

MOST-FAVOURED-NATION TREATMENT IN DIRECT TAXATION: DOES EC LAW PROVIDE FOR COMMUNITY MFN IN BILATERAL DOUBLE TAXATION TREATIES?

Georg W. Kofler*

I.	THE CONCEPT OF MOST-FAVOURED-NATION TREATMENT AND THE ISSUE OF COMMUNITY PREFERENCE IN BILATERAL DOUBLE TAXATION TREATIES.....	4
	A. <i>The Lack of a Most-Favoured-Nation Clause in the EC Treaty</i>	4
	B. <i>EC Law, Most-Favoured-Nation Treatment, and Bilateral Tax Treaties: The Current State of Affairs</i>	7
	1. The Starting Point	7
	2. The Range of Opinions in Legal Scholarship and National Courts	9
	3. Positions taken by the “Official Europe”.....	13
	C. <i>The Possible Application and Scope of MFN Treatment</i>	16
II.	PREFACE: NON-DISCRIMINATION IN EC TAX LAW	19
	A. <i>A Brief Overview: The ECJ and Direct Taxation</i>	19
	B. <i>“Overt” and “Covert” Discrimination on Grounds of Nationality in Tax Law</i>	24
	C. <i>Justifications and the “Rule of Reason” in Direct Taxation</i>	27
III.	MOST-FAVOURED-NATION TREATMENT IN BILATERAL DOUBLE TAXATION TREATIES?.....	31
	A. <i>A Clash of Principles: Internal Market vs. Sovereignty of the Member States</i>	31
	B. <i>National Treatment vs. Most Favoured Nation</i>	

* Dr. Georg W. Kofler, LL.M. (NYU), is assistant professor of tax law with Johannes Kepler University of Linz in Austria. I would like to thank Prof. Joseph H.H. Weiler of NYU’s Hauser Global Law School for discussing the topic with me, providing insightful comments, and critically reviewing the preliminary draft of this paper. Further, I am indebted to Prof. H. David Rosenbloom, Prof. Kees van Raad, Prof. Ruth Mason, Prof. Michael Lang, Prof. Michael Tumpel, and Dr. Herbert Buzanich for their willingness to discuss a broad range of EC tax issues with me during the preparation of this paper.

2 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

	<i>Treatment: The Case law of the European Court of Justice</i>	34
	1. The “Close-To-Cases”	34
	2. The Case Law from <i>Humbel</i> to <i>Open Skies</i>	35
	3. The <i>D</i> Case and the <i>Bujura</i> Case: Will the ECJ Solve the Issue?	51
	4. Conclusions	60
C.	<i>Does the EC Treaty Forbid Discrimination Between Two Non-Residents?</i>	60
	1. The Scope of Non-Discrimination in EC Law	60
	2. Article 12 EC and “Horizontal Discrimination”	62
	3. The Implications of Article 17 EC	65
	4. Are Two Non-Residents in Comparable Situations?	66
D.	<i>Different Treatment Due to Different Tax Treaties: Discrimination?</i>	68
	1. The Allocation of Taxing Rights: What Gilly Means for the Issue of MFN Treatment.....	68
	2. The Influence of the Tax Situation of a Non-Resident in Its Country of Residence: From the Legal Merits of an “Overall Tax Burden” Inquiry to the Permissibility of Shifting an Obligation under EC Law.....	70
	3. Example: The Issue of Withholding Taxes.....	74
	4. Remaining Issues.....	78
E.	Justification under the “Rule of Reason”?.....	80
IV.	CONCLUSIONS	85
A.	<i>MFN Treatment and the Implications for National Treatment</i>	85
B.	<i>A Brief Glance at the Perspectives: Multilateral Tax Treaty, EC Model Convention, or Work on Specific EU Concepts?</i>	87

LIST OF ABBREVIATIONS

- AIR & SPACE L.=“Air & Space Law”
 B. C. INT’L & COMP. L. REV.=“Boston College International and Comparative Law Review”
 BB=“Der Betriebsberater”
 BIFD=“Bulletin for International Fiscal Documentation”
 BTR=“British Tax Review”
 CDFI=“Cahiers de Droit Fiscal International”
 CML REV.=“Common Market Law Review”
 DB=“Der Betrieb”

- DFI="Derivatives & Financial Instruments"
 DSTR="Deutsches Steuerrecht"
 DSTZ="Deutsche Steuerzeitung"
 DWIR="Deutsche Zeitschrift für Wirtschaftsrecht"
 E.C.R.="European Court Reports"
 E.C.R.="European Court Reports"
 EC TAX J.="The EC Tax Journal"
 EC TAX REV.="EC Tax Review"
 EJIL="European Journal of International Law"
 EMORY INT'L L. REV.="Emory International Law Review"
 ET="European Taxation Journal"
 EuR="Europarecht"
 EUROP. J. MIGR. & L.="European Journal of Migration and
 Law"
 EUROP. L. REV.="European Law Review"
 EUZW="Zeitschrift für Europäisches Wirtschaftsrecht"
 EWS="Europäisches Wirtschafts- und Steuerrecht"
 FR="Finanz-Rundschau"
 GES="GeS aktuell – Zeitschrift für Gesellschafts- und
 Steuerrecht"
 HOUS. J. INT'L L.="Houston Journal of International Law"
 INT'L TAX J.="International Tax Journal"
 INT'L TAX REV.="International Tax Review"
 INTERTAX="Intertax – International Tax Review"
 ISTR="Internationales Steuerrecht"
 IWB="Internationale Wirtschaftsbriefe"
 J. OF AIR L. AND COM.="Journal of Air Law and Commerce"
 J. OF WORLD TRADE="Journal of World Trade"
 L. ISSUES OF ECON. INT.="Legal Issues of Economic
 Integration"
 LAW & POL'Y INT'L BUS.="Law and Policy in International
 Business"
 MICH. J. INT'L L.="Michigan Journal of International Law"
 NW. J. INT'L L. & BUS.="Northwestern Journal of
 International Law & Business"
 O.J.="Official Journal of the European Communities"
 ÖStZ="Österreichische Steuer-Zeitung"
 RDW="Österreichisches Recht der Wirtschaft"
 RIW="Recht der Internationalen Wirtschaft"
 SWI="Steuer und Wirtschaft International"
 SYRACUSE J. INT'L L. & COM.="Syracuse Journal of
 International Law and Commerce"

TAX L. REV.=“Tax Law Review”

TAX MGM'T INT'L J.=“Tax Management International
Journal”

TAX NOTES INT'L=“Tax Notes International Magazine”

TAX PLANNING INT'L REV.=“Tax Planning International
Review”

VAND. J. TRANSNAT'L L.=“Vanderbilt Journal of
Transnational Law”

WORLD COMP.=“World Competition”

WTD=“Worldwide Tax Daily”

I. THE CONCEPT OF MOST-FAVoured-NATION TREATMENT AND
THE ISSUE OF COMMUNITY PREFERENCE IN BILATERAL
DOUBLE TAXATION TREATIES

A. *The Lack of a Most-Favoured-Nation Clause in the EC
Treaty*

Unlike other multilateral economic agreements the EC Treaty (EC)¹ does not explicitly provide for most-favoured-nation treatment (“MFN treatment”).² MFN treatment may be defined as “treatment accorded by the granting State to the beneficiary State, or to persons or things in a determined relationship with that State, not less favourable than treatment extended by the granting State to a third State or to persons or things in the same relationship with that third State.”³ The principle of MFN treatment is, together with the principle of national treatment, the cornerstone of the multilateral trading system under the WTO agreements.⁴ Both principles complement each other to a

1. Treaty Establishing the European Community, Nov. 10, 1997, O.J. (C 340) 3 [hereinafter EC Treaty]; a consolidated version of the EC Treaty is published in 2002 O.J. (C 325) 33, and can also be found, along with the case law of the European Court of Justice [hereinafter ECJ] and other legal documents, in the official database “Eur-Lex – The portal to European Union law,” available at <http://europa.eu.int/eur-lex/>.

2. See, for example, Wolfgang Schön, *WTO und Steuerrecht*, 50 RIW 50, 51 (2004) for a comparative survey.

3. Report of the International Law Commission to the General Assembly, Draft Articles on Most-Favoured-Nation Clauses, ILC Report, A/33/10, 1978, Art. 5. See generally, e.g., Stefan Kramer, *Die Meistbegünstigung*, 35 RIW 473 (1989); Christian Tietje, *Die Meistbegünstigungsverpflichtung im Gemeinschaftsrecht*, 30 EUR 398 (1995); Jesús Santa-Bárbara Rupérez, *Non-Fiscal Discrimination in the WTO and EC Law: Relations and Solutions*, 4 EC TAX J. 111, 112-13 (2000); see also PASQUALE PISTONE, *THE IMPACT OF COMMUNITY LAW ON TAX TREATIES* 207 et seq. (2002).

4. See General Agreement on Tariffs and Trade (GATT), July 1986, art I:1,

comprehensive system of non-discrimination: for example, the MFN treatment principle guarantees that a party must extend to all other GATT party's products the same treatment as granted to a party that receives that most favorable treatment, and the national treatment principle guarantees that imported products not be discriminated against in favor of the domestic product by the imposition of an internal tax or regulation.

Both principles arise from a broadly understood idea of equal treatment of economic activities and non-discrimination in cross-border situations.⁵ This said, one may wonder why the EC Treaty provides for a sophisticated set of rules guaranteeing national treatment, but does not deal with MFN treatment, which is just another standard of non-discrimination⁶ and may even be seen as embraced by the rules governing national treatment. Thus, MFN treatment could be considered to be generally inherent in the concept of a close community of states: a Member State of the European Union may not give a treatment to nationals of another Member State that is less favourable than the treatment it gives to nationals of a particular Member State or of a third country.⁷ However, some authors take the opposite theoretical position and suggest that where national treatment exists, there is no need for MFN treatment because the former is the more advanced stage of integration than the latter.⁸ It is argued that the MFN clause assumes that nationals of other countries may not be treated as nationals of the country where the comparison is being made; put in other words, "the most-favoured-nation clause assumes that discriminatory treatment is

available at <http://pacific.commerce.ubc.ca/trade/GATT.html#I>; General Agreement on Trade in Services (GATS), part II, art. II, available at http://www.wto.org/english/docs_e/legal_e/26-gats.pdf; and Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), April 1994, part I, art 4, available at http://www.wto.org/english/docs_e/legal_e/27-trips.pdf. See, for example, Kramer, *supra* note 3, at 473 for a comprehensive overview; Santa-Bárbara Rupérez, *supra* note 3, at 120; Lothar Ehring, *De Facto Discrimination in World Trade Law – National and Most-Favoured-Nation Treatment – or Equal Treatment?* 36 J. OF WORLD TRADE 921 (2002).

5. See, e.g., Tietje, *supra* note 3, at 406–407; see generally Stefaan De Ceulaer, *Community Most-Favoured-Nation Treatment: One Step Closer to the Multilateralization of Income Tax Treaties in the European Union?*, 57 BIFD 493, 495 (2003).

6. See, e.g., Kramer, *supra* note 3, at 478.

7. See generally De Ceulaer, *supra* note 5, at 495; see, for example, Luc Hinnekens, *Compatibility of Bilateral Tax Treaties with European Community Law – Application of the Rules*, 4 EC TAX REV. 202, 213 (1995), for examples from non-tax areas.

8. See, e.g., AXEL CORDEWENER, EUROPÄISCHE GRUNDFREIHEITEN UND NATIONALES STEUERRECHT [EUROPEAN FUNDAMENTAL FREEDOMS AND NATIONAL TAX LAW] 838 (2002); see generally Adolfo J. Martín-Jiménez & F. Alfredo Garcia Prats, *Triangular Cases, Tax Treaties and EC Law: The Saint-Gobain Decision of the ECJ*, 55 BIFD 241 (2001).

6 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

possible, whereas discrimination is forbidden under EC law.⁹ However, it has to be pointed out that situations where no comparison between nationals and non-nationals is possible cannot be solved by other means than the MFN doctrine.¹⁰

This said, the question of whether MFN is required as a consequence of the non-discrimination principle of the EC Treaty becomes especially striking in the area of direct taxation.¹¹ The Member States have concluded a multitude of different bilateral tax treaties, or, synonymously, double taxation conventions (DTCs), between each other and with third countries. These treaties distribute taxing rights between the treaty partners and provide for mutual benefits for the residents of the contracting states.¹² However, it is the rule, rather than the exception, that such benefits vary from treaty to treaty. This may, of course, result in a situation whereby 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.

