Commentary
Judicial Restraint and Three Trends in the ECJ's Direct Tax Case Law

PETER J. WATTEL*

I. The Cyclical Pattern in the ECJ's Direct Tax Case Law

Let me start by complimenting my good friend and colleague Servaas van Thiel on his excellent article,[1] which also very well serves the purpose of this Symposium, as it gave me much to disagree with. I will first highlight the points on which he and I agree, as these do not take very long.

We agree that a cyclical pattern is visible in the twenty years of ECJ case law on direct taxes: hesitance in the beginning (until 1994), followed by outright activism (1995-2004), and a return to judicial restraint and a certain deference to the fiscal sovereignty of the Member States (since 2005). With the *Manninen* case,[2] the pendulum of ruthless free movement precedence over jurisdictional-consistent taxation reached its outermost position, as a backswing set in with *D. v. Inspecteur*,[3] holding that EC law does not require most-favored nation (MFN) tax treatment. The tax administrations' win rate is up considerably since then, especially on principles, as illustrated by the following subsequent cases.

In *Schempp*,[4] maintenance payments to a resident were not treated as comparable to maintenance payments to a nonsubject nonresident (implying that a one-jurisdiction position is not automatically comparable to a two-jurisdiction position. Thus, subject to tax in one jurisdiction is not automatically comparable to subject to tax in another jurisdiction). In *Marks & Spencer*,[5] the court held that the parent company State is not required to set off current losses of foreign subsidiaries, even though it sets off current losses of domestic subsidiaries

* Professor of EC Tax Law, University of Amsterdam; Advocate-General, Netherlands Supreme Court.

1 Servaas van Thiel, The Direct Income Tax Case Law of the European Court of Justice: Past Trends and Future Developments, 62 Tax L. Rev. 145 (2008).

2 Case C-319/02, Manninen, 2004 E.C.R. I-7477.

3 Case C-376/03, D. v. Inspecteur van de Belastingdienst, 2005 E.C.R. I-5821.

4 Case C-403/03, Schempp v. Finanzamt München V., 2005 E.C.R. I-6421.

5 Case C-446/03, Marks & Spencer plc v. Halsey, 2005 E.C.R. I-10837.

under a domestic group relief scheme, as that would jeopardize a balanced allocation of taxing power. Definitive foreign subsidiary losses that cannot be offset in the subsidiary State, however, must be set off as if they were domestic.

N v. Inspecteur[6] held that Member States may issue an exit tax assessment to ensure taxation of unrealized capital gains on shares in the hands of emigrants, provided payment is extended unconditionally until the moment on which a comparable nonemigrant would be taxed and taxation is limited to the amount for which a comparable nonemigrant would be taxed.

In *Kerckhaert*[7] the ECJ recognized that a two-country problem cannot be solved by the court blaming just one country; an unfavorable tax disparity between two jurisdictions is not the same thing as a prohibited unilateral discrimination or restriction. The ECJ accepts that the "exercise in parallel by two Member States of their fiscal sovereignty"[8] may lead to unrestricted international double taxation of a cross-border item of income as long as neither of the two Member States concerned distinguishes between domestic and cross-border positions.

FII Test Claimants[9] held that a Member State may apply the indirect credit method for foreign group dividends even though it exempts domestic group dividends.

In *ACT Class IV Test Claimants*,[10] the court ruled that imputation credits do not need to be extended to nonsubject (that is, foreign) shareholders, not even if the Member State involved chooses to selectively extend such credit in some tax treaties with other Member States (no MFN tax treatment).

In *Oy AA*,[11] the ECJ ruled that Member States cannot be required to apply their domestic group profit contribution system also on a cross-border basis as that would seriously undermine a balanced allocation of taxing power.

Amurta[12] held that discriminatory taxation in one jurisdiction may be pardoned if that jurisdiction makes sure that it is neutralized in the other jurisdiction by way of a bilateral tax treaty provision, for exam-

[6] Case C-470/04, N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo, 2006 E.C.R. I-7409.

[7] Case C-513/04, Kerckhaert & Morres v. Belgium, 2006 E.C.R. I-10967.

[8] Id. ¶ 20.

[9] Case C-446/04, Test Claimants in the FII Group Litig. v. Commissioners of Inland Revenue, 2006 E.C.R. I-11753.

[10] Case C-374/04, Test Claimants in Class IV of the ACT Group Litig. v. Commissioners of Inland Revenue, 2006 E.C.R. I-11673.

[11] Case C-231/05, Oy AA, 2007 E.C.R. I-6373.

[12] Case C-379/05, Amurta SGPS v. Inspecteur van de Belastingdienst/Amsterdam, 2007 E.C.R. I-9569.

ple, a discriminatory source State withholding tax is credited in the home State of the recipient. Such division of taxing jurisdiction is the sovereign concern of the two jurisdictions involved, provided that overall, the tax position of the nonresident is not less favorable than the tax position of the resident recipient.

