tax Review (1999), p. 216.

22. See the German Bundesfinanzhof, 30 October 1990, II R 176/87, BFHE 162, 374, BSBI 1991 II 161 (regarding the wealth taxation of an Italian corporation in Germany); and the German Bundesfinanzhof, 26 May 2004, I R 54/03, BFHE 206, 332, BSBI 2004 II 767 (concerning the German dividend withholding tax on profit distributions paid to a Russian parent company in light of the free movement of capital). More recently, an Austrian Tax Court has denied MFN treatment in a case regarding royalty payments made by an Austrian to a Netherlands corporation, as the Austrian withholding tax did not create a disadvantage and the Netherlands had to credit the Austrian tax. See UFS Wien, 23 June 2005, RV/1799-W/03 and the discussion of this case by Ines Hofbauer, “UFS verneint die Geltung der Meistbegünstigung im Europarecht”, 15 Steuer und Wirtschaft International 8 (2005), p. 376 et seq. In two other reported cases, two Netherlands courts denied the application of MFN treatment with regard to a certain tax benefit for individuals without posing preliminary questions to the ECI. See R. Betten, “Lower Courts Deny Application of Most-Favoured-Nation Clause: A Lost Opportunity?”, 37 European Taxation 11 (1997), p. 417 et seq. 23. ECJ, 12 May 1998, Case C-336/96, Mr and Mrs Robert Gilly v. Directeur des services fiscaux du Bas-Rhin [1998] ECR I-2793.


as, under the 1970 Belgium–Netherlands tax treaty, residents of Belgium who own property in the Netherlands are granted tax benefits that are not available under the Germany–Netherlands tax treaty. This would create an impermissible difference in treatment between Belgians and Germans. The Court of Appeal of ’s-Hertogenbosch, however, primarily asked the ECJ a question on the national treatment, i.e. whether or not EC law and, in particular, Arts. 56 et seq. of the EC Treaty, preclude legislation under which a domestic taxpayer is always entitled to deduction of a tax allowance in respect of wealth tax, whereas a non-resident taxpayer has no such entitlement in the case where the assets in question are situated predominantly in the taxpayer’s State of residence (in which no wealth tax is levied)?

If this question was answered by the ECJ in the negative, the Court of Appeal of ’s-Hertogenbosch asked a second question, regarding MFN treatment, i.e. whether it makes a difference in this case that the Netherlands has, under a bilateral treaty, granted to residents of Belgium, who in all other respects are in comparable circumstances, entitlement to the tax allowance (no wealth tax being levied in Belgium either)?

The third question, which was not answered by the ECJ and is not discussed in this article, was posed if either of the first two questions was answered affirmatively and asked whether or not Community law precludes a legal costs scheme under which, in principle, only a limited contribution is made towards legal costs where a citizen is successful in proceedings brought before the national courts for breach of Community law by a Member State?

4. ANALYSIS OF THE ECJ’S DECISION IN THE “D” CASE

4.1. Tax-free allowances and national treatment: vertical discrimination between non-residents and residents

The first question (see 3.2.) as to whether or not the Netherlands wealth tax entails vertical discrimination against a non-resident taxpayer that is prohibited by Art. 56 and Art. 58 of the EC Treaty has its obvious root in the fact that, if wealth of an equal amount (being less than 90%) is held in the Netherlands, only residents are entitled to an allowance against wealth tax. Mr D, therefore, argued that this discriminatory treatment constituted an impediment to the free movement of capital that was contrary to Art. 56 of the EC Treaty and was not justified by Art. 58. Mr D also suggested that the wealth tax should be distinguished from income tax and, therefore, the reasoning in the Schumacker case should not be adopted. Conversely, the Netherlands, Belgian, French and German governments, as well as the Commission, relied on the Schumacker case. These bodies argued that residents and non-residents are not, as a rule, in a comparable situation in relation to direct taxes and that the difference in treatment contested by Mr D was compatible with the EC Treaty rules. The ECJ followed the latter line of reasoning.