9. Martín-Jiménez, *supra* note 8, at 250; *see also* CORDEWENER, *supra* note 8, at 836.

10. *See* Luc Hinnekens, *Non-Discrimination in EC Income Tax Law: Painting in the Colours of a Chameleon-Like Principle*, 36 ET 286, 297 (1996); PISTONE, *supra* note 3, at 211; Pasquale Pistone, *An EU Model Tax Convention*, 11 EC TAX REV. 129, 131 (2002); *see also* Malcolm Gammie & Guy Brannan, *EC Law Strikes at the UK Corporation Tax—The Death Knell of UK Imputation?*, 23 INTERTAX 389, 402 (1995).

11. However, it seems necessary to note that, for example, in the NAFTA framework MFN treatment explicitly does not apply to tax treaty relations within this framework; *see* North American Free Trade Agreement (NAFTA), Dec. 17, 1992, art. 2103, 32 I.L.M. 605; *see, e.g.*, Jeffrey Owens, *Taxation within a Context of Economic Globalization*, 52 BIFD 290, 291 (1998). Although this fact demonstrates that MFN treatment is not essential or axiomatic in a free-trade association, no conclusions can be derived for the question of MFN treatment within the EU. It should nevertheless be mentioned that, of course, there is neither a general rule of MFN treatment in international tax law nor are bilateral tax treaties axiomatically hostile towards MFN treatment. For an overview of MFN clauses in tax treaties, *see* PISTONE, *supra* note 3, at 208 et seq, and Albert J. Rädler, *Most Favoured Nation Concept in Tax Treaties*, in MULTILATERAL TAX TREATIES 1, 7-8 (Michael Lang ed., 1998). However, even in an EU context it should be mentioned that some Europe Agreements contained MFN clauses, but explicitly excluded the application of such clauses in the field of tax law; *see e.g.*, Europe Agreement Establishing an Association between the European Communities and their Member States, of the one part, and the Republic of Estonia, of the other part, Sept. 3, 1998, Eur.-Est., art. 57(1), OJ (L 068) 3.

12. *See, e.g.*, Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, Oct. 21, 1989, U.K. – N.Ir. – Belg.

B. *EC Law, Most-Favoured-Nation Treatment, and
Bilateral Tax Treaties:
The Current State of Affairs*

1. The Starting Point

Despite of lack of harmonization of direct taxation in the European Union, several landmark decisions of the European Court of Justice (ECJ) in recent years have clearly put the focus on the far-reaching impact of the fundamental freedoms of the EC treaty on direct taxation.¹³ This is because in the absence of political solutions, taxpayers have been compelled to have recourse to the legal process to overcome discriminatory rules and other obstacles. In consequence, the ECJ has developed a large body of case law on the compatibility of national tax rules with the EC Treaty.¹⁴ The basis of this case law is that, although the Member States retain their competence in direct tax matters,¹⁵ they must exercise that power consistently with EC Law and therefore avoid any overt or covert discrimination on grounds of nationality.¹⁶

An important part of the ECJ's jurisprudence is concerned with the provisions of the EC Treaty which establish the Internal Market: "the four freedoms", i.e., the free movement of goods, the free movement of persons, including the freedom of establishment, the freedom of movement of services, and the freedom of movement of capital.¹⁷ Between them, the four freedoms cover all forms of cross-border activity and investment and, in conjunction with the principle of equal treatment

13. Recent and extensive discussion of the impact of the fundamental freedoms of the EC Treaty on direct taxation is provided. *See, e.g.*, CORDEWENER, *supra* note 8, and BEN TERRA & PETER WATTEL, *EUROPEAN TAX LAW* (3d ed. 2001). A focus on the relationship between the fundamental freedoms and double taxation treaties is put forth by PISTONE, *supra* note 3.

14. The two underlying principles of this case law are the supremacy and the direct effect of EC Law: The principle of supremacy ensures that Community law has primacy over conflicting national law, while the principle of direct effect means that individuals can invoke their Community rights directly before national courts. *See, e.g.*, Case 26/62, *Van Gend & Loos v. Netherlands Inland Revenue Admin.*, 1963 E.C.R. 3.

15. Harmonization in the field of direct taxation, such as areas of the personal and corporate income tax, is still limited to some directives, e.g., the Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, which eliminates double taxation of dividends paid by a subsidiary in one Member State to a parent company in another. Council Directive 90/435/EEC, art. 7, 1990 O.J. (L 225) 6. For an overview, see TERRA & WATTEL, *supra* note 13, 335 et seq.

16. *See infra* Part II.B.

17. *See* Pat Cullen & Evelyn Forde, *Irish Corporate Tax and EC Treaty Computability*, at <http://www.deloitte.com/dtt/article/0,1002,sid%253D2883%2526cid%253D24625,00.html>.

8 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

(another principle central to the *acquis communautaire*), they impose a prohibition on tax provisions which may pose obstacles to cross-border economic activities.¹⁸ Based on these principles of non-discrimination on grounds of nationality, the ECJ has expanded the reach of the fundamental freedoms well beyond this initial basis. For example, the ECJ has held that unequal treatment of resident and non-resident taxpayers in comparable situations constitutes a violation of EC Law, unless such treatment is justified under the “rule of reason”.

However, an unsolved issue is whether an EU Member State is obligated under EC Law to treat non-resident taxpayers equally, i.e., that an EU taxpayer is eligible for the benefit of the most favorable tax treaty concluded by the Member State from which he derives income.¹⁹ The ECJ has, due to judicial self-restraint or hesitation, left this issue open in several cases.²⁰ However, from a policy standpoint, it seems unacceptable in the Internal 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. Such conclusion would, however, lead to MFN treatment, or, as sometimes used synonymously, “Community preference,”²¹ “Community MFN,”²² or “treaty preference,”²³ in direct taxation. Doing so would result in an immediate “multilateralization” of all bilateral tax treaties concluded by EU Member States.²⁴ Although it may be true that, from a policy point of view, the judicial imposition of MFN

18. *Id.*

19. See Company Taxation in the Internal Market: Working Paper from the Commission of the European Communities, COM(01)582 final at 359 [hereinafter Company Taxation in the Internal Market].

20. See *infra* 0. for an analysis of the existing case law.

21. However, the term “Community preference” is usually used with regard to the questions whether a Member State may grant more beneficial treatment to a non-Member State than to other Member States. See, e.g., Klaus Eicker, *Recent Developments Regarding Cross-Border Pensions: Landmark Decision by the ECJ in the Case C-55/00 Gottardo*, 30 INTERTAX 156 (2002); see also Luc Hinnekens, *Compatibility of Bilateral Tax Treaties with European Community Law – The Rules*, 3 EC TAX REV. 146, 152 (1994); see generally De Ceulaer, *supra* note 5, at 495.

22. See Paul Farmer, *EC Law and Direct Taxation – Some Thoughts on Recent Issues*, 1 EC TAX J. 91, 101 (1995).

23. Hans van den Hurk, *The European Court of Justice knows its limits – A discussion inspired by the Gilly and ICI cases*, 8 EC TAX REV. 211 (1999).

24. See generally Tietje, *supra* note 3, at 399; Hinnekens, *supra* note 22, at 154; Josef Schuch, *‘Most favoured nation clause’ in Tax Treaty Law*, 5 EC TAX REV. 161 (1996); Michael Lang, *Doppelbesteuerungsabkommen und Gemeinschaftsrecht*, in STEUERRECHT UND EUROPÄISCHE INTEGRATION 429, 435 (Gottfried E. Breuninger et al. eds., 1999); Michael Lang, *Die Zukunft des Internationalen Steuerrechts in Europa*, in DIE ZUKUNFT DES INTERNATIONALEN STEUERRECHTS 71, 82 (Wolfgang Gassner et al. eds., 1999).

treatment, and thus negative harmonization, cannot be a surrogate of positive Community harmonization of tax treaties,²⁵ it should nevertheless be noted that until now the ECJ has not hesitated to revolutionize long-standing principles of internal tax systems²⁶ or international tax policies of Member States²⁷ and is clearly not impressed by the fiscal consequences of a judgment.²⁸

2. The Range of Opinions in Legal Scholarship and National Courts

Because of this far-reaching impact, there is an understandably strong hesitation to draw the conclusion of the existence of an implicit MFN clause, both from a policy standpoint as well as from a result-oriented legal rationale, despite the fact that the recent case law of the ECJ seems to point in this direction. Nevertheless, it may be noted that, from a policy point of view, a judicial application of the MFN doctrine to tax treaties undoubtedly ensures full compatibility with EC Law and the idea of a single market.²⁹ However, it would also clearly impair the reciprocity of tax treaties and domestic laws.³⁰

Due to its potentially enormous impacts the issue of MFN treatment has been subject to intensive discussion in legal writing, although most statements are based on policy considerations rather than on legal argumentation. Thus it is often read that “such a most favoured nation effect would really ruffle settled international tax law,”³¹ that MFN treatment “would result in the abolition of the principle of reciprocity which, however, forms the backbone of bilateral agreements,”³² or that through MFN treatment “one of the pillars of tax treaty law, the reciprocity principle, would have been demolished.”³³ On the

25. Hinnekens, *supra* note 7, at 213; Hinnekens, *supra* note 10, at 297.

26. See Georg W. Kofler, *Bosal: Abzugsverbot für Beteiligungsaufwendungen verstößt gegen die im Lichte der Niederlassungsfreiheit ausgelegte Mutter-Tochter-RL*, 2003 ÖStZ 554.

27. See Case C-234/01, *Gerritse v. Finanzamt Neukölln-Nord*, 2003 E.C.R. I-5933 for a recent example.

28. See Case C-200/90, *Dansk Denkvit ApS v. Skatteministeriet*, 1992 E.C.R. I-2217, paras. 20-21, where the ECJ tackled down a Danish levy that yielded approximately 4% of Denmark's revenue.

29. See also Helmut Loukota, *Multilateral Tax Treaty Versus Bilateral Treaty Network*, in MULTILATERAL TAX TREATIES 83, 103 (Michael Lang ed., 1998).

30. See, e.g., Moris M. Lehner, *The Influence of EU Law on Tax Treaties from a German Perspective*, 54 BIFD 461, 470 (2000).

31. Peter J. Wattel, *The EC Court's Attempts to Reconcile the Treaty Freedoms with International Tax Law*, 33 CML REV. 223, 252 (1996).

32. Lehner, *supra* note 31, at 470.

33. Eric C.C.M. Kemmeren, *The termination of the 'most favoured nation clause' dispute in tax treaty law and the necessity of a Euro Model Tax Convention*, 6 EC TAX REV. 146, 148 (1997).

10 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

other side, it is argued, the judicial application of MFN treatment, and thus a loss in revenue, would be an enormous motivation for the Community and the Member States to harmonize international tax law on the EC level.³⁴ Thus, by such move, the ECJ would once more prove to be the “motor” of integration. However, an analysis of the scholarship on whether Member States should have an actual obligation to give MFN treatment in their bilateral tax treaties shows that opinions range from clear favor,³⁵ over sympathetic,³⁶ neutral,³⁷ short

34. So, e.g., Michael Lang, *Doppelbesteuerungsabkommen und Gemeinschaftsrecht*, in STEUERRECHT UND EUROPÄISCHE INTEGRATION 429, 435 (Gottfried E. Breuninger et al. eds., 1999).