Columbus Container[13] held that Member States may distinguish between "good" (high-tax) jurisdictions (exemption of foreign source income) and "bad" (low-tax) jurisdictions (switch-over to the credit method), and between direct foreign investment (no deferral) and indirect foreign investment (deferral).

In *Deutsche Shell*,[14] the court ruled that the head office State is not required to take into account (negative) branch results that are territorially attributable to another jurisdiction, even though it takes into account domestic negative branch results, and even though the foreign loss cannot be offset (yet) in the foreign jurisdiction for lack of positive income. Only currency losses that are not visible in the source State must be taken into account in the head office State.

By contrast, van Thiel and I do not agree on the attractiveness of this case law in the light of the EC Treaty provisions on free movement of persons (employment and establishment) and of capital.[15] Van Thiel generally disapproves of the ECJ's recent judicial restraint, especially of the court's case law implying that the EC Treaty's free movement provisions do not contain an obligation for the Member States to provide MFN tax treatment, nor a general prohibition of international double taxation.[16] He believes the EC Treaty freedoms do imply the (directly applicable) obligations for Member States to provide MFN treatment and to prevent international double taxation.[17] I, on the other hand, generally welcome the court's recent restraint, as I feel the court was overplaying its hand (its competence and its possibilities) in its activist years and had given us an intractable ball of unacceptably inconsistent case law, as the court was regularly backing out—without saying so—of consequences of its previous vigorous case law. For that matter, this is another point on which van Thiel and I disagree. He considers the court's case law to be generally consistent as, like a sailboat, the court has to "catch the wind" of the internal

[13] Case C-298/05, Columbus Container Servs. BVBA & Co. v. Finanzamt Bielefeld-Innenstadt, 2007 E.C.R. I-10451.

[14] Case C-293/06, Deutsch Shell GmbH v. Finanzamt für Großunternehmen in Hamburg, 2008 E.C.R._____, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62006J0293:EN:HTML.

[15] Consolidated Version of the Treaty Establishing the European Community, Dec. 29, 2006, arts. 39, 43, 2006 O.J. (C 321E) 37 [hereinafter EC Treaty].

[16] Van Thiel, note 1, at 151-55.

[17] Id. at 156-57.

market goals.[18] I observe, however, mixing the metaphor, that the course of a sailboat tacking upwind is necessarily quite inconsistent.

II. Three Trends

I especially welcome three broad trends I discern in the ECJ's recent direct tax case law.

First, the court seems to have accepted that subject-to-tax (within my tax turf) is generally not comparable to not-subject-to-tax (outside my tax turf), implying that the existence of discriminations and unilateral restrictions in principle is limited to the area of subjection to tax (to the area of exertion of taxing power). The EC Treaty freedoms provide no legal basis for requiring a Member State to subject to tax someone or something over which it consistently chose not to exert taxing jurisdiction, such as foreign results of nonresident subsidiaries and nonresident parent companies or foreign results of foreign branches or head offices, not even if this leads to a clear (cash flow) disadvantage in the cross-border position as compared to the domestic position.[19]

Second, the court has shifted from an "obstacle"-based assessment of cross-border positions to a discrimination-based assessment, both in its case law on products and services taxation and in its direct taxes jurisprudence. At first, the court regarded any obstacle to the cross-border provision of services ensuing from a national tax measure, whether or not equally arising in a purely domestic position, as a restriction requiring justification. *Sea-Land Service*,[20] for example, con-

---

[18] Id. at 190-91.

[19] See, e.g., Case C-293/06, Deutsch Shell GmbH v. Finanzamt für Großunternehmen in Hamburg, 2008 E.C.R. ____, ¶ 44, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62006J0293:EN:HTML; Case C-231/05, Oy AA, 2007 E.C.R. I-6373, ¶ 59-60; Case C-374/04, Test Claimants in Class IV of the ACT Group Litig. v. Commissioners of Inland Revenue, 2006 E.C.R. I-11673, ¶¶ 74, 91; Case C-446/03, Marks & Spencer plc v. Halsey, 2005 E.C.R. I-10837, ¶ 51. Admittedly, there are still exceptions to this subject-to-tax approach in the recent case law, especially where the court is unable to accept the consequence that certain losses, necessary expenses, or personal allowances would not be deductible anywhere in the internal market (the always-somewhere-relief exception). See, e.g., Case C-470/04, N. v. Inspecteur van de Belastingdienst Oost/kantoor Almelo, 2006 E.C.R. I-7409, ¶ 55 (post-emigrational value depreciation if it is not taken into account by way of a step-up in the immigration state); *Marks & Spencer*, 2005 E.C.R. I-10837, ¶ 59 (definitive foreign subsidiary losses); Case C-168/01, Bosal Holding BV v. Staatssecretaris van Financiën, 2003 E.C.R. I-9409, ¶ 27 (financial expenses); De Groot v. Staatssecretaris van Financiën, 2002 E.C.R. I-11819, ¶ 91 (personal deduction allowances). For elaboration of both the subject-to-tax comparison trend and the always-somewhere-relief exception (and some other exceptions), see Ben J.M. Terra & Peter J. Wattel, European Tax Law 727-45, ¶¶ 17.3.2-17.3.3.5 (5th ed. 2008).