After concluding that the real estate investment of Mr D in question fell within the scope of the rules relating to the free movement of capital set out in Arts. 56 et seq. of the EC Treaty, the ECJ moved on to state that Art. 56 prohibits restrictions on the movement of capital, subject to Art. 58. From this it is clear that the Member States may, in their tax law, distinguish between resident and non-resident taxpayers insofar as the distinction drawn does not constitute an arbitrary discrimination or a disguised restriction on the free movement of capital. Based on this, the ECJ restated its line of reasoning in the Schumacker case regarding income taxation. In this, the ECJ accepted that the situations of residents and of non-residents are not, as a rule, comparable. Accordingly, a Member State that withholds from a non-resident certain tax benefits that it grants to residents is not, as a rule, discriminatory.

The ECJ, nevertheless, held that the position could be different if the non-resident receives no significant income in the Member State of residence and derives the major part of his taxable income from an activity performed in the Member State of employment. The result is that the Member State of residence is not in a position to

27. Under this non-discrimination provision of the Belgium–Netherlands tax treaty (Art. 25(3)) ‘[i]ndividuals who are residents of one of the States shall benefit in the other State from the same personal allowances, reliefs and deductions on account of civil status or family responsibilities which the last-mentioned State grants to its own residents’. (Unofficial translation, IBFD Tax Treaties Database.)


29. Id., Para. 19(2).


31. ECJ, 5 July 2005, Case C-376/03, D. v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen, Para. 19(3).


33. ECJ, 5 July 2005, Case C-376/03, D. v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen, Para. 24-43.


36. ECJ, 5 July 2005, Case C-376/03, D. v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen, Para. 28.
grant him the benefits derived from the taking into account of his personal and family circumstances. There is then no objective difference between this non-resident and a resident engaged in comparable employment so as to justify different treatment regarding the taking into account of the taxpayer’s personal and family circumstance for taxation purposes. The ECJ has, therefore, allowed a Member State to make the granting of a benefit to non-residents subject to the condition that at least 90% of their worldwide income must be taxable in that Member State.

In contrast to speculation in legal writing, in the “D" case, the ECJ transposed its case law on income taxation to the wealth taxation in question. Specifically, “the situation of a person liable to wealth tax and that of a person liable to income tax are similar in several respects”. With regard to this, the ECJ pointed out that wealth tax is “a direct tax based on the taxpayer’s ability to pay” and is often “regarded as a complement to income tax”. The ECJ also reasoned that a person liable to wealth tax has, as a rule, the greater part of his assets in the Member State in which he is resident, which is usually where the taxpayer’s personal and financial interests are centred. After reaching this conclusion, the ECJ moved on to examine whether or not, as with income tax, the situation of a resident and that of a non-resident are generally not comparable in the context of wealth tax. Based on the worldwide wealth taxation that Netherlands residents are subjected to, as opposed to the source-based wealth taxation of non-residents, the ECJ answered this question in the affirmative, i.e.:

It follows that a taxpayer who holds only a minor part of his wealth in a Member State other than the State where he is resident is not, as a rule, in a situation comparable to that of residents of that other Member State and the refusal of the authorities concerned to grant him the allowance to which residents are entitled does not discriminate against him. This, however, left unresolved the tricky question of whether or not the fact that Germany did not impose wealth tax in the tax year in question influenced the analysis of the (potential) discrimination. Whilst the Advocate General thought so, the ECJ rightly did not follow this line of reasoning. The taxpayer’s argument for comparability was straightforward. As Germany did not levy wealth tax and, therefore, did not take into account Mr D’s personal and family circumstances, all of the relevant taxable wealth of Mr D was located in the Netherlands, which, consequently, appeared to be under the Schumacker obligation. Advocate General Ruiz-Jarabo Colomer sympathized with this conclusion and found it decisive that no tax of that kind was levied in Germany because, as regards his assets in the Netherlands, D, is in the same position as a resident since, in reality, 100% of his taxable wealth is located in the latter country, because the property he owns in his country of domicile is irrelevant for tax purposes.