35. See, for example, however with different nuances towards a possible justification, COMMISSION OF THE EUROPEAN COMMUNITIES, REPORT OF THE COMMITTEE OF INDEPENDENT EXPERTS ON COMPANY TAXATION – RUDING REPORT 378 (1992) (Annex 6: Albert J. Rädler, *Tax treaties and the Internal Market*); Norbert Herzig & Norbert Dautzenberg, *Der EWG-Vertrag und die Doppelbesteuerungsabkommen – Rechtsfragen im Verhältnis zwischen Doppelbesteuerungsabkommen und den Diskriminierungsverboten des EWGV*, 1992 DB 2519, 2521; Albert J. Rädler, *Most-favoured-nation Clause in European Tax Law?* 4 EC TAX REV. 66, 67 (1995); Gammie & Brannan, *supra* note 10, at 402; Tietje, *supra* note 3, at 406; Farmer, *supra* note 23, at 101; Schuch, *supra* note 25, at 161; Josef Schuch, *Verpflichtet das EU-Recht zur DBA-rechtlichen Meistbegünstigung?*, 1996 SIW 267; Josef Schuch, *Will EC Law Transform Tax Treaties into Most Favoured-Nation Clauses?*, in TAX TREATIES AND EC LAW 89, 89 (Wolfgang Gassner et al. eds., 1996); Franz Wassermeyer, *Die Vermeidung der Doppelbesteuerung im Europäischen Binnenmarkt*, in STEUERRECHT IM EUROPÄISCHEN BINNENMARKT, DSTJG 19, 151, 162 (Moris Lehner ed., 1996); Norbert Herzig & Norbert Dautzenberg, *Die Einwirkungen des EG-Rechts auf das deutsche Unternehmenssteuerrecht*, 1997 DB 1997, 8, 16; Josef Schuch, *EC Law Requires Multilateral Tax Treaty*, 7 EC TAX REV. 29, 36 (1998); Norbert Dautzenberg, *Die Kapitalverkehrsfreiheit des EG-Vertrages, der Steuervorbehalt des Art 73d EGV und die Folgen für die Besteuerung*, 44 RIW 537, 544 (1998); Gerald Toifl, *Austria*, in THE COMPATIBILITY OF ANTI-ABUSE-PROVISIONS IN TAX TREATIES WITH EC LAW 41, 60 (Peter H.J. Essers et al. eds., 1998); Rädler, *supra* note 11, at 3; Franz Wassermeyer, *Does the EC-Treaty Force the EU Member States to Conclude a Multilateral Tax Treaty?* in MULTILATERAL TAX TREATIES 15, 21 (Michael Lang ed., 1998); Josef Schuch, *Bilateral Tax Treaties Multilateralized by the EC TREATY*, in MULTILATERAL TAX TREATIES 33, 35 (Michael Lang ed., 1998); Michael Lang, *Die Zukunft des Internationalen Steuerrechts in Europa*, in DIE ZUKUNFT DES INTERNATIONALEN STEUERRECHTS 71, 78 (Wolfgang Gassner et al. eds., 1999); Paul Farmer, *EC Law and Double Taxation Agreements*, 4 EC TAX J. 137, 152 (1999); SERVAAS VAN THIEL, FREE MOVEMENT OF PERSONS AND INCOME TAX LAW: THE EUROPEAN COURT IN SEARCH OF PRINCIPLES 486 et seq. (2002); Albert J. Rädler, *Most-Favourite-Nation-Treatment in Direct Taxation – Some New Aspects*, 2003 SWI 360; De Ceulaer, *supra* note 5, at 494; Ruud van der Linde, *Some thoughts on most-favoured-nation treatment within the European Community legal order in pursuance of the D case*, 13 EC TAX REV. 10 (2004).

36. See, e.g., Y. Kergall, *Aspects of Treaty Overriding*, 21 INTERTAX 458, 459 (1993); Lang, *supra* note 35, at 432; Mario Züger, *Neue Internationale Steuerfälle vor dem EuGH*, 2000 SWI 2000 133, 137; Dennis Weber & Etienne Spierts, *The “D Case”: Most-Favoured-Nation Treatment and Compensation of Legal Costs before the European Court of Justice*, 44 ET 65 (2004).

37. See, e.g., Kees van Raad, *The Impact of the EC TREATY’s Fundamental Freedoms Provisions on EU Member States’ Taxation in Border-crossing Situations – Current State of Affairs*, 3 EC TAX REV. 190, 201 (1994); see also Pistone, *supra* note 10, at 130; PISTONE, *supra* note 3, 211-212.

antipathetic statements,³⁸ to vehement rejection of such conclusion.³⁹

The arguments from both sides of the spectrum are, at first glance, equally persuasive. In a nutshell, the antagonists of MFN treatment rely on the textual argument that the EC Treaty indeed prohibits “any discrimination on grounds of nationality” but does not explicitly provide for MFN treatment. Furthermore, they invoke the avoidance of a “free-rider course” including the prevention of multiple non-taxation,⁴⁰ the “sovereignty” of the Member States in direct tax matters, the “reciprocity” of bilateral tax treaties,⁴¹ and the possible “chaos” MFN treatment would create. On the other hand, the proponents of MFN treatment argue with Article 14 EC, which foresees an internal market that functions as a national market, and with Article 12 EC, which prohibits “any discrimination on grounds of nationality,” including discrimination between two non-residents. Additionally, the proponents hold against the “sovereignty” argument the obligation to exercise powers in compliance with EC Law, and that EC obligations are unconditional and do not depend on “reciprocity.”⁴²

Extracting the legal arguments of both sides and fitting them in the usual scheme applied by the ECJ in non-

38. See the brief statements to the negative by Wattel, *supra* note 32, at 252; Klaus Vogel, *Some Observations Regarding “Gilly”*, 7 EC TAX REV. 150 (1998); *see generally* van den Hurk, *supra* note 24, at 216; Lehner, *supra* note 31, at 470; René Offermanns & Carlo Romano, *Treaty Benefits for Permanent Establishments: The Saint-Gobain Case*, 40 ET 180, 188 (2000); *see also* TERRA & WATTEL, *supra* note 13, at 96.

39. *See, e.g.*, Hinnekens, *supra* note 22, at 152; Hinnekens, *supra* note 7, at 209; Klaus Vogel, *Problems of a Most-Favoured-Nation Clause in Intra-EU Treaty Law*, 4 EC TAX REV. 264 (1995); Hinnekens, *supra* note 10, at 297; David Hughes, *Withholding Taxes and The Most Favoured Nation Clause*, 51 BIFD 126 (1997); Kemmeren, *supra* note 34, at 147; David Hughes, *Gilly and the Big Picture*, 52 BIFD 329, 332 (1998); Moris Lehner, *Annotations on the Judgment of the European Court of Justice, Case 336/96 – The Gilly Case – of 12 May 1988*, 52 BIFD 334, 335 (1998); ERIC C.C.M. KEMMEREN, *EC Law: Specific Observations, in THE COMPATIBILITY OF ANTI-ABUSE-PROVISIONS IN TAX TREATIES WITH EC LAW* 17, 22 (Peter H.J. Essers et al. eds., 1998); John F. Avery Jones, *Flows of capital between the EU and third countries and the consequences of disharmony in European international tax law*, 7 EC TAX REV. 95, 97 (1998); Martín-Jiménez & Prats, *supra* note 8, at 250; Ana Paula Dourado, *From the Saint-Gobain to the Metallgesellschaft case: scope of non-discrimination of permanent establishments in the EC Treaty and the most-favoured-nation clause in EC Member States tax treaties*, 11 EC TAX REV. 147, 151 (2002); *but see* Luc Hinnekens, *The search for the framework conditions of the fundamental EC Treaty principles as applied by the European Court to Member States’ direct taxation*, 11 EC TAX REV. 112, 114 (2002).

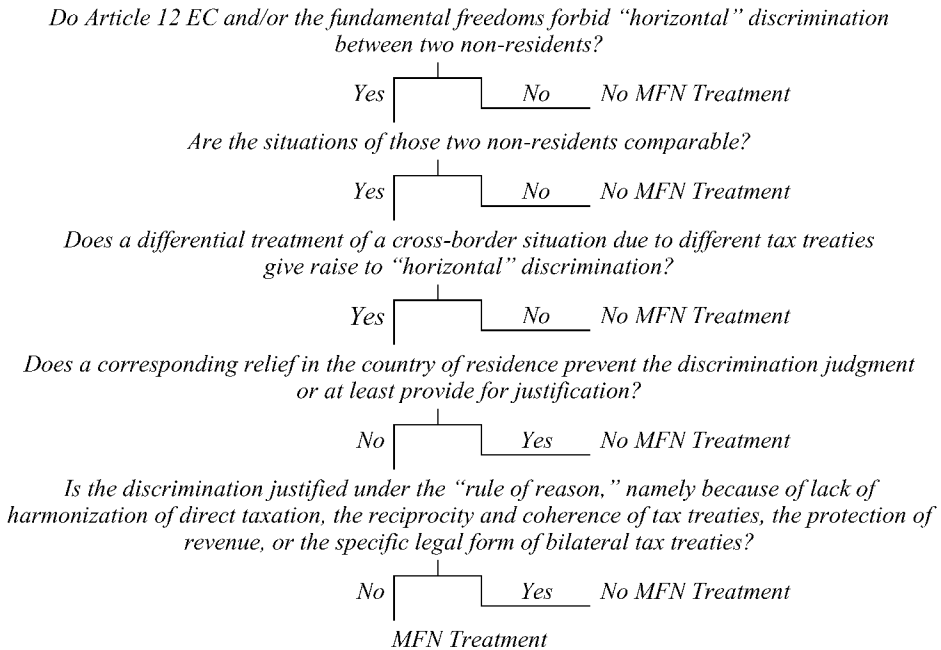
40. *See, e.g.*, Hinnekens, *supra* note 7, at 213; *contra* De Ceulaer, *supra* note 5.

41. *See*, Hinnekens, *supra* note 7, at 213; Kemmeren, *supra* note 34, at 147; Kemmeren, *supra* note 40, at 23; Lehner, *supra* note 31, at 470; Hinnekens, *supra* note 40, at 114; *see also* Wattel, *supra* note 32, at 252-53; *see generally* van den Hurk, *supra* note 24.

42. *See* discussion *infra* Part II.

12 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

discrimination cases,⁴³ the basic structure of the issue may be outlined as follows:⁴⁴



The national courts of the Member States have also shown clear hesitation towards the issue of MFN treatment under EC Law. Although, for example, the German Bundesfinanzhof (BFH) has already interpreted a non-discrimination clause in a bilateral tax treaty as providing for MFN treatment,⁴⁵ it did a step back and, in a very questionable decision, simply denied MFN treatment without any further investigation of the EC aspects of this case.⁴⁶ In two other reported cases a Dutch court also denied application of MFN treatment with regard to a certain tax benefit for individuals without posing preliminary questions to

43. See *id.*

44. See *infra* Part 0 for a detailed examination; see also the six-point-structure suggested by van der Linde, *supra* note 36, at 12.

45. German Bundesfinanzhof BFHE 157, 77, BStBl 1989 II 649.

46. German Bundesfinanzhof BFHE 162, 374, BStBl 1991 II 161. The issue in this case was whether the wealth taxation of an Italian corporation because of its participation in the capital of a German corporation is in compliance with Art 12 EC, since corporations of other Member States are exempt from this taxation by way of tax treaties. *Id.* Although the Court assumed that the German tax provisions have discriminatory character, it first stated that Art 12 EC does not apply to corporations, and second held that Art 12 EC does not hinder Germany to conclude tax treaties with differing provisions with other Member States. See Wienand Meilicke, *Vermögensteuerliches Schachtelprivileg für deutsche Betriebsstätten ausländischer Kapitalgesellschaften*, 37 RIW 172 (1991) for critical comments.

the ECJ.⁴⁷

However, the Dutch Court of 's-Hertogenbosch has recently put preliminary questions in two cases to the ECJ, concerning, *inter alia*, whether EC Law allows the Netherlands not to give a tax advantage to German residents whereas, based on a treaty agreed upon by the Netherlands and Belgium, such a tax advantage is given to residents of Belgium.⁴⁸ It seems that the Court of 's-Hertogenbosch was able to pose the question in at least one of these cases in a way that the ECJ cannot avoid a clear answer to the MFN issue by solving the case on other grounds, such as national treatment.⁴⁹

3. Positions taken by the "Official Europe"

As early as 1992, the issue of MFN treatment in bilateral double taxation treaties was brought to the attention of the European Commission. In a parliamentary question, the Commission was asked whether it agrees that "the concept of most-favoured nation treatment will apply to tax treaties concluded by a Member state with either (a) another Member State or (b) with a third country."⁵⁰ The scope of this question was further specified by asking whether, in a case in which

the tax treaty between the taxpayer's home country Member State A has concluded with Member State B is less favourable than a tax treaty with Member State B has concluded with Member State C (or a third country D) . . . the taxpayer of Member State A will be entitled to the benefits of the most favourable provision of the third party treaty.⁵¹

However, aware of the issue, the Commission rejected the application of MFN treatment by considering "that current community law does not oblige a Member State to grant automatically the withholding tax rate of its most favourable

47. See R. Betten, *Lower Courts Deny Application of Most-Favoured-Nation Clause: A Lost Opportunity?* 37 ET 417 (1997).

48. Gerechtshof te 's-Hertogenbosch Case 00/00296, Case C-376/03, *D*, 2003 O.J. (C 289) 12 and Gerechtshof te 's-Hertogenbosch Case 03/00788, Case C-8/04, *Bujura*, 2004 O.J. (C 59) 17; see *infra* 0 for a discussion of these cases.