[20] Joined Cases C-430/99 and C-431/99, Inspecteur van de Belastingdienst Douane District Rotterdam v. Sea-Land Service Inc. and Nedlloyd Lijnen BV, 2002 E.C.R. I-5235, ¶ 37.

cerned a tariff imposed for public vessel traffic services in the Netherlands, payable only by sea-going vessels longer than forty-one meters, although inland waterway vessels—to a lesser extent—also used the service. The court explicitly did not consider this distinction to be a discrimination, as the two categories were not comparable and not in competition with each other. The court went on to find, however, that "the VTS system . . ., in that it requires the payment of a tariff by sea-going vessels longer than 41 meters, is liable to impede or render less attractive the provision of those services and therefore constitutes a restriction on their free circulation."[21]

This is startling, because it says that the EC Treaty is offended by any tax, levy, or fee that makes it less attractive to use or undertake the activity triggering such tax, levy, or fee, implying that *every* tax is a restriction on free circulation, and can be justified only if the court considers it justified! And in point of fact, the court went on to assess the reasonableness of the tariff.[22] It is not for the court, however, to develop any views on how a Member State should finance a completely neutral vessel traffic services system. After this had been pointed out to the court by its advocates-general in subsequent cases, it clearly changed its position in *Mobistar*,[23] which concerned Belgian local taxes on transmission pylons, masts, and antennae for GSM-communication. It considered that

> By contrast, 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 59 of the Treaty.
>
> . . . .
>
> . . . . Admittedly, introducing a tax on pylons, masts and antennae can make tariffs for mobile telephone communications to Belgium 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.[24]

The court came to a similar conclusion as regards Article 90, prohibiting discriminatory or protective product taxation, in two cases of manifest international double taxation, *Nygård v. Svineafgift-*

[21] Id. ¶ 38.

[22] Id. ¶¶ 41-44.

[23] Case C-544/03, Mobistar SA v. Commune de Fléron, 2005 E.C.R. I-7723.

[24] Id. ¶¶ 31-33.

sfonden,[25] concerning a Danish charge on the slaughter of pigs, and *Visserijbedrijf D. J. Koornstra & Zn. vof v. Productschap Vis.*,[26] dealing with a Netherlands charge on the landing of shrimps. In both cases, the product was hit twice by a similar charge, once in the Member State of origin and, after transportation, again in the Member State of destination.[27] The court accepted the national measure as nonprotective, as in both cases both States applied their levy indiscriminately as compared to locally slaughtered pigs and locally landed shrimps, even though this led to hard core international double taxation.[28]

Finally, in *Schempp v. Finanzamt München V.*,[29] *Lindfors*,[30] and especially *Kerckhaert v. Belgium*,[31] the court recognized also for direct taxes that the EC Treaty does not guarantee that a change of jurisdiction (or the exposure to two jurisdictions at the same time) will be neutral taxwise.[32] In *Deutsche Shell GmbH v. Finanzamt für Großunternehmen in Hamburg*,[33] the court explicitly referred to *Schempp* in answer to Deutsche Shell's complaint that Germany did not take into account a foreign permanent establishment (PE) loss where a domestic PE loss would have been taken into account.[34]

These parallel lines in the case law on product, services, and direct taxation seem to indicate a *Keck*[35]—like exclusion from the destructive scope of the Treaty prohibitions of indiscriminate national tax measures that equally affect both residents and nonresidents, or both emigrants and nonemigrants, or both foreign source and domestic source income, even if double taxation persists.

Third, the court has shifted, from requiring anti-base erosion measures to be specifically targeted at "wholly artificial arrangements"[36] in order to be justified, to allowing more general tax base protection measures, as it came to the finding that "a balanced allocation of the

---

25 Case C-234/99, Nygård v. Svineafgiftsfonden, 2002 E.C.R. I-3657.

26 Case C-517/04, Visserijbedrijf D. J. Koornstra & Zn. vof v. Productschap Vis., 2006 E.C.R. I-5015.

27 Id. ¶ 10; *Nygård*, 2002 E.C.R. I-3657, ¶¶ 7-8.

28 *Visserijbedrijf*, 2006 E.C.R. I-5015, ¶ 28; *Nygård*, 2002 E.C.R. I-3657, ¶ 49.