In support of his view, the Advocate General referred to the Wallentin case. In this case, the ECJ, with reference to income tax, treated the situation of a taxpayer who received only tax-free income in his Member State of origin in the same way as that of a person with no income. Accordingly, the ECJ held that the Schumacker doctrine applied to him, thereby leaving the Member State of employment the obligation of taking his personal and family circumstances into account. The ECJ did not, however, follow this line of reasoning in the “D" case, i.e.:

The different treatment of residents and non-residents by the Member State in which the person concerned holds only 10% of his wealth and the lack of an allowance in that case can be explained by the fact that the person concerned holds only a minor part of his wealth in that State and that he is accordingly not in a situation comparable to that of residents. The circumstance that that person’s State of residence has abolished wealth tax has no bearing on this factual situation. Since he holds the major part of his wealth in the State where he is resident, the Member State in which he holds only a proportion of his wealth is not required to grant him the benefits which it grants to its own residents.

Consequently, the ECJ attempted to distinguish the Wallentin case, i.e.:

sums such as the subsistence allowance paid to Mr Wallentin by his parents and the grant which he received from the German State did not of their nature constitute taxable income under German tax legislation. Accordingly, the sums received by Mr Wallentin in Germany and the wealth held by Mr D. there cannot be regarded as comparable for the purpose of determining whether, with regard to taxation of the wealth possessed by him in the Netherlands, Mr D. must be eligible for the allowance provided for by Netherlands legislation.

The authors submit that the ECJ was right to conclude that Art. 56 and Art. 58 of the EC Treaty do not preclude legislation, under which a Member State denies non-resident taxpayers, who hold the major part of their wealth in the Member State in which they are resident, the entitlement to the allowances that it grants to resident taxpayers.

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47. Id., Para. 2.
48. Id., Para. 43.
the ECJ had found that the non-imposition of wealth tax in Germany was of decisive importance, the borderline between prohibited discrimination and allowed disparities between the tax systems of the Member States would be completely blurred. At the outset, it is necessary to be aware that the ECJ has frequently dealt with and accepted disparities between existing tax systems and has already concluded so in the Schumacker case, insofar as it acknowledged differences in the consideration by the Member States of family and personal circumstances. Accordingly, if the disadvantage to the taxpayer disappears where hypothetically identical tax systems in the Member States involved in the particular cross-border tax case are assumed, a mere disparity is at issue. This cannot be dealt with under the non-discrimination clauses of the EC Treaty. From this, it can be concluded that every Member State is free to establish its own tax system as it wishes without being bound by the systems of other Member States. As a result, differences in tax rates, the calculation of the tax base and the like are outside the scope of the fundamental freedoms. In addition, the mere existence of a particular tax in one Member State, which does not exist in another Member State, cannot have any effect on evaluating the tax system of the latter Member State in the light of the fundamental freedoms. Conversely, the non-existence of a tax in one Member State cannot influence a discrimination analysis of the tax system of another Member State, in which such a tax exists.

This clear conclusion was, however, questioned by the Advocate General in the “D” case. The Advocate General’s finding that the refusal of the tax-free allowance in the Netherlands in the tax year 1998 was discriminatory, as the taxpayer could not obtain a similar tax-free allowance in Germany because Germany had abolished its wealth tax in 1997, would, however, conversely lead to the conclusion that, if Germany had imposed wealth tax in the tax year in question, the refusal of the tax-free allowance in the Netherlands would not have been discriminatory. The ECJ correctly rejected this conclusion. The Court, thereby, avoided creating a paradox in its case law on mere disparities. This said, it may be speculated as to what is the real difference between the Wallentin and the “D” cases. In the Wallentin case, the ECJ disregarded amounts that Mr Wallentin received in his residence Member State, Germany, that were not included in the German tax base in deciding whether or not he had reached the 90% Schumacker threshold in Sweden, his Member State of employment. Conversely, and in contrast to the Advocate General, in the “D” case, the ECJ rightly did not disregard property held in Germany in respect of the 90% Schumacker threshold for the purposes of Netherlands wealth taxation. This was despite the fact that the German wealth tax was not taxed in Germany. The apparent inconsistency between the two decisions has already given rise to criticism. As the ECJ did not overrule, but rather distinguished, its highly questionable Wallentin decision, the difference may at first sight only be explained by the mere existence of the tax in the Member State of residence. It will, however, have to be seen in future case law whether the ECJ employs the Wallentin or the “D” case type of reasoning in respect of the Schumacker threshold, if the taxpayer’s Member State of residence chooses not to tax the relevant income or wealth.