49. See *infra* 0 for a survey of the existing "close to" case law.

50. Christa Randzio-Plath & Karla Peijs, Written Question No 647/92 to the Commission of the European Communities, (93/C 40/18), 1993 O.J. (C 40) 13 (Mar. 23, 1992); see also Hinnekens, *supra* note 22, at 154.

51. Randzio-Plath & Peijs, *supra* note 51.

14 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. V

bilateral agreement to taxpayers of another Member State which is not covered by that agreement.”⁵²

However, a more offensive view was taken in Annex 6 to the Ruding Report. As stated there, “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.”⁵³ For example, a policy granting a preferential withholding tax rate in relation to one Member State and not to other Member States, would therefore be in conflict with basic EC principles concerning competition undistorted by government rules. As the Annex stated, in 1992, there “are good reasons to believe that such treatment is already today in conflict with the provisions against discrimination of the Treaty of Rome, especially under the principle of Community preference.”⁵⁴ A similar point concerns special incentives granted to taxpayers resident in only some Member States. Annex 6 to the Ruding Report gave as an example for such situation the full or partial extension of the imputation tax credit to taxpayers of only certain treaty countries.⁵⁵

During recent years the Commission has put further emphasis on this issue and has taken a quite spirited approach in its 2001 Report on “Company Taxation in the Internal Market.”⁵⁶ In discussing the case law of the ECJ, the Commission concluded that it is an open issue as to the extent to which “a Member State can offer differing privileges to nationals of other Member States under its bilateral treaties with other Member States or whether indeed the Treaty imposes an obligation to the Member States to offer nationals of other Member States the most favoured nation treatment as offered under their treaties with third countries.”⁵⁷ The Commission goes on by stating that it “remains unclear whether all differences between tax treaties will be incompatible with the equal treatment principle. In particular it is arguable that the equal treatment principle does not allow reciprocal concessions which go beyond mere allocation of taxing rights, such as differences in concessions to avoid

52. See the Answer given by Mrs. Scrivener on behalf of the Commission, 1993 OJ (C 40) 13.

53. COMMISSION OF THE EUROPEAN COMMUNITIES, REPORT OF THE COMMITTEE OF INDEPENDENT EXPERTS ON COMPANY TAXATION – RUDING REPORT 378 (1992) (Annex 6: Albert J. Rädler, *Tax treaties and the internal market*) [hereinafter RUDING REPORT].

54. *Id.*

55. *Id.*

56. Company Taxation in the Internal Market, *supra* note 20.

57. *Id.* at 316.

economic double taxation (refunds of imputation credits).⁵⁸

The Report on “Company Taxation in the Internal Market” puts further emphasis on this issue in discussing a multilateral tax treaty as a policy option, stating that some “commentators even go as far as arguing that an EU taxpayer must get the benefit of the most favourable tax treaty concluded by the Member State where he is resident or from which he derives income.”⁵⁹ Following this, the Commission broadly referred to Annex 6 to the Ruding Report, and concluded that if “the fundamental freedoms of the EC Treaty are reflected in bilateral tax treaties between EU Member States, there is an implicit move in the direction of the multilateralisation of those tax treaties.”⁶⁰ However, a recent Commission Communication dated 2003 still keeps the issue on a policy level by stating that it “will become necessary to examine in detail whether some form of ‘most-favoured-nation’ clause between EU Member States might be required at some stage in the future.”⁶¹ This approach seems to be compatible with a recent Report of the European Parliament which calls the Commission “to submit a report on whether it is possible to introduce a most-favoured treatment clause for fiscal treatment within the EU in order to achieve competition neutrality within the internal market.”⁶²

Although the Commission has until now hesitated to state a clear position towards the “classical” MFN situation and has not yet submitted its report on this issue to the European Parliament, it has nevertheless pursued infringement proceedings against France in a tax case that was arguably a case of MFN treatment. The basic facts of this procedure were straightforward:⁶³ The French “Code Général des Impôts” (General Tax Law) subjected the profits of permanent establishments of companies which have their headquarters in other Member States to a withholding tax of 25% (“branch

58. *See id.*

59. *See infra* Part 0.

60. Company Taxation in the Internal Market, *supra* note 20, at 359.

61. Commission to the European Council, European Parliament, and European Economic and Social Committee, *An Internal Market without Company Tax Obstacles: Achievements, Ongoing initiatives and Remaining Challenges*, COM(03)726 final at 11.

62. EUR. PARL. DOC. (SEC A5-0048) 6-7 (2002).

63. Press release, Commission of European Communities, *Company taxation: European Commission Pursues Infringement Proceedings against France and Greece*, IP/97/730 (Jul. 31, 1997); *see also* Nigel Tutt, *European Commission Threatens Legal Action Regarding French Taxation of Profits*, 15 TAX NOTES INT’L 433 (Aug. 11, 1997); Deloitte & Touche, *Challenge to French Branch Tax*, 24 TAX PLANNING INT’L REV. 27 (Nov. 1997); Josef Schuch, *EC Law Requires Multilateral Tax Treaty*, 7 EC TAX REV. 29, 29 (1998); D. Berlin & V. Chaulin, *Legislation: France*, 7 EC TAX REV. 296 (1998).

remittance tax”). This withholding tax may, however, be reduced on the basis of a double taxation convention entered into between France and the other Member State. Some conventions provide for a reduction of this tax to zero, but others do not.⁶⁴ The Commission ruled that such differential tax treatment cannot be objectively justified and that it is incompatible with EC Treaty rules on freedom of establishment and on equal treatment for firms with their headquarters in any Member State.⁶⁵ Although France changed its practice of different treatment of permanent establishments dependent on the tax treaty with the residence country of the respective company and thus avoided a decision by the ECJ,⁶⁶ the infringement proceedings show at least the awareness – and the positive approach – of the Commission towards the application of MFN treatment.

C. *The Possible Application and Scope of MFN Treatment*

As indicated above, the issue of MFN treatment in tax law basically concerns this “classical” situation, that is, the equal treatment of two non-resident taxpayers by the country of source: Should the source state in its quality as an EU Member State grant to residents of the other Member States the same, i.e., the most far-reaching, benefits which it grants to residents of a contracting partner, both third states and Member States, under the various tax treaties?⁶⁷ Thus, this “classical” understanding of MFN treatment with regard to bilateral tax treaties is coherent with the classical meaning of MFN treatment in international public law, which refers only to unequal treatment of nationals of different foreign countries.⁶⁸

“Classical” MFN treatment thus deals, for example, with a resident of Member State A who derives income from Member

64. See, for example, Deloitte & Touche, *supra* note 64, at 27 for the different treaties; Berlin & Chaulin, *supra* note 64, at 296.

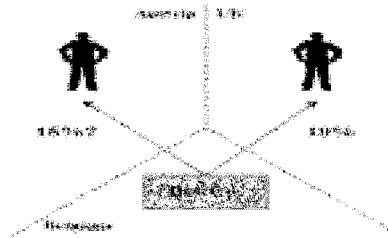
65. Tutt, *supra* note 64.

66. See Berlin & Chaulin, *supra* note 64, at 296. The system of the “branch remittance tax” is still in force, but as of 1998, it no longer applies to companies which have their place of effective management in an EU Member State and which are subject therein to corporate income tax with no possibility of opting for taxation or of being exempt. See, e.g., Opinion of AG Mischo, Case C-307/97, *Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt*, 1999 E.C.R. I-6161, para. 105(2).

67. See, e.g., Josef Schuch, *Verpflichtet das EU-Recht zur DBA-rechtlichen Meistbegünstigung?*, 1996 SIW 267, 267; Kemmeren, *supra* note 34, at 146; Mark Persoff, *The impact of EU developments on Member State's Tax Systems*, 15 INT'L TAX REV. 10 (Feb. 2004) available at <http://legalmediagroup.com/internationaltaxreview/includes/print.asp?SID=2923>.

68. See, e.g., Kramer, *supra* note 3, at 473; see also Josef Schuch, *Will EC Law Transform Tax Treaties into Most Favoured-Nation Clauses?*, in TAX TREATIES AND EC LAW 89, 101 (Wolfgang Gassner et al. eds., 1996); Vogel, *supra* note 40, at 264.

State B and invokes the more favourable treaty between Member State B and country C, whereby C may either be another Member State or a third country. This situation may be viewed as the “classical” situation of MFN treatment: The main example of this “classic” situation of MFN treatment concerns withholding taxes.⁶⁹ The withholding tax rates on dividends, interest, and royalties paid from one Member State to another still vary from 0% up to perhaps 15%.⁷⁰ This may be illustrated by a short example: An Austrian resident (A) derives dividends from a small shareholding in a Belgian company (B), which are, according to the double taxation treaty between Austria and Belgium, subject to a 15% withholding tax.⁷¹ Under the “classical” MFN scenario, the Austrian resident may now rely on the principle of non-discrimination and invoke the more favourable 10% withholding tax rate Belgium has granted to UK residents (C) in the double taxation treaty between Belgium and the UK,⁷²



“Classical” MFN treatment: A resident of Member State A (Austria) who derives income from Member State B (Belgium) may invoke the more favourable treaty between Member State B (Belgium) and Member State C (United Kingdom)

for sake of simplicity (incorrectly) assuming this is the lowest rate the UK has granted any other country.

However, this “classical” situation covers a multitude of tax issues. Apart from withholding taxes, one may, for example, think about the selective refund of credits under the current UK

69. See, e.g., Rädler, *supra* note 36, at 67; Vogel, *supra* note 40, at 264; Schuch, *supra* note 68, at 267; Schuch, *supra* note 69, at 104.

70. However, it may be noted in this context that the issue of MFN treatment with regard to withholding tax on dividends, interest, and royalties between corporations or permanent establishments is of decreasing importance due to the level of harmonization achieved in this field by means of directives. See Council Directive 90/435/EEC of 23 Jul. 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, 1990 O.J. (L 225) 6, and the Council Directive 2003/49/EC of 3 Jun. 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, 2003 O.J. (L 157) 6.

71. Convention for the Avoidance of Double Taxation and the Regulation of Certain Other Matters with Respect to Taxes on Income and Capital including the Business Tax and Land Tax, Jun. 28, 1973, Belg.-Aus., art. 10(2).

72. Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, Oct. 21, 1989, U.K.-N. Ir.-Belg., art. 10(2)(b).

18 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

corporate tax system.⁷³ Although the UK has basically abolished the former system of advanced corporation tax (ACT), a distribution of a UK corporation still generally carries a tax credit in the amount of one-ninth of the distribution.⁷⁴ However, if the distribution is received by a non-UK parent company, the entitlement to such credit depends on the provisions in the respective DTC.⁷⁵ Currently, for example, a Dutch parent company would receive a reduced credit,⁷⁶ while a German parent company would not be entitled to such credit. Thus the German parent company may think about invoking the more favourable treatment the UK has granted to Dutch parent companies. Other purported issues concern the definition of permanent establishments, the calculation of the 183-day-clause with regard to workers, or the taxation of artists.⁷⁷ Given these situations, the question is less whether one must read a MFN clause into each bilateral tax treaty; instead, the focus is on whether the EC Treaty forbids “horizontal” discrimination, (that is, discrimination between two non-residents), whether the concrete application of different treaties to two non-residents constitutes such discrimination, and, if so, whether such discrimination may be justified.⁷⁸

Finally, and although not dealt with in the following discussion, two other variations of the MFN issue may come to mind.⁷⁹ The first may be called the “inverse” MFN issue, since it

73. For a brief overview, see, for example, Georg W. Kofler, *Océ van der Grinten: Gestattet die Mutter-Tochter-RL eine abkommensrechtlich vorgesehene Quellenbesteuerung?* 2004 ÖStZ 28, 29; see Rädler, *supra* note 11, at 10 for a discussion of this issue with regard to MFN treatment; Robert Newey, *Hoechst Decision: Interest as Compensation for Discriminatory Tax Charge*, 41 ET 287, 292 (2001); Persoff, *supra* note 68, at 13.