29 Case C-403/03, Schempp v. Finanzamt München V., 2005 E.C.R. I-6421.

30 Case C-365/02, Lindfors, 2004 E.C.R. I-7183.

31 Case C-513/04, Kerckhaert & Morres v. Belgium, 2006 E.C.R. I-10967.

32 Id. ¶ 24; *Schempp*, 2005 E.C.R. I-6421, ¶ 47; *Lindfors*, 2004 E.C.R. I-7183, ¶ 34.

33 Case C-293/06, Deutsche Shell GmbH v. Finanzamt für Großunternehmen in Hamburg, 2008 E.C.R.____, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62006J0293:EN:HTML.

34 Id. ¶¶ 42-43.

35 Joined Cases C-267/91 and 268/91, Criminal Proceedings against Keck and Mithouard, 1993 E.C.R. I-6097.

36 Case C-231/05, Oy AA, 2007 E.C.R. I-6073, ¶ 62.

power to tax"[37] (or the prevention of "seriously undermin[ing] a balanced allocation of the power to impose taxes"[38]) may justify certain differences between one-juridisction (domestic) situations and two-jurisdiction (cross-border) situations.[39]

Unlike van Thiel, I do not regard this case law as indicating that the ECJ has accepted a fiscal "sovereignty exception" to the reach of Treaty freedoms.[40] Rather, the court is simply starting to see the merits of staying within the limits of its competence and out of the quagmire of unguided tax harmonization, especially jurisdictional choices (income and loss allocation) in two-State situations.

III. (No) Most-Favored Nation Treatment; Tax Treaties "Above the Law"?

Van Thiel understands the court's rulings in the cases *D. v. Inspecteur van de Belastingdienst*,[41] *Bujura v. Inspecteur der Belastingdienst Limburg*,[42] *Test Claimants in the ACT Class IV Group Litigation v. Commissioners of Inland Revenue*[43] and *Columbus Container Services BVBA & Co. v. Finanzamt Bielefeld-Innenstadt*,[44] as meaning that bilateral tax treaties between member States are placed above the (EC) law, because the court does not require *Member State A* to grant the same tax treaty concessions to residents of *Member State B* as it grants to residents of *Member State C*.[45] He also submits that this case law is inconsistent with the court's case law in social security matters.[46] I disagree on both counts. MFN treatment in bilateral treaties on the basis of the EC Treaty freedoms has never existed in the court's case law, including its social security case law. All of the social security cases van Thiel puts forward, such as *F.G. Roders BV v. Inspecteur der Invoerrechten en Accijnzen*,[47] *Gottardo v.*

---

37 Id. ¶ 46.

38 Id. ¶ 55.

39 Id. ¶ 67; Case C-470/04, N. v. Inspecteur van de Belastingdienst Oost/kantoor Almelo, 2006 E.C.R. I-7409, ¶ 55; Case C-446/03, Marks & Spencer plc v. Halsey, 2005 E.C.R. I-10837, ¶ 59.

40 Van Thiel, note 16, at 151.

41 Case C-376/03, D. v. Inspecteur van de Belastingdienst, 2005 E.C.R. I-5821.

42 Case C-8/04, Bujura v. Inspecteur der Belanstingdienst Limburg, 2004 O.J. (C 59) 17, subsequently removed from register by Order of the President of the Fourth Chamber of the Court of Justice of the European Communities, 2006 O.J. (C 60) 32.

43 Case C-374/04, Test Claimants in Class IV of the ACT Group Litig. v. Commissioners of Inland Revenue, 2006 E.C.R. I-11673.

44 Case C-298/05, Columbus Container Services BVBA & Co. v. Finanzamt Bielefeld-Innenstadt, 2007 E.C.R. I-10451.

45 Van Thiel, note 1, at 155.

46 Id. at 153 n.39.

47 Joined Cases C-367/93 to C-377/93, F. G. Roders BV v. Inspecteur der Invoerrechten en Accijnzen, 1995 E.C.R. I-2229.

Instituto Nazionale della Previdenza Sociale (INPS),[48] and *Mateucci v. Communauté Française of Belgium*,[49] concerned either national treatment, or simply application of secondary EC law (interpretation of EC regulations on social security contributions, implying that in these cases, there was harmonization at EC level, which is absent in direct tax matters).[50] The court's conceptual approach in all of these cases was a comparison between the cross-border position and the domestic position (between residents and nonresidents, or between nationals and non-nationals, or between emigrants and nonemigrants),[51] but never between two nonresidents from different Member States *B* and *C*; therefore not MFN.

Neither are tax treaties placed above the law. *Bouanich v. Skatteverket*,[52] *Denkavit Internationaal BV v. Ministre de l'Économie, des Finances et de l'Industrie*,[53] and *Amurta SGPS v. Inspecteur van de Belastingdienst/Amsterdam*,[54] show that tax treaties in principle take the same position as national law for puposes of ECJ scrutiny under the freedoms of the EC Treaty.[55] They are to be taken into account as part of the overall legal framework to be judged in order to establish the overall (international) tax position of the taxpayer for purposes of comparing it to the domestic position.[56] Therefore, Member States may not achieve via a bilateral tax treaty that which would be prohibited if done unilaterally. They cannot circumvent, for example, the *Royal Bank of Scotland PLC v. Elliniko Dimosio*[57] judgment by putting a discriminatory tax rate in their tax treaties. This is illustrated by the *Open Skies* cases,[58] and *Saint-Gobain v. Finanzamt Aachen Innen-*

---

[48] Case C-55/2000, Gottardo v. Instituto Nazionale della Previdenza Sociale (INPS), 2002 E.C.R. I-413.