4.2. Most-favoured-nation treatment: horizontal discrimination between non-residents by the source Member State

In answering the first question in the negative, the ECJ opened the way to deal with the MFN issue. Before, however, considering to the ECJ’s findings on the second question (see 3.2.), the contrary arguments of Mr D, on the one hand, and those of both the Member States and the Commission, on the other hand, are summarized below.

Mr D argued that the difference, resulting from the application of the Belgium–Netherlands tax treaty between his situation and that of a Belgian resident in an equivalent situation amounted to discrimination prohibited by the EC Treaty. First, whilst it is true that the ECJ has accepted differences in treatment between Community citizens resulting from the allocation of taxing powers, the granting of the allowance to residents of Belgium alone was not the result of such an allocation. Second, the treatment accorded by the Netherlands to Belgian residents did not reflect reciprocal treatment accorded to residents of the
Netherlands by Belgium, as Belgium does not impose a wealth tax and, therefore, does not grant an allowance to residents of the Netherlands who own property in its territory.

Conversely, the Member States and the Commission argued that the different treatment of a person, such as Mr D, and a Belgian resident was not discriminatory. This followed from the concept that a Member State that is a party to a bilateral convention is not in any way required, by virtue of the EC Treaty, to extend to all Community residents the benefits that it grants to residents of the other contracting Member State. Reference was also made to the danger that extending the benefits provided for by a bilateral convention to all Community residents would have regarding the application of existing bilateral conventions and those which the Member States might conclude in the future, as well as to the legal uncertainty that this would cause.

The ECJ noted that, apart from Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of the profits of associated enterprises, no unifying or harmonizing measure for the elimination of double taxation has been adopted at Community level. The Court also noted that the Member States have not concluded any multilateral convention to this effect under Art. 293 of the EC Treaty. Instead, the ECJ restated its former judicature, under which the Member States are at liberty to determine the connecting factors for the purposes of allocating powers of taxation in tax treaties and that a difference in treatment between nationals of the two contracting states that results from that allocation cannot constitute discrimination contrary to Art. 39 of the EC Treaty.

Thereafter, the ECJ pointed out that the “D” case does not, however, relate to the consequences of allocating powers of taxation in relation to nationals or residents of Member States that are party to a convention, but is concerned with drawing a comparison between the situation of a person resident in a State not party to such a convention and that of a person covered by the convention.

This is, therefore, a question of horizontal comparability between non-residents of different Member States in a situation in which the source Member State grants more favourable tax treaty provisions to residents of Member State A compared to residents of Member State B.

The ECJ denied this very comparability, a limine, by stating that “the scope of a bilateral tax convention is limited to the natural or legal persons referred to in it” and that the “reciprocal rights and obligations” [granted herein] “apply only to persons resident in one of the two contracting Member States.” The latter is an inherent consequence of bilateral double taxation conventions according to the ECJ’s reasoning. From this it follows that a taxable person resident in Belgium is not in the same situation as a taxable person resident outside Belgium so far as concerns wealth tax on real property situated in the Netherlands, leading to the concluding answer to the second question that Articles 56 EC and 58 EC do not preclude a rule laid down by a bilateral convention for the avoidance of double taxation such as the rule at issue in the main proceedings from not being extended, in a situation and in circumstances such as those in the main proceedings, to nationals of a Member State which is not party to that convention.