74. See Newey, *supra* note 74, at 292.

75. See Schuch, *supra* note 25.

76. For the respective provision in the UK-Neth. DTC, see, for example, Kofler, *supra* note 74, at 29.

77. See, e.g., Schuch, *supra* note 68, at 267; Schuch, *supra* note 69, at 102; Franz Wassermeyer, *Die Vermeidung der Doppelbesteuerung im Europäischen Binnenmarkt*, in STEUERRECHT IM EUROPÄISCHEN BINNENMARKT, DSTJG 19, 162 (Moris Lehner ed., 1996).

78. A subsequent question is, of course, whether the scope of application is limited to the EU context, i.e., the so called “garden Community MFN treatment”, or whether tax treaties with third countries also come into play, i.e., the so called “non-garden Community MFN treatment”. See De Ceulaer, *supra* note 5, at 495; see also, Schuch, *supra* note 69, at 122. Although this issue will not be addressed in the following discussion, it seems, *a maiori ad minus*, that with regard to the “classical” MFN situation the latter would follow from the former, since a Member State which is not allowed to treat an EU non-resident worse than another EU non-resident, may the less be allowed to treat a non-EU non-resident better than an EU non-resident. See De Ceulaer, *supra* note 5, at 495; see also Schuch, *supra* note 69, at 122.

79. See Georg W. Kofler, *Generalanwalt zur Kapitalverkehrsfreiheit und Meistbegünstigung bei DBA-Anwendung*, 2004 ÖStZ 558, at 562.

would require favourable treatment from the perspective of the residence state.⁸⁰ This situation therefore deals with a resident of Member State A who derives income from Member State B and invokes the more favourable treaty between Member State A and country C, whereby C may either be another Member State or a third country. The second situation may be viewed as the “extended” MFN issue, since it would require favourable treatment based on an unconnected treaty relation.⁸¹ Thus the “extended” MFN situation demonstrates the most far-reaching approach and deals with a resident of Member State A who derives income from Member State B and invokes the more favourable treaty between Member State C and country D, whereby D may either be another Member State or a third country. The argument in such case would be that equal treatment forbids a Dutch resident from receiving less favourable treatment from of Italy than a German resident would receive from France. However, it seems clear and undisputed that EC Law does not cover such situation. It may, in this context, be noted that one prerequisite for the issue of comparability is a relationship to the tax system of one and the same country,⁸² which seems not to be met in such situation.

II. PREFACE: NON-DISCRIMINATION IN EC TAX LAW

A. *A Brief Overview: The ECJ and Direct Taxation*

Since the EC Treaty does not contain provisions for direct taxes comparable to its provisions for indirect taxes,⁸³ the Member States retain their competence in direct tax matters such as the individual and corporate income tax.⁸⁴ But even if a matter falls within the power of the Member States, they must exercise that power consistently with EC Law and therefore

80. See also Schuch, *supra* note 69, at 101; van den Hurk, *supra* note 24, at 216; see also Vogel, *supra* note 40, at 264.

81. See also van den Hurk, *supra* note 24, at 216.

82. See also Timothy Lyons, *Discrimination Against Individuals and Enterprises on Grounds of Nationality: Direct Taxation and the European Court of Justice*, 1 EC TAX J. 27, 35 (1995); van Raad, *supra* note 38, at 195; Schuch, *supra* note 68, at 269; Schuch, *supra* note 25, at 162; Schuch, *supra* note 69, at 113.

83. EC Treaty art. 90. For an overview, see, for example, TERRA & WATTEL, *supra* note 13, at 235.

84. Harmonization in the field of direct taxation is still limited to some directives. See, e.g., Council Directive 90/435/EEC of 23 Jul. 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, 1990 OJ (L 225) 6, which aims to eliminate double taxation of dividends paid by a subsidiary in one Member State to a parent company in another; for an overview, see, for example, TERRA & WATTEL, *supra* note 13, at 335.

20 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V]

avoid any overt or covert discrimination on grounds of nationality.⁸⁵ Generally, such discrimination arises through application of different rules to comparable situations or the application of the same or a similar rule to different situations.⁸⁶

The tangent at which EC Law and national laws on direct taxation meet is a result of the combined application of the four freedoms of the EC Treaty and the principle of equal treatment. The principle of equal treatment, which the Court has derived in part from the EC Treaty⁸⁷ and also from the national laws of Member States, has had a decisive influence on the interpretation of the EC Treaty itself. It is of particular importance to, and forms a fundamental element of, the provisions of the Treaty that establish the Internal Market. As often pointed out, violations of the equal treatment principles generate tax obstacles to cross-border economic activity in the Internal Market.⁸⁸ In EC Tax Law, prohibition of discrimination is a common thread for the fundamental freedoms provisions: Article 39 EC guarantees freedom of movement for workers

85. See, e.g., Case C-279/93, Finanzamt Köln-Altstadt v. Schumacker, 1995 E.C.R. I-225, para. 21; Case C-80/94, Wielockx v. Inspecteur der Directe Belastingen, 1995 E.C.R. I-2493, para. 16; Case C-107/94, Asscher v. Staatssecretaris van Financiën, 1996 E.C.R. I-3089, para. 36; Case C-250/95, Futura Participations SA and Singer v. Admin. des Contributions, 1997 E.C.R. I-2471, para. 19; Case C-118/96, Safir v. Skattemyndigheten i Dalarnas Län, 1998 E.C.R. I-1897, para. 21; Case C-264/96, ICI v. Colmer, 1998 E.C.R. I-4695, para. 19; Case C-311/97, Royal Bank of Scotland plc v. Greece, 1999 E.C.R. I-2651, para. 19; Case C-391/97, Gschwind v. Finanzamt Aachen-Außenstadt, 1999 E.C.R. I-5451, para. 20; Case C-307/97, Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt, 1999 E.C.R. I-6161, para. 57; Case C-294/97, Eurowings Luftverkehrs AG v. Finanzamt Dortmund-Unna, 1999 E.C.R. I-7447, para. 32; Case C-55/98, Skatteministeriet v. Bent Vestergaard, 1999 E.C.R. I-7641, para. 15; Case C-251/98, Baars v. Inspecteur der Belastingdienst Particulieren, 2000 E.C.R. I-2787, para. 17; Case C-35/98, Staatssecretaris van Financiën v. Verkooijen, 2000 E.C.R. I-4071, para. 32; Case C-156/98, Germany v. Commission, 2000 E.C.R. I-6857, para. 80; Case C-141/99, AMID v. Belgium, 2000 E.C.R. I-11619, para. 19; Joined Cases 397 and 410/98, Metallgesellschaft Ltd. and Others v. Commissioners of Inland Revenue, 2001 E.C.R. I-1727, para. 37; Case C-55/00, Gottardo, 2002 E.C.R. I-413, para. 32; Case C-431/01, Mertens v. Belgium, 2002 E.C.R. I-7073, para. 25; Case C-136/00, Danner, 2002 E.C.R. I-8147, para. 28; Case C-436/00, X, Y v. Riksskatteverket, 2002 E.C.R. I-10829, para. 32; Case C-324/00, Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt, 2002 E.C.R. I-11779, para. 26; Case C-385/00, De Groot v. Staatssecretaris van Financiën, 2002 E.C.R. I-11819, para. 75; Case C-422/01, Ramstedt v. Riksskatteverket, 2003 E.C.R. I-6817, para. 25.

86. Case C-279/93, Finanzamt Köln-Altstadt v. Schumacker, 1995 E.C.R. I-225, para. 30; Case C-80/94, Wielockx v. Inspecteur der Directe Belastingen, 1995 E.C.R. I-2493, para. 17; Case C-107/94, Asscher v. Staatssecretaris van Financiën, 1996 E.C.R. I-3089, para. 40; Case C-311/97, Royal Bank of Scotland plc v. Greece, 1999 E.C.R. I-2651, para. 26; Case C-391/97, Gschwind v. Finanzamt Aachen-Außenstadt, 1999 E.C.R. I-5451, para. 21; Case C-431/01, Mertens v. Belgium, 2002 E.C.R. I-7073, para. 32. However, very different treatment of not very different situations may be seen as a third category. See Richard Lyal, *Non-discrimination and Direct Tax in Community Law*, 12 EC TAX REV. 68 (2003).

87. See, e.g., EC Treaty arts. 12, 34, 39, 43, 49, 56 and 58.

88. See, e.g., Company Taxation in the Internal Market, *supra* note 20, at 309–318.

within the Community, including the abolition of any discrimination based on nationality, Article 43 EC prohibits restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State, Article 49 EC prohibits restrictions on freedom to provide services within the Community, and Article 56 EC prohibits restrictions on the movement of capital between Member States and between Member States and third countries, subject to certain caveats contained in Article 58 EC.⁸⁹ Due to the so-called convergence of the fundamental freedoms, all freedoms basically follow the same pattern of protection of cross-border economic activities in their respective form.⁹⁰ It must furthermore be noted that, of course, each of the Treaty freedoms is directly applicable in the Member States and takes precedence over domestic legislation to the extent of any inconsistency.⁹¹ Undoubtedly the fundamental freedoms of the EC Treaty apply also to provisions in double taxation treaties;⁹² EC Law, of course, also prevails over

89. EC Treaty arts. 39, 43, 49, 56 and 58.

90. See generally CORDEWENER, *supra* note 8, at 103.

91. Case 270/83, *Commission v. France*, 1986 E.C.R. 273 (“*avoir fiscal*”), para. 13; Case 81/87, *The Queen v. H.M. Treasury*, 1988 E.C.R. 5483, para. 15; Case C-1/93, *Halliburton Serv. BV v. Staatssecretaris van Financien*, 1994 E.C.R. I-1137, para. 16; Case C-307/97, *Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt*, 1999 E.C.R. I-6161, para. 33; Case C-311/97, *Royal Bank of Scotland plc v. Greece*, 1999 E.C.R. I-2651, para. 22; Case C-251/98, *Baars v. Inspecteur der Belastingdienst Particulieren*, 2000 E.C.R. I-2787, para. 27. See also, e.g., *TERRA & WATTEL*, *supra* note 13, at 29. While the provisions on the free movement of goods, services, and persons were considered to be directly applicable in the Member States since the end of the transitional period on Dec. 31, 1969, the free movement of capital has a somewhat moved history. See, e.g., *Joined Cases C-397/98 and C-410/98, Metallgesellschaft Ltd. v. Commissioners of Inland Revenue*, 2001 E.C.R. I-1727, para. 41. In a nutshell, Art 67 of the EEC Treaty was considered not to be directly applicable. Case C-484/93, *Svensson and Gustavsson v. Ministre du Logement et de l’Urbanisme*, 1995 E.C.R. I-3955, para. 5. However, it should be noted in that regard that restrictions on movements of capital were abolished by Council Directive 88/361/EEC of 24 Jun. 1988 for the implementation of Article 67 of the Treaty, arts. 1, 4, 1988 O.J. (L 178) 5. The decisive Articles 1 and 4 of this Directive had direct effect since July 1, 1990. See *Joined Cases C-358/93 and C-416/93, Bordessa*, 1995 E.C.R. I-361, paras. 32–33; Case C-484/93, *Svensson and Gustavsson v. Ministre du Logement et de l’Urbanisme*, 1995 E.C.R. I-3955, para. 6. With effect of Jan. 1, 1994, the Maastricht Treaty introduced new provisions on “Capital and payments” in the EC Treaty, including Art 73b, which substantially reproduced the contents of Art 1 of Directive 88/361/EEC. After the Treaty of Amsterdam, Art 73b was renumbered as Art 56 EC. Thus, effectively since Jan. 7, 1990 the freedom of capital movement is directly applicable in the Member States. See *Bordessa*, 1995 E.C.R., at paras. 32–33. However, the concept of movement of capital is neither defined in Art 56 nor in the Directive. Case C-222/97, *Trummer und Mayer*, 1999 E.C.R. I-1661, para. 20. Nevertheless, the Nomenclature of capital movements in Annex I of the Directive still indicates the scope of capital movements for the purpose of Art 56 and Art 1 of the Directive. See, *id.* at para 21; Case C-464/98, *Westdeutsche Landesbank Girozentrale v. Stefan*, 2001 E.C.R. I-0173, para. 5; see also EFTA-Court Case E-1/00, *Íslandsbanki*, para. 14.