[49] Case C-235/87, Matteucci v. Communauté Française of Belgium, 1988 E.C.R. 5589.

[50] *Gottardo*, 2002 E.C.R. I-413, ¶¶ 34-35; *F. G. Roders BV*, 1995 E.C.R. I-2229, ¶¶ 37-38; *Matteucci*, 1988 E.C.R. I-5589, ¶ 23.

[51] *Gottardo*, 2002 E.C.R. I-413, ¶ 39; *F. G. Roders BV*, 1995 E.C.R. I-2229, ¶ 40; *Matteucci*, 1988 E.C.R. I-5589, ¶¶ 17-18.

[52] Case C-265/04, Bouanich v. Skatteverket, 2006 E.C.R. I-923.

[53] Case C-170/05, Denkavit Internationaal BV v. Ministre de l'Économie, des Finances et de l'Industrie, 2006 E.C.R. I-11949.

[54] Case C-379/05, Amurta SGPS v. Inspecteur van de Belastingdienst/Amsterdam, 2007 E.C.R. I-9569.

[55] *Amurta*, 2007 E.C.R. I-9569, ¶ 24; *Denkavit*, 2006 E.C.R. I-11949, ¶ 35; *Bouanich*, 2006 E.C.R. I-923, ¶ 51.

[56] *Amurta*, 2007 E.C.R. I-9569, ¶ 80; *Denkavit*, 2006 E.C.R. I-11949, ¶ 45; *Bouanich*, 2006 E.C.R. I-923, ¶ 51.

[57] Case C-311/97, Royal Bank of Scotland plc v. Elliniko Dimosio, 1999 E.C.R. I-2651.

[58] Case C-466/98, Commission v. United Kingdom, 2002 E.C.R. I-9427; Case C-467/98, Commission v. Denmark, 2002 E.C.R. I-9519; Case C-468/98, Commission v. Sweden, 2002 E.C.R. I-9575; Case C-469/98, Commission v. Finland, 2002 E.C.R. I-9627; Case C-471/98, Commission v. Belgium, 2002 E.C.R. I-9681; Case C-472/98, Commission v. Luxembourg, 2002 E.C.R. I-9741; Case C-475/98, Commission v. Austria, 2002 E.C.R. I-9797; Case C-476/98, Commission v. Germany, 2002 E.C.R. I-9855 [hereinafter Open Skies].

stadt,[59] in which the ECJ prohibited provisions in treaties with third States that denied national treatment to nonresidents or to companies with nonresident shareholders.[60] Since these cases concerned the comparison between residents and nonresidents, they are not at all inconsistent with *D. v. Inspecteur*,[61] *ACT Group Litigation*,[62] and *Columbus Container*.[63] The fact that Member States may not achieve via a bilateral tax treaty that which would be prohibited if done unilaterally, also may be relevant where tax treaties contain investment incentives in the form of tax breaks. But in the latter category of cases, probably the EC Treaty provisions on State aid[64] will be more relevant than those on free circulation,[65] as in such cases, probably the foreign investor is getting better than national treatment.

I believe the court rightly views MFN treatment as not making sense in bilateral tax treaties, as national tax system *B* is far from identical to national tax system *C*. Both differ from national tax system *A*, with which a tax treaty seeks to coordinate them, but in different ways, implying that different coordination is required and negotiations will have different stakes. Nonresidents from *Member State B* are simply not in the same tax position as nonresidents from *Member State C* vis à vis the interaction with the tax system of *Member State A*. MFN treatment in bilateral tax treaties presupposes preceding harmonization of the direct tax systems of the Member States, which is not reality. The EC Treaty does not even require Member States to conclude bilateral tax treaties at all (it only nonbindingly encourages them to do so),[66] let alone in a specific manner.

Van Thiel submits that MFN treatment in bilateral tax treaties logically follows from the EC law imperative of national treatment,[67] but it does not. National treatment would mean treating nonresidents as residents, that is, taxing them on their worldwide income and granting them the same prevention of double taxation as residents. I would agree that conceptually, that would be the best policy, but that re-

[59] Case C-307/97, Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v. Finanzamt Aachen-Innenstadt, 1999 E.C.R. I-6161.