The ECJ’s initial statement that the MFN doctrine at issue must be analysed using the concept of horizontal comparability between non-residents, rather than being a result of the allocation of taxing powers that, as a matter of law, falls outside the scope of the fundamental freedoms was, indeed, a good start. To deny comparability because of the existence of a tax treaty should, however, be criticized, as this is a circular reasoning that terminates the ECJ’s
examination before it has actually begun. It also does not explicitly consider the inherent preliminary issue, i.e. whether or not discrimination between non-residents in similar circumstances is prohibited by EC law. In addition, the ECJ held that the granting of a tax-free allowance to Belgians must be considered, not as a unilateral benefit, but, rather, as part of the tax treaty’s overall balance and reciprocity. It is unclear whether or not this balance and reciprocity is to be considered as an element of comparability or as an *obiter dictum* laying the ground for future decisions. The ECJ has, however, by this put a hold on the prevailing opinion in legal writing that questioned such a notion as being a successful justification.

The ECJ based its comparability examination only on the legal circumstances, whilst the factual circumstances were not considered. In legal writing, it has been established that the former judicature of the ECJ is inconsistent with regard to this. In some cases, the ECJ has followed the approach taken in the “D” case. In the *Schumacker* case, however, only the factual circumstances were taken into account by the ECJ. In other cases, the ECJ has mixed both approaches and decided cases on the basis of an overall view as to whether or not taxpayers are in a comparable situation. In the authors’ opinion, the latter appears to be the most appropriate approach, although greater attention must be paid to the legal circumstances. A further criticism is that only tax treaty provisions were taken into account in the comparability examination, whereas national rules, especially those on the wealth tax, were completely disregarded. To deny the comparability only by reference to the nature of a bilateral convention, in the case in question in the form of a tax treaty, is a very unsatisfying result for such a highly debated issue as the MFN doctrine.

As previously stated, the ECJ expressly accepted the argument that bilateral tax treaties are reciprocal in their nature and, therefore, individual tax treaty rules “cannot be regarded as a benefit separable from the remainder of the Convention, but [are] an integral part thereof and contribute to its overall balance”. This line of reasoning, based on the overall reciprocity of tax treaties, mirrors, in addition to the argument that no legal basis is available, the primary objection of those scholars who deny an MFN doctrine. The ECJ’s decision also steals the thunder from those authorities in recent scholarship who favoured a differentiated view, based on the ECJ’s decision in the *Gilly* case, by taking into account the specific tax treaty rule in question and concluding that only provisions conferring a “unilateral” benefit, and not those providing for an allocation of taxing rights, may result in horizontal discrimination and thereby require MFN treatment. This differentiated view would have also been very reasonable in terms of achieving the true objective of a tax treaty, i.e. the avoidance of double taxation and double non-taxation. The granting of non-reciprocal benefits does not contribute to this objective at all. At least for the inbounds situation, however, this prospect appears to have been lost. This is because the view that the ECJ’s decision in the “D” case can, by analogy to the development initiated by the *Schumacker* case, be limited to personal tax concessions lacks any basis in the decision in question. Although it must be admitted that the ECJ has given the Member States leeway to derogate from the 90% *Schumacker* threshold by way of bilateral tax treaties, the reasoning of the Court in the “D” case appears to be sufficiently broad to exclude not only rules regarding personal and

82. To deny the comparability only by reference to the nature of a bilateral convention, whereas national rules, especially those on the wealth tax, were completely disregarded.
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family circumstances, but rather all tax treaty rules from MFN treatment. Consequently, the authors submit that the ECJ has already set out its reasoning for the other pending inbound MFN cases, i.e. the Bujura cases and ACT Group Litigation cases. Some scholars, however, still have doubts as to whether or not the final word on inbound MFN situations has been given, especially with regard to different witholding rates.