92. See, Michael Lang, *Die Bindung der Doppelbesteuerungsabkommen an die Grundfreiheiten des EU-Rechts*, in: *DOPPELBESTEUERUNGSABKOMMEN UND EU-RECHT* 25,

22 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

bilateral treaties by virtue of hierarchy – *lex superior derogat de lege inferiori*.⁹³

These freedoms aim at removing the borders between the Member States (as much as possible) for intra-EC economic activities, and give, *inter alia*, specific expression to the prohibition of discrimination on grounds of nationality in Article 12 EC – itself a manifestation of the general principle of equal treatment. However, the fundamental freedoms are two faced: They do not only require the elimination of all discrimination against a person making use of such freedom on ground of his nationality, but also the abolition of any restriction, even if it applies without distinction to own nationals and to those of other Member States. Despite the fact that historically the fundamental freedoms were viewed (only) as a specific form of the general principle of non-discrimination under Article 12 EC,⁹⁴ the ECJ has expanded the scope of the fundamental freedoms well beyond the prohibition of discrimination because the provisions regarding the Treaty freedoms refer generally to “restrictions” to the exercise of the freedoms guaranteed by them.

The overriding importance of these provisions also for the field of direct taxation was first encountered in 1986, when the Court extended its case law on the four freedoms to the sphere of direct taxation in its judgment in the *Commission v. France* case,⁹⁵ commonly known as the “*avoir fiscal*” case. The Court held that a national tax law that refused a dividend imputation tax credit to permanent establishments of foreign (nonresident) companies while granting it to resident companies was contrary to Community law.⁹⁶ Unsurprisingly, this decision caused a great deal of confusion among practitioners of international tax law at the time; for them, it was practically unheard of that non-residents and residents could not be subjected to different tax treatment, since such different treatment is usually a cornerstone of national tax laws. However, since the decision in *avoir fiscal*, the jurisprudence in this area has developed rapidly and it is fair to say that of all the Community institutions, the Court has so far proved to be the most efficient at removing tax obstacles to cross-border economic activities within the EC.

27 (Wolfgang Gassner et al. eds., 1996); PISTONE, *supra* note 3, at 11); *see also* Case 270/83, *Commission v. France*, 1986 E.C.R. 273 (“*avoir fiscal*”), para. 26; Case C-307/97, *Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt*, 1999 E.C.R. I-6161, para. 58.

93. *E.g.*, PISTONE, *supra* note 3, at 84; *see also* Hinnekens, *supra* note 22, at 160.

94. For a comprehensive historical overview *see*, for example, CORDEWENER, *supra* note 8, at 104. For the relationship between EC Treaty art. 12 and the fundamental freedoms, *see also infra* Part 0.

95. Case 270/83, *Commission v. France*, 1986 E.C.R. 273 (“*avoir fiscal*”), para. 27.

96. *See generally id.*

In its non-tax case law on the free movement of goods, the Court has repeatedly held that non-discriminatory restrictions are unlawful unless justified by defined imperative requirements of public interest. As early as its 1974 decision in the *Dassonville* case,⁹⁷ the Court held that all trading rules which are capable of hindering intra-EC trade – directly or indirectly, actually or potentially – are in contradiction with Article 28 EC. In the widely cited decision in the *Cassis-de-Dijon* case,⁹⁸ the Court qualified the compatibility of such restrictions with the Treaty freedoms (because of their negative effect on trade) to situations where they are necessary for the protection of certain public interests, such as fiscal supervision, public health, and consumer protection. Thus, for example, domestic product regulations cannot be applied to products imported from other Member States – even though they did not discriminate against imported goods – unless such restrictions can be justified on imperative grounds such as fair trading, consumer protection, or environmental protection. However, with regard to Article 39 EC, Article 43 EC, and Article 49 EC, the question whether the fundamental freedoms also exceed beyond the prohibition of discrimination was disputed for a long time.⁹⁹ The ECJ has in recent years answered this question to the affirmative. In the *Säger* case,¹⁰⁰ the Court transposed this “restriction based approach” to cover the free provision of services. Many other cases show that such approach also applies to the other fundamental freedoms, although, as the *Keck* case¹⁰¹ may show that the breadth, and more importantly the limitations, of this approach are not yet clarified.

However, this restriction based approach has not gained much importance in the area of direct taxation, which may be due to two reasons: First, most tax cases are clearly based on the classical pattern of a distinction between cross-border and domestic situations and thus may easily be solved under the principle of non-discrimination. Second, the scope of a restriction based approach may be very narrow in the area of direct taxation¹⁰² because one “must not arrive at a situation where Member States are required to justify as ‘imperative

97. Case 8/74, *Procureur du Roi v. Benoît and Gustave Dassonville*, 1974 E.C.R. 837, para. 5.

98. Case 120/78, *Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein*, 1979 E.C.R. 649, para. 8.

99. See, e.g., CORDEWENER, *supra* note 8, at 106.

100. Case C-76/90, *Säger v. Dennemeyer & Co.*, 1991 E.C.R. I-4221, para. 12.

101. Opinion of AG Van Gerven, Case C-267/91, *Keck*, 1993 E.C.R. I-06097, para. 4.

102. For the possible scope of the restriction based approach in tax law, see, for example, CORDEWENER, *supra* note 8, at 843.

24 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

requirements' all kinds of provisions of their legislation, for instance rates of corporate taxation or their rates of VAT, which are higher than elsewhere," whenever someone claims that such a provision makes the exercise of a fundamental freedom less attractive.¹⁰³ Therefore it should be noted that the Court has so far only applied a restriction based analysis unequivocally to compliance issues, such as accounting records required of a branch to substantiate losses.¹⁰⁴ Despite these hints of a broader approach and the tendency in the Court's analysis towards a restriction based approach, the issue of MFN treatment is clearly an issue of non-discrimination, i.e., the equality-component of the four freedoms, and not a question of non-restriction, i.e., the liberty-component of the four freedoms.¹⁰⁵

B. "Overt" and "Covert" Discrimination on Grounds of Nationality in Tax Law

The non-discrimination principle of the EC Treaty, as specifically laid down in the fundamental freedoms, applies by reference to nationality, i.e., as Article 12 EC states, "discrimination on grounds of nationality shall be prohibited."¹⁰⁶ With regard to companies or firms formed in accordance with the laws of a Member State, their corporate seat¹⁰⁷ serves to determine, like nationality for natural persons, their connection to a Member State's legal order¹⁰⁸ without any regard to the residence of their shareholders.

Thus, for example, the freedom of establishment under

103. Opinion AG Mischo, Case C-255/97, *Pfeiffer Großhandel GmbH v Löwa Warenhandel GmbH*, 1999 E.C.R. I-2835, para. 58.

104. See Case C-250/95, *Futura Participations SA and Singer v. Admin. des Contributions*, 1997 E.C.R. I-2471, para. 76; see also *Hinnekens*, *supra* note 18, at 115; *Lyal*, *supra* note 76, at 70; Paul Farmer, *The Court's case law on taxation: a castle built on shifting sands?* 2 EC TAX REV. 75, 78-79 (2003).

105. See CORDEWENER, *supra* note 8, at 837; Tietje, *supra* note 3, at 408.

106. EC Treaty, art. 12.

107. Art 48 EC requires that companies formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the EU are to be treated in the same way as natural persons who are nationals of Member States. See, e.g., *Commission v. France*, 1986 E.C.R. at para. 18; Case C-330/91, *The Queen v. Inland Revenue Commissioners, ex parte Commerzbank AG*, 1993 E.C.R. I-4017, para. 13; Case C-264/96, *Imperial Chem. Indus. (ICI) v. Colmer*, 1998 E.C.R. I-4695, para. 20; Case C-311/97, *Royal Bank of Scotland plc v. Greece*, 1999 E.C.R. I-2651, para. 23; Case C-141/99, *AMID v. Belgium*, 2000 E.C.R. I-11619, para. 20.

108. Case 270/83, *Commission v. France*, 1986 E.C.R. at para. 18; *Queen v. Inland Revenue Commissioners*, 1993 E.C.R. at para. 13; *ICI*, 1998 E.C.R. at para. 20; Case C-307/97, *Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt*, 1999 E.C.R. I-6161, para. 35; *Royal Bank of Scotland*, 1999 E.C.R. at para. 23; *Joined Cases C-397/98 and 410/98, Metallgesellschaft Ltd. v. Commissioners of Inland Revenue*, 2001 E.C.R. I-1727, para. 42; *AMID*, 2000 E.C.R. at para. 20.

Article 43 EC and Article 48 EC guarantees to nationals of the Member States and companies which are assimilated to them the same treatment in the host Member State as that is accorded to nationals of that Member State.¹⁰⁹ Under Article 43 EC, this includes “the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.” A difference in tax treatment based on the place of incorporation of a corporate entity may therefore amount to a so-called “overt” discrimination. This interpretation is based on the wording of Article 43 EC, under which “restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited.”¹¹⁰

However, the ECJ has made clear that the rules regarding equal treatment forbid not only *overt* discrimination by reason of nationality but also all *covert* forms of discrimination that, by the application of other criteria of differentiation, lead in fact to the same result.¹¹¹ This is especially important for tax rules, since, in principle, none of the Member States imposes its taxing rights by reference to the nationality of the taxpayers but operate with the concept of residence.¹¹² Thus, differences in treatment based on tax residence are treated as giving rise to covert, or indirect, discrimination on the basis that non-residents usually are nationals of another Member State.¹¹³ It must furthermore be kept in mind that discrimination can only result from different treatment of similar situations and vice versa; thus, the comparability of situations is a main cornerstone in the ECJ's

109. Commission v. France, 1986 E.C.R., at para. 13; *Saint-Gobain*, 1999 E.C.R. at para. 34; *ICI*, 1998 E.C.R. at para. 20; *Royal Bank of Scotland*, 1999 E.C.R. at paras. 22–23; Queen v. Inland Revenue Commissioners, 1993 E.C.R. at para. 13; *Metallgesellschaft*, 2001 E.C.R. at para. 41; *AMID*, 2000 E.C.R. at para. 20.

110. EC Treaty, art. 43.

111. Queen v. Inland Revenue Commissioners, 1993 E.C.R. at para. 14; Case C-1/93, *Halliburton Serv. BV v. Staatssecretaris van Financiën*, 1994 E.C.R. I-1137, para. 15; Case C-279/93, *Finanzamt Köln-Altstadt v. Schumacker*, 1995 E.C.R. I-225, para. 26; Case C-254/97, *Baxter*, 1999 E.C.R. I-480, para. 10; Case C-87/99, *Zurstrassen v. Admin. des Contributions Directes*, 2000 E.C.R. I-3337, para. 18; Case C-156/98, *Germany v. Commission*, 2000 E.C.R. I-6857, para. 83; see also Case C-294/97, *Eurowings Luftverkehrs AG v. Finanzamt Dortmund-Unna*, 1999 E.C.R. I-7447, para. 33.

112. See Brigitte Knobbe-Keuk, *Restrictions on the Fundamental Freedoms Enshrined in the EC Treaty by Discriminatory Tax Provisions – Ban and Justification*, 3 EC TAX REV. 74, 76 (1994); Gammie & Brannan, *supra* note 10, at 396; Martin Jann, *How Does EC Law Affect Benefits Available to Non-Resident Taxpayer under Tax Treaties?*, in TAX TREATIES AND EC LAW 33, 48 (Wolfgang Gassner et al. eds., Kluwer Law Int'l 1997) (1996).

113. See, e.g., *Schumacker*, 1995 E.C.R. at para. 28; Case C-107/94, *Asscher v. Staatssecretaris van Financiën*, 1996 E.C.R. I-3089, para. 38; *Eurowings Luftverkehrs*, 1999 E.C.R. at para. 35; Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt*, 2002 E.C.R. I-11779, para. 28. See also, e.g., David B. Oliver, *Tax Treaties and the Market-State*, 56 TAX L. REV. 587, 593 (2003).