[60] *United Kingdom*, 2002 E.C.R. I-9427, ¶ 61; *Denmark*, 2002 E.C.R. I-9519, ¶ 140; *Sweden*, 2002 E.C.R. I-9575, ¶ 126; *Finland*, 2002 E.C.R. I-9627, ¶ 132; *Belgium*, 2002 E.C.R. I-9681, ¶ 145; *Luxembourg*, 2002 E.C.R. I-9741, ¶ 136; *Austria*, 2002 E.C.R. I-9797, ¶ 145; *Germany*, 2002 E.C.R. I-9855, ¶ 162; *Saint-Gobain*, 1999 E.C.R. I-6161, ¶ 63.

[61] Case C-376/03, D. v. Inspecteur van de Belastingdienst, 2005 E.C.R. I-5821.

[62] Case C-374/04, Test Claimants in Class IV of the ACT Group Litig. v. Commissioners of Inland Revenue, 2006 E.C.R. I-11673.

[63] Case C-298/05, Columbus Container Services BVBA & Co. v. Finanzamt Bielefeld-Innenstadt, 2007 E.C.R. I-10451.

[64] EC Treaty, note 15, arts. 87-89.

[65] Id. arts. 23-31.

[66] EC Treaty, note 15, art. 293.

[67] See Van Thiel, note 1, at 156-57.

quires harmonization. In the meantime, Member States are free to decide to subject nonresidents to tax to a lesser extent than residents, for example, only for their sourced income, or not at all. The only thing the Treaty freedoms forbid them to do is to tax nonresidents more extensively than residents.[68] Correspondingly, the court held, in cases like *Schumacker*[69] and *Futura Participations*[70] that residents and nonresidents are not generally in the same tax position, and that Member States are at liberty to treat them differently in that they subject nonresidents to tax only for sourced income.[71] National treatment then only entails taxing that sourced income in the hands of nonresidents in the same manner as in the hands of residents. Thus, no treaty issue even arises. In a case such as that of Mr. D. (a resident of Germany claiming the same personal allowances as provided for in the tax treaty between the Netherlands and Belgium), national treatment in the Netherlands would never entitle Mr. D. to more than a proportional fraction of the Netherlands personal allowances, and according to the court in *De Groot*, national treatment in the Netherlands would not even entitle him to anything, as the bulk of his personal wealth was not in the Netherlands, but in his home State Germany.[72] In a case such as that of the test claimants in the *ACT Class IV Group Litigation*, national treatment of the foreign parent company would mean subjecting it to full domestic corporate income tax (in which case, obviously, it also would be entitled to the ACT credit). Foreign parent companies, however, are not subject to domestic corporate income tax and are, therefore, not in the same position as residents. This clearly illustrates that national treatment is something quite different from MFN treatment. The one does not logically follow from the other.

A "substantive rights" approach (tax treaties should only be in the business of dividing taxing power and preventing double taxation) cannot be based on any EC Treaty provision, would wrongfully encroach upon the Member State's sovereignty, would lead to impossible distinction-making exercises within the text of (sub)provisions of tax treaties, and would leave the Member States at a loss, when they are negotiating a specific tax treaty provision, whether they are yielding to just one Member State or to the entire EC.

---

[68] See EC Treaty, note 15, arts. 43, 49, 56.

[69] Case C-279/93, Finanzamt Köln-Alstadt v. Schumacker, 1995 E.C.R. I-225.

[70] Case C-250/95, Futura Participations SA v. Admin. des Contributions, 1997 E.C.R. I-2471.

[71] Id. ¶¶ 32–35; *Schumacker*, 1995 E.C.R. I-225, ¶¶ 32–38.

[72] Case C-385/00, De Groot v. Staatssecretaris van Financiën, 2002 E.C.R. I-11819, ¶¶ 88–90.

Finally, van Thiel puts forward the example of a trader from Marseille who is surprised to be subjected to different product standards on the Paris regional market than a trader from Bordeaux.[73] That example has no bearing on MFN treatment. In the absence of product safety standard harmonization, Member States may exclude products not meeting their safety standards, provided the standards in the origin State are not comparable (and provided such exclusion is not disproportionate in view of the justified goal pursued). If the Marseille safety standards are lousy and the Bordeaux standards are superlative, then there is nothing wrong in Paris excluding Marseille products and at the same time allowing Bordeaux products. Such policy would be inexcusable only if the Bordeaux and Marseille standards were both comparable to the Paris safety level. But in our case the *Member State B* and *Member State C* direct tax systems are *not* comparable, and even if they were as regards specific parts, still a tax treaty is a package deal, encompassing innumerous different, possibly comparable, possibly incomparable, items to be coordinated. The court rightly held in *D. v. Inspecteur*,[74] that cherry-picking from such package is improper.[75] Moreover, mutual recognition, which may work for diploma requirements and product safety requirements, does not work for direct taxes, as which State is to recognize whose taxing power? EC law contains no clue as to a jurisdiction choice or priority. The court has never hinted at inacceptability of worldwide (that is, extraterritorial) taxation; thus double taxation issues and political (jurisdictional) choices are unavoidable.