It should also be noted that, in recent legal writing, a growing fear has been expressed that the Member States may be induced by the decision in the “D” case to “hide” discriminatory provisions in tax treaties and thereby to immunize them from the ECJ’s scrutiny. This is due to the fact that a literal interpretation of the ECJ’s decision would exclude tax treaty rules from the scope of the protection granted by EC law, as reciprocity is not determined on a stand-alone basis, but, rather, from an overall perspective. According to some scholars, this should not be the case for rules that are atypical for tax treaties. For the sake of completeness, it should, however, be remembered that such “immunization” is at its most valid in cases of horizontal discrimination, whereas the issue of vertical discrimination in purely bilateral cases remains within the ECJ’s scrutiny.

5. CONCLUSIONS AND FUTURE PROSPECTS

It can only be speculated what has led the ECJ to its increasingly reluctant approach in direct tax cases. Not so long ago “[i]t would be a brave gambler who bet against the taxpayer before the European Court of Justice these days”.

Recent decisions against the taxpayer, such as in the “D”, Schempp and Blanckaert cases, have, however, resulted in hard times for gamblers. There seems to be agreement amongst observers of EC tax law that the decision in the “D” case was, as its meagre reasoning implies, heavily disputed within the ECJ’s Grand Chamber and that political pressure from Member States may have given the judicature a Member State-friendly spin. The decision in the “D” case, however, leaves the impression that the ECJ wanted to keep Pandora’s box shut at all costs, although a differentiated view based on the decision in the Gilly case could have revealed that the implications of an MFN obligation should not be overestimated, as allocatory provisions would have been carved out from such an obligation.

It is still, however, an open question as to whether or not there are concepts such as “outbound most favoured nation treatment” within the European Union or “Community preference” with regard to third countries, both of which would require the most favourable treatment from the perspective of the residence Member State. Specifically, can a resident of Member State A who derives income from Member State B invoke the more favourable tax treaty between Member State A and country C, whereby country C may either be another Member State or a third country?

The MFN issues pending in the Bujura and ACT Group Litigation cases also affect inbound situations. This is especially so with regard to the first case that very much resembles the facts in the “D” case, but which deals with income taxation. In its decision in the “D” case, the ECJ, however, stressed the similarities between income tax, on


92. ECJ, Pending, Case C-374/04, Test Claimants in Class IV of the ACT Group Litigation, Official Journal (EC), 2004, C 273/17 et seq.


95. See, for example, Oumar Thömmes, “EG-Recht und Meistbegünstigung”, Internationale Wirtschafts-Briefe, Sec. 1a (2005), p. 887.


97. See, for example, ECJ, Pending, Case C-8/04, Bujara, Official Journal (EC), 2004, C 59/17.


100. ECJ, 8 September 2005, Case C-512/03, J.E.J. Blanckaert v. Inspecteur van de Belastingdienst/Particuliers/Ondernemingen buitenland te Heerlen.


102. For an extensive discussion of these issues, see Georg W. Kofler, “Most-Favoured-Nation Treatment in Direct Taxation: Does EC Law Provide for Community MFN in Bilateral Double Taxation Treaties?”, 5 Houston Business and Tax Law Journal (2005), p. 68 et seq.


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the one hand, and wealth tax, on the other hand. Accordingly, the “D” case is very likely to predict the outcome in the Bujura case. In fact, it seems that the ECJ has closed the door for other inbound situations too, or at least it would require a more in-depth reasoning to distinguish a case, such as the ACT Group Litigation case, from the “D” case.

Accordingly, the issue of horizontal discrimination between non-residents may have revealed another limit on the capability of the fundamental freedoms to enhance the (negative) harmonization of direct taxation in the Community. This does not, in the authors’ opinion, necessarily mean that MFN as an EU idea has been buried, since it is absolutely unacceptable in the single market that bilateral tax treaties between Member States give preferential tax treatment to enterprises in one or several Member States and not to enterprises resident in the remaining Member States.

Finally, the “D” case places an additional focus on the MFN clauses already embedded in bilateral tax treaties and in other sources of law, such as the General Agreement on Tariffs and Trade.