26 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

case law.¹¹⁴ In this regard it should be noted that in a line of case law, which seems to be limited to benefits resulting from the taking into account of personal and family circumstances, the situations of resident individuals and non-resident individuals are generally not comparable, unless it is established that, having regard to the purpose and content of the national provisions in question, the two categories of taxpayers are in a comparable situation.¹¹⁵

The archetypal form of discrimination that the Court has found unlawful arises in situations where the tax treatment of residents of a Member State is less burdensome than that to which non-residents of that Member State are subjected. For example, the Court has found in several occasions that less favourable tax treatment by a Member State of a permanent establishment of a company established in another Member State is discriminatory and incompatible with the Treaty freedoms.¹¹⁶ Although much of the case law is concerned with non-residents who are nationals of another Member State, the EC Treaty also protects individuals from measures adopted by their own Member State which restrict the exercise of Treaty freedoms.¹¹⁷ Furthermore, it is settled case law that discriminatory tax treatment of a subsidiary based on the reason that its parent company is resident in another Member State is prohibited.¹¹⁸ In this respect the ECJ has frequently dealt with cases where tax benefits were denied to resident parent or subsidiary companies because their respective counterpart was resident in another Member State, and in every case has held that such treatment is an unjustified infringement of the EC Treaty.¹¹⁹ Thus, a host

114. See, e.g., *Royal Bank of Scotland*, 1999 E.C.R. at para. 27.

115. See, e.g., *Schumacker*, 1995 E.C.R. at para. 31; Case C-80/94, *Wielockx v. Inspecteur der Directe Belastingen*, 1995 E.C.R. I-2493, para. 18; *Asscher*, 1996 E.C.R. at para. 41; Case C-391/97, *Gschwind v. Finanzamt Aachen-Außenstadt*, 1999 E.C.R. I-5451, para. 22; *Zurstrassen*, 2000 E.C.R. at para. 21. See also *Royal Bank of Scotland*, 1999 E.C.R. at para. 27.

116. See, e.g., *Commission v. France*, 1986 E.C.R. at para. 27; *Saint-Gobain*, 1999 E.C.R. at para. 63; Case C-311/97, *Royal Bank of Scotland*, 1999 E.C.R. at para. 34.

117. See, e.g., Case 81/87, *The Queen v H.M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail*, 1988 E.C.R. 5483, para. 16; *ICI*, 1998 E.C.R. at para. 21; Case C-200/98, *X AB and Y AB v. Riksskatteverket*, 1999 E.C.R. I-8261, para. 26; Case C-251/98, *Baars v. Inspecteur der Belastingdienst Particulieren*, 2000 E.C.R. I-2787, para. 28; *AMID*, 2000 E.C.R. at para. 21; Case C-431/01, *Mertens v. Belgium*, 2002 E.C.R. I-7073, para. 27; see also, e.g., *Lyal*, *supra* note 87, at 71; *Farmer*, *supra* note 105, at 77.

118. For a discussion of these situations see, for example, *Kofler* *supra* note 27, at 554.

119. In the *ICI* case, the Court evaluated a British rule under which the utilization of losses of subsidiaries, which were held by a intermediate holding company, by their parent company was just if the holding company mainly held British subsidiaries. *ICI*, 1998 E.C.R. at paras. 2, 30. In the *X AB and Y AB* case, the ECJ was confronted with Swedish provisions under which certain tax benefits for inter-company payments were

state subsidiary cannot be treated less favorably because its parent company is a resident of another Member State.¹²⁰

C. *Justifications and the “Rule of Reason” in Direct Taxation*

Once it appears that a different rule applies to objectively comparable situations by reference either to nationality as such, i.e., an overt discrimination, or to some other criterion that draws a similar distinction in most cases, i.e., a covert discrimination, the emphasis shifts to a consideration of whether the Member State in question can justify that infringement of the freedoms guaranteed by the EC Treaty. While in the former case the possible grounds of justification are, under the current, but still evolving case law of the ECJ, limited to the very narrow circumstances explicitly described in the EC Treaty: public policy, public security or public health.¹²¹ The latter, as well as non-discriminatory restrictions, may be justified based on a much broader “rule of reason”.¹²²

Focusing on the “usual” case of a covert discrimination in the tax area, this discrimination can, under the aforementioned “rule of reason,” be justified only if that provision pursues a legitimate

not available in cases where foreign subsidiaries were involved; the Court simply held that such differentiation based on the residence of a subsidiary is a forbidden discrimination. Case C-200/98, X AB and Y AB v. Riksskatteverket, 1999 E.C.R. I-8261, paras. 32–33. In the *Baars* case, the Court had to deal with a Dutch provision which granted tax benefits for shareholders of Dutch companies, but denied such benefits to shareholders of other EU companies. Case C-251/98, *Baars v. Inspecteur der Belastingdienst Particulieren*, 2000 E.C.R. I-2787, para. 4; see also Case C-35/98, *Staatssecretaris van Financiën v. Verkooijen*, 2000 E.C.R. I-4071, para. 2. The court impressively confirmed this case law in the *Metallgesellschaft* and *Hoechst* cases, in which the option to a group relief and the connected renunciation of advance corporate tax payments was only available where parent and subsidiary were residents of the UK; in this case the ECJ plainly stated that the residency of the parent company must not lead to an unequal taxation of the subsidiary its Member State of residence. *Metallgesellschaft*, 2001 E.C.R. at para. 96. Furthermore, in the *Lankhorst-Hohorst* case, the ECJ held that German thin capitalization rules which only apply for cross-border payments are an infringement of the EC TREATY. Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt*, 2002 E.C.R. I-11779, para. 32. Finally, as the Court held in the *Bosal* case, a differentiation between the deductibility of financing costs for domestic subsidiaries and those for subsidiaries which are resident in other Member States, is not in compliance with EC Law. Case C-168/01, *Bosal Holding BV v. Staatssecretaris van Financiën*, 2003 E.C.R. I-9409, paras. 2, 43.

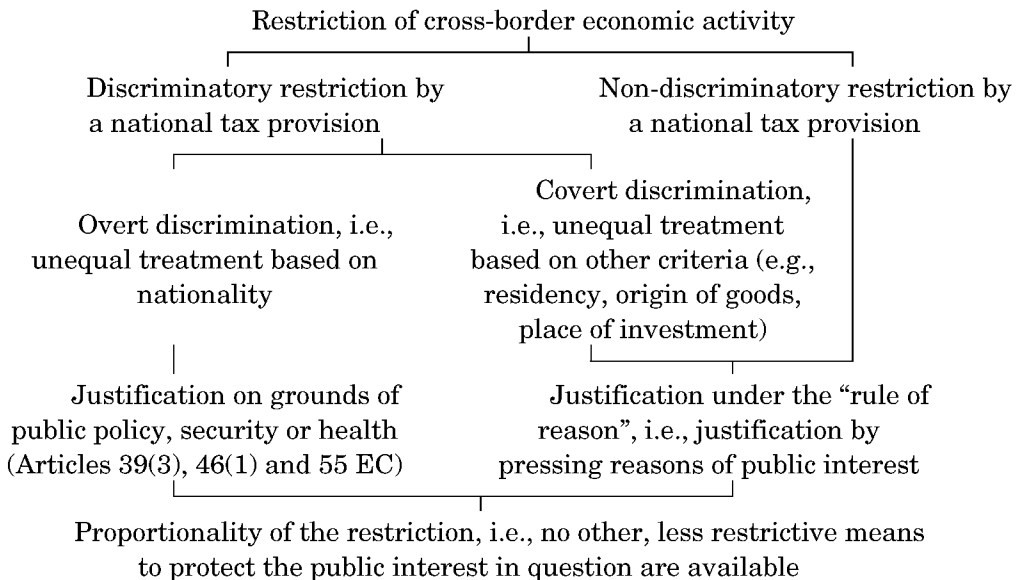
120. *Metallgesellschaft*, 2001 E.C.R. at para. 42; Case C-436/00, X, Y v. Riksskatteverket, 2002 E.C.R. I-10829, para. 38; *Lankhorst-Hohorst*, 2002 E.C.R. at para. 32.

121. See EC Treaty, arts. 39(3), 46(1) and 55.

122. For a recent discussion of the relationship between the type of discrimination and the available grounds of justification, see, for example, Georg W. Kofler, *Ramstedt: Benachteiligung von Beitragszahlungen an ausländische Rentenversicherer ist nicht mit der Dienstleistungsfreiheit vereinbar!* 2003 ÖSTZ 404, 406.

aim compatible with the EC Treaty and is justified by pressing reasons of public interest, i.e., objective factors other than nationality.¹²³ But even in such case, it would still have to be of such a nature as to ensure achievement of the aim in question and not go beyond what was necessary for that purpose.¹²⁴ Thus, in order to satisfy the proportionality test, the provision in question must be necessary in the sense that there would be no other less-restrictive means to protect the public interest in question.

This said, the basic structure of the application of the four fundamental freedoms – from the perspective of the host Member State – and the possible grounds of justification may be outlined in very simplified manner as follows:¹²⁵



However, a justification of an infringement in the ECJ's case law is quite restrictive. For example, the reduction in tax revenue

123. See, e.g., Case C-204/90, *Bachmann v. Belgium*, 1992 E.C.R. I-249, para. 21; Case C-300/90, *Commission v. Belgium*, 1992 E.C.R. I-305, para. 14; *Asscher*, 1996 E.C.R. at para. 49 et seq.; Case C-136/00, *Danner*, 2002 E.C.R. I-8147, paras. 33, 44. It may be noted that under settled case law the inquiries for and the possibility of a justification of covert discriminations are basically identical under all four freedoms, including the freedom of capital movement, although Art 58 EC contains some further guidelines. See also CORDEWENER, *supra* note 8, at 130.

124. Case C-250/95, *Futura Participations SA and Singer v. Admin. des Contributions*, 1997 E.C.R. I-2471, para. 26; Case C-35/98, *Staatssecretaris van Financien v. Verkooijen*, 2000 E.C.R. I-4071, para. 43; Case C-436/00, *X, Y v. Riksskatteverket*, 2002 E.C.R. I-10829, para. 49; *Lankhorst-Hohorst*, 2002 E.C.R. at para. 33.

125. See Kofler, *supra* note 123, at 406.

can not be regarded as a matter of overriding general interest which can be relied upon in order to justify unequal treatment that is, in principle, incompatible with Article 43 EC.¹²⁶ Neither can the host state justify a different tax treatment on the basis that the non-resident taxpayer or its subsidiary receives more favorable treatment under other rules of the host state's tax system.¹²⁷ On the other hand, it is clear from the case law of the ECJ that the need to safeguard the cohesion of a tax system,¹²⁸ the prevention of tax evasion or tax avoidance,¹²⁹ or the effectiveness of fiscal supervision¹³⁰ can constitute overriding requirements of general interest capable of justifying a restriction on the exercise of fundamental freedoms guaranteed by the EC Treaty.¹³¹ However, the *in abstracto* recognition of the prevention of tax evasion as a ground of justification has to date *in concreto* never been able to save restrictive national measures brought before the ECJ.¹³² This said, it may generally be stated that the Court has been very reluctant to accept justifications put forward on the basis of the administrative difficulties involved in

126. *ICI*, 1998 E.C.R. at para. 28; *Metallgesellschaft*, 2001 E.C.R. at para. 59; *Saint-Gobain*, 1999 E.C.R. at para. 51; Case C-35/98, *Staatssecretaris van Financiën v. Verkooijen*, 2000 E.C.R. I-4071, para. 48; Case C-436/00, *X, Y v. Riksskatteverket*, 2002 E.C.R. I-10829, para. 50.

127. See, e.g., *Commission v. France*, 1986 E.C.R. at para. 21; Case C-330/91, *The Queen v. Inland Revenue Commissioners, ex parte Commerzbank AG*, 1993 E.C.R. I-401, para. 16; *Saint-Gobain*, 1999 E.C.R. at para. 51; *AMID*, 2000 E.C.R. at para. 27.

128. *Bachmann*, 1992 E.C.R. at para. 21.; Case C-300/90, *Commission v. Belgium*, 1992 E.C.R. I-305, para. 14. However, since those two cases, which were basically decided upon a wrong factual and legal determination of the facts, the ECJ has subsequently denied a justification on the ground of the cohesion of the tax system. See, e.g., Case C-279/93, *Finanzamt Köln-Altstadt v. Schumacker*, 1995 E.C.R. I-225, para. 40–41; Case C-80/94, *Wielockx v. Inspecteur der Directe Belastingen*, 1995 E.C.R. I-2493, para. 13; Case C-484/93, *Svensson and Gustavsson v. Ministre du Logement et de l'Urbanisme*, 1995 E.C.R. I-3955, para. 15; Case C-55/98, *Skatteministeriet v. Bent Vestergaard*, 1999 E.C.R. I-7641, para. 24; *ICI*, 1998 E.C.R. at para. 29; *Eurowings Luftverkehrs*, 1999 E.C.R. at para. 41; Case C-251/98, *Baars v. Inspecteur der Belastingdienst Particulieren*, 2000 E.C.R. I-2787, para. 37; Case C-35/98, *Staatssecretaris van Financiën v. Verkooijen*, 2000 E.C.R. I-4071, para. 49; *Metallgesellschaft*, 2001 E.C.R. at para. 67; Case C-136/00, *Danner*, 2002 E.C.R. I-8147, para. 33; Case C-324/00, *Lankhorst-Hohorst*, 2002 E.C.R. at para. 40; Case C-422/01, *Ramstedt v. Riksskatteverket*, 2003 E.C.R. I-6817, para. 30.