I am also rather pleased with the court's (non-)MFN case law as, for a change, the court is consistent and accepts consequences: no exceptions, no u-turns, no nuancing, no "buts" and "ifs." This greatly serves legal certainty.

IV. (No) Prohibition of Double Tax Burdens

Van Thiel submits that the EC Treaty provides a legal basis for prohibiting international double taxation of the same (cross-border) income.[76] I disagree. Prohibiting double taxation means that one of the two States involved will have to yield to the other State's exercise of jurisdiction. The EC Treaty freedoms provide no guidance whatsoever on which State's jurisdiction takes priority over the other. The court is neither legally competent nor politically equipped to make any such jurisdictional choice. It must be admitted that it sometimes

73 See van Thiel, note 16, at 152 n.34.
74 Case C-376/03, D v. Inspecteur van Belastingdienst, 2005 E.C.R. I-5821.
75 Id. ¶ 62.
76 See van Thiel, note 16, at 154.

does not seem to bother the court much that it does not have the competence to allocate (negative) income, as it regularly designates—on a mysterious legal basis—a jurisdiction to take into account losses or expenses that clearly do not belong in that jurisdiction (foreign subsidiary financing expenses in *Bosal Holding*,[77] personal allowances in *De Groot*,[78] definitive foreign subsidiary losses in *Marks & Spencer*,[79] post-emigrational capital losses in *N v. Inspecteur*[80]), but apparently this is explained by an "always-somewhere"-approach only applicable to deductions. In an internal market, the court considers it unacceptable that an economic operator would lose deductions or rebates solely because of exposing himself to another taxing jurisdiction or to two taxing jurisdictions simultaneously.[81] An economic operator always must be able to deduct his financing expenses, losses incurred, personal allowances, and the like, *somewhere* in the internal market—if not in the correct jurisdiction, then in the jurisdiction with sufficient tax base to absorb the deduction.[82]

As regards positive items of income, however, the ECJ accepts that it is not competent or able to make jurisdictional choices, that is, to decide which of the two jurisdictions asserting a claim to the income has priority over the other. As the cases mentioned above[83] show, the court does not intervene if neither of the two jurisdictions asserting a tax claim distinguishes between the domestic position and the cross-border position, even though double taxation persists.[84]

The real problem here is that the court—I believe rightly so—decided that the EC Treaty provides no legal basis for prohibiting the Member States from defining their taxing jurisdictions in an extraterritorial manner (worldwide taxation for residents). As the recent case

---

[77] Case C-168/01, Bosal Holding BV v. Staatssecretaris van Financiën, 2003 E.C.R. I-9409.

[78] Case C-385/00, De Groot v. Staatssecretaris van Financiën, 2002 E.C.R. I-11819.

[79] Case C-62/00, Marks & Spencer plc v. Halsey, 2005 E.C.R. I-10837.

[80] Case C-470/04, N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo, 2006 E.C.R. I-7409.

[81] See Terra & Wattel, note 19, ¶ 17.3.3.2.

[82] See id.

[83] See Case C-293/06, Deutsche Shell GmbH v. Finanzamt für Großunternehmen in Hamburg, 2008 E.C.R. ___, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62006J0293:EN:html; Case C-513/04, Kerckhaert & Morres v. Belgium, 2006 E.C.R. I-10967; Case C-517/04, Visserijbedrijf D. J. Koornstra & Zn. vof v. Productschap Vis., 2006 E.C.R. I-5015; Case C-403/03, Schempp v. Finanzamt München V, 2005 E.C.R. I-6421; Case C-365/02, Lindfors, 2004 E.C.R. I-7183; Case C-234/99 Nygård v. Svineafgiftsfonden, 2002 E.C.R. I-3657.

[84] See *Deutsche Shell*, 2008 E.C.R. ___, ¶¶ 42–43; *Kerckhaert*, 2006 E.C.R. I-10967, ¶ 24; *Koornstra*, 2006 E.C.R. I-5015, ¶ 27; *Schempp*, 2005 E.C.R. I-6421, ¶ 34; *Lindfors*, 2004 E.C.R. I-7183, ¶ 34; *Nygård*, 2002 E.C.R. I-3657, ¶ 38.

Lidl Belgium[85] shows, a worldwide taxation system also has important advantages for economic operators if their foreign source income is negative. The German corporate taxpayer in *Lidl Belgium* suffered an important cash flow disadvantage because of the fact that Germany limited its taxing jurisdiction to its territory, excluding foreign PE results, therefore also foreign PE losses.[86] Thus, the court can hardly be expected to require Member States to limit their taxing jurisdiction to their territory. In a worldwide taxation system, the taxpayer would have been able to deduct the foreign PE loss temporarily. The only thing the court can do is to require national treatment. Therefore, it could mitigate the problem by requiring Member States applying worldwide taxation of residents to provide national treatment to nonresidents (either upon request or imperatively) in the form of worldwide taxation also for nonresidents deriving sourced income (with the same prevention of international double taxation, evidently).[87] National treatment would not help, however, if all Member States were to adopt the German system of territoriality at issue in *Lidl Belgium*. The dislocation problem (compartmentalization of the total tax base over different jurisdictions, entailing the loss of offsetting possibilities) would persist if both Member States were to choose to subject both residents and nonresidents only according to the territoriality principle.

Thus, for the time being (absent harmonization of the assertion of taxing power at the EC level), Member States are free to subject nonresidents to tax to a lesser extent than residents (only for sourced income[88]), but are also free to subject residents to tax either on their worldwide income or according to the territoriality principle.[89] This being so, double taxation cannot be remedied on the basis of the Treaty freedoms if neither of the two Member States involved in the double burden is taxing the cross-border situation less favorably than the domestic situation. Article 293 of the EC Treaty clearly has no direct effect. Even if it did, a tax treaty being in place does not necessarily mean that double taxation is always prevented. Only positive integration can remedy double taxation and compartmentalization still remaining in the internal market.

---

85 Case C-414/06, Lidl Belgium GmbH & Co. KG v. Finanzamt Heilbronn, 2008 E.C.R. ___, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62006J0414:EN:html.

86 See id. ¶ 25.

87 See Terra & Wattel, note 19, ¶ 17.2.

88 See Case C-250/95, Futura Participations SA v. Admin. des Contributions, 1997 E.C.R. I-2471, ¶¶ 20–22.

89 *Lidl Belgium*, 2008 E.C.R. ___.

V. *FII Test Claimants*

Let me finish—for variety—with a point van Thiel and I do agree on: It is the puzzling judgment of the ECJ in *Test Claimants in the FII Group Litigation*.[90] We agree that in this case, the court did not go far enough in protecting taxpayer's rights under the EC Treaty freedoms.[91] The court astonishingly accepted asymmetrical application, by the United Kingdom, of an exemption system for domestic group dividends where only cumbersome indirect credit was available for foreign dividends.[92] Thus, the U.K. system amounted to:

- A direct discrimination on the basis of origin;
- A very, very serious administrative and bureaucratic discrimination against foreign indirect investment as compared to domestic indirect investment (so serious the United Kingdom is planning to abandon its underlying credit system in favor of an exemption system for foreign group dividends as well)[93];
- The taxing away by the United Kingdom of foreign tax reliefs for foreign subsidiaries resulting from, for example, foreign tax credits or loss compensation rights of that foreign subsidiary, whereas the same kind of credits and compensation rights of domestic subsidiaries remained entirely intact because of the exemption for domestic dividends.

Also, the judgment's reasoning is conspicuously incompatible with the reasoning in *Bosal Holding*.[94] In the latter case, the court denied Member States reliance on Article 4 of the Parent-Subsidiary Directive[95] (granting Member States, the choice to disallow deduction of financing costs related to exempted foreign group dividends) if such choice of nondeduction was made only for nonsubjected subsidiaries, as in the court's view, such choice only for nonsubjected (mostly foreign) subsidiaries would offend the freedom of establishment (interpretation of the Directive in conformity with the EC Treaty). In *FII Test Claimants*, the court did the exact opposite.[96] It allowed a comparable asymmetrical choice, based on the very same Article 4 of the very same Directive, to exempt domestic dividends whereas for for-

[90] Case C-446/04, Test Claimants in the FII Group Litig. v. Commissioners of Inland Revenue, 2006 E.C.R. I-11753.

[91] See van Thiel, note 16, at 169-70.

[92] *FII Group Litig.*, 2006 E.C.R. I-11753, ¶¶ 41–42.

[93] See H.M. Revenue & Customs, Taxation of the Foreign Profits of Companies: Draft Provisions 1-4 (2008), available at www.hmrc.gov.uk/CNR/Tax-foreign-profits.pdf.

[94] Case C-168/01, Bosal Holding BV v. Staatssecretaris van Financiën, 2003 E.C.R. I-9409.

[95] See id. ¶¶ 22–24, 43; Council Directive 90/435, Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States, 1990 O.J. (L 225) 6, as amended by Council Directive 2003/123, 2004 O.J. (L 7) 41.

[96] See *FII Group Litig.*, 2006 E.C.R. I-11753, ¶¶ 44–57.

eign dividends only cumbersome multi-tier indirect credit was provided.[97] Thus, this time the freedom of establishment seems to have been subordinated to Article 4 of the Directive, instead of *vice versa.* Van Thiel and I are equally baffled by this judgment.

VI. Conclusion

Maybe it should, but the EC Treaty does not contain an obligation for Member States to provide most favored nation treatment in bilateral tax treaties, nor an obligation to prevent international double taxation, as long as the Member States involved do not distinguish between the domestic position and the cross-border position. The judicial restraint, shown in recent direct tax case law of the ECJ, generally is to be welcomed, but in *FII Test Claimants* the court failed to provide enough protection for economic operators under the freedom of establishment.

---

[97] See id.