129. *ICI*, 1998 E.C.R. at para. 26; *Metallgesellschaft*, 2001 E.C.R. at para. 57; Case C-436/00, *X, Y v. Riksskatteverket*, 2002 E.C.R. I-10829, para. 61; *Lankhorst-Hohorst*, 2002 E.C.R. at para. 37.

130. *Futura Participations*, 1997 E.C.R. at para. 31; Case C-254/97, *Baxter*, 1999 E.C.R. I-4809, para. 18; Case C-55/98, *Skatteministeriet v. Bent Vestergaard*, 1999 E.C.R. I-7641, para. 25; *Danner*, 2002 E.C.R. at para. 51.

131. See Case C-55/98, *Skatteministeriet v. Bent Vestergaard*, 1999 E.C.R. I-7641, para. 23, regarding such justifications in the context of restrictions concerning a difference in income tax treatment.

132. See *TERRA & WATTEL*, *supra* note 13, at 77; see, e.g., *ICI*, 1998 E.C.R. at para. 26; *Lankhorst-Hohorst*, 2002 E.C.R. at para. 37.

30 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

ensuring efficient fiscal supervision or the prevention of tax avoidance.¹³³ It has taken the view that Member States should, if need be, provide each other with mutual assistance to overcome such difficulties.¹³⁴

Furthermore, as mentioned before, an insight into the case law concerning national rules on direct taxation shows that the Court has enforced the principle of non-discrimination very strictly. In line with general principles developed outside the tax field, the Court has rejected a number of justifications for discriminatory measures advanced by Member States, many of them repeatedly. These include, for example, the lack of harmonization of direct taxation.¹³⁵ In such a case, a non-resident could have avoided the discrimination by, among other things, setting up a subsidiary company rather than a branch,¹³⁶ economic aims or the protection of tax revenue,¹³⁷ the absence of reciprocity,¹³⁸ the existence of discretionary or equitable procedures to ensure appropriate fiscal treatment,¹³⁹ or by the lower taxation of a service provider in its country of residence as a justification for higher, compensatory taxation of the recipient of the services.¹⁴⁰

Finally, a particularly delicate area is the interpretation of the free movement of capital and payments as provided for in Articles 56 and 58 EC as the latter makes an express reference to permissible non-discriminatory restrictions while at the same time prohibiting arbitrary discrimination and disguised restrictions. Under Article 58(1)(a) EC, the Member States keep the right “to apply the relevant provisions of their tax law which

133. See, e.g., Case C-254/97, *Baxter*, 1999 E.C.R. I-4809, para. 18–19; Case C-55/98, *Skatteministeriet v. Bent Vestergaard*, 1999 E.C.R. I-7641, para. 22–25.

134. See Council Directive 77/799/EEC, 1977 O.J. (L 336) 15 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation; *Schumacker*, 1995 E.C.R. at para. 45; Case C-55/98, *Skatteministeriet v. Bent Vestergaard*, 1999 E.C.R. I-7641, para. 26–28; *Danner*, 2002 E.C.R. at para. 49.

135. See, e.g., Case 270/83, *Commission v. France*, 1986 E.C.R. 273, para. 24; *Bachmann*, 1992 E.C.R. at para. 10–11; see also *Knobbe-Keuk*, *supra* note 113, at 78.

136. *Commission v. France*, 1986 E.C.R. at para. 22; see also *Saint-Gobain*, 1999 E.C.R. at para. 42.

137. *ICI*, 1998 E.C.R. at para. 28; *Metallgesellschaft*, 2001 E.C.R. at para. 59; *Saint-Gobain*, 1999 E.C.R. I-6161, para. 50; Case C-35/98, *Staatssecretaris van Financien v. Verkooijen*, 2000 E.C.R. I-4071, para. 48; *Danner*, 2002 E.C.R. at para. 56; Case C-436/00, *X, Y v. Riksskatteverket*, 2002 E.C.R. I-10829, para. 50; *Lankhorst-Hohorst*, 2002 E.C.R. at para. 36.

138. See, e.g., *Commission v. France*, 1986 E.C.R. at para. 26.

139. See Case C-279/93, *Finanzamt Köln-Altstadt v. Schumacker*, 1995 E.C.R. I-225, para. 53–57.

140. See, e.g., Case C-294/97, *Eurowings Luftverkehrs AG v. Finanzamt Dortmund-Unna*, 1999 E.C.R. I-7447, para. 43–44; *Danner*, 2002 E.C.R. at para. 56.

distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested;" Article 58(3) EC on the other side states specifically that the national provisions referred to by Article 58(1)(a) EC are not to constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments, as defined in Article 56 EC.¹⁴¹ Until recently, the interpretation of these clauses was unclear. However, the prevailing opinion in legal writing suggested that they just have clarifying character.¹⁴² In the *Verkooijen* case¹⁴³ the ECJ basically confirmed this view and qualified Article 58(1)(a) EC as a codification of its prior case law. The Court stated that according to that case law, national tax provisions of the kind to which Article 58(1)(a) EC refers – in so far as they establish certain distinctions based, in particular, on the residence of taxpayers – could be compatible with EC Law provided that they applied to situations which were not objectively comparable or could be justified by overriding reasons in the general interest, in particular in relation to the cohesion of the tax system.¹⁴⁴

III. MOST-FAVORED-NATION TREATMENT IN BILATERAL DOUBLE TAXATION TREATIES?

A. *A Clash of Principles: Internal Market vs. Sovereignty of the Member States*

In the absence of unifying or harmonizing measures adopted in the Community, in particular under Article 293 EC,¹⁴⁵ the Member States remain competent to determine the criteria for taxation of income and wealth with a view to eliminating double taxation by means, *inter alia*, of international agreements.¹⁴⁶ Thus, since taxation of income and profits still falls within the competence of the Member States, they are at liberty to conclude

141. EC Treaty art. 58.

142. See, e.g., Dautzenberg, *supra* note 36, at 541.

143. See Case C-35/98, *Staatssecretaris van Financiën v. Verkooijen*, 2000 E.C.R. I-4071, para. 41–43.

144. See CORDEWENER, *supra* note 8, at 747; Leo Flynn, *Coming of Age: The Free Movement of Capital Case Law 1993-2002*, 39 CML REV. 773, 793 (2002).

145. Under the second indent of Art 293 EC the Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals "the abolition of double taxation within the Community." EC Treaty, art. 293.

146. Case C-307/97, *Saint-Gobain*, 1999 E.C.R. at para. 56; see also, e.g., Avery Jones, *supra* note 40, at 96.

32 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

bilateral double taxation treaties.¹⁴⁷ From this liberty it may be derived that the EC Treaty accepts that tax treaties are individual bargains between states. Thus it may furthermore seem inconceivable that the EC Treaty would encourage Member States to negotiate tax treaties if, having done so, one could on the basis of MFN treatment pick the best of each states treaties. The subsequent argument is that MFN treatment would destroy either the bargain or the balance, and would eventually lead to a situation where no treaties are concluded at all, because budgetary restraints would not allow a state to grant, for example, a very low withholding tax rate to all other Member States. However dramatized, this situation would be the exact opposite of what Article 293 EC requires, that is, the “abolition of double taxation within the Community.”¹⁴⁸

However, this alone seems not to be enough of an argument against MFN treatment, since it is nevertheless undisputed that, as far as the exercise of the power of taxation so allocated is concerned, the Member States may not disregard EC Law.¹⁴⁹ The ECJ thus transfers the demands on domestic legislation¹⁵⁰ also to the level of bilateral tax treaties by stating in a tax treaty context that, “although direct taxation is a matter for the Member States, they must nevertheless exercise their taxation powers consistently with Community law.”¹⁵¹ However, as the ECJ has already stated in this context, the Member States are at liberty, in the framework of bilateral agreements concluded in order to prevent double taxation, to determine the connecting factors for the purposes of allocating powers of taxation as between themselves.¹⁵²

The treaty policy of Member States, as it now stands, shows a great degree of diversity: One Member State may, for example, want to attract foreign direct investment, loan capital, technology, et cetera, by granting a low or zero withholding tax

147. See, e.g., Franz Wassermeyer, *Does the EC-Treaty Force the EU Member States to Conclude a Multilateral Tax Treaty?* in MULTILATERAL TAX TREATIES 15, 18 (Michael Lang ed., 1998); Christoph Urtz, *The Elimination of Double Taxation within the European Union and Between Member States and Non-Member States – Multilateral Treaty or Directive?* in MULTILATERAL TAX TREATIES 107, 108 (Michael Lang ed., 1998); Dourado, *supra* note 40, at 151; see also, e.g., *Saint-Gobain*, 1999 E.C.R. at para. 56.

148. EC Treaty art. 293; see Avery Jones, *supra* note 40, at 97.

149. See *Saint-Gobain*, 1999 E.C.R. at para. 57; Case C-385/00, *De Groot v. Staatssecretaris van Financiën*, 2002 E.C.R. I-11819, para. 94; see also, *ex multis*, *Rädler*, *supra* note 11, at 9; *Schuch*, *supra* note 64, at 36.

150. See generally *supra* Part II.

151. See *Saint-Gobain*, 1999 E.C.R. at para. 57.

152. See Case C-336/96, *Gilly v. Directeur des Services Fiscaux du Bas-Rhin*, 1998 E.C.R. I-2793, para. 24, 30; *Saint-Gobain*, 1999 E.C.R. at para. 56.

on such cross-border activities, while another Member State may want to encourage outbound investment by providing attractive conditions for foreign tax credits. Against this background many hold to the view that MFN treatment goes beyond non-discrimination and “limits this contract freedom of individual Member States and effectively replaces (bi-)national tax treaty policies by common treaty policies which are nowhere defined and assigned to the Community in the Treaty.”¹⁵³ Thus, it is argued, the uncontrollable influence of MFN treatment on the Member States’ budgetary policies and their internal taxation policies should be considered as public interest grounds of justification.¹⁵⁴ However, the question is whether the *willingness* of a country to extend treaty benefits – which of course depends on such factors as budgetary considerations, the characteristics of its tax system, its concerns in relation to inbound and outbound investment, foreign policy, its relative negotiating strength, et cetera – may eventually justify discrimination.¹⁵⁵

On the other hand, it may be argued that a teleological interpretation of Article 14 EC, which is designed to create a true internal market, that is, a market characterized by the abolition between Member States of obstacles to the free movement of goods, persons, services and capital, prevents the Member States from considering each other as third countries in their relations.¹⁵⁶ This can easily be demonstrated based on the legal situation in the pending *Bujura* case.¹⁵⁷ Three EU citizens, a Dutchman, a German, and a Belgian, each invest in a holiday house in a holiday park in the Netherlands; all of them are residents of their respective home countries and their only income in the Netherlands consists of the income from the holiday house.¹⁵⁸ As an internal taxpayer, The Dutchman enjoys the tax-free allowance and tax credits at the calculation of his income tax.¹⁵⁹ The same is basically true for the Belgian; to him, the tax-free allowance and a certain part of the tax credits are available under the Netherlands-Belgium DTC.¹⁶⁰ However, the

153. Hinnekens, *supra* note 22, at 154; *see also* Hinnekens, *supra* note 7, at 210.

154. *See* Hinnekens, *supra* note 7, at 210.

155. *See also* Farmer, *supra* note 23, at 103.

156. *See generally* Rädler, *supra* note 36, at 361.

157. Case C-8/04, *Bujura v. Inspecteur van de Belastingdienst Limburg*, 2004 O.J. (C 59) 17; *see infra* Part 0.

158. Gerechtshof te ‘s-Hertogenbosch, 03/00788, Case C-8/04, *available at* http://zoeken.rechtspraak.nl/zoeken/dtluitspraak.asp?searchtype=ljn&ljn=AO5108&u_ljn=AO5108.

159. *Id.*

160. *Id.*

German – who did not use the option to be treated as a resident taxpayer and who does not earn 90% of his income in the Netherlands – is taxed in the Netherlands and enjoys neither the tax-free allowance nor a tax credit.¹⁶¹ Walking through this holiday park, one may wonder why the owners of three identical houses, all citizens of the EU, encounter different tax treatment in the Netherlands. This situation is striking insofar, as it would be unthinkable that a Dutchman from Maastricht is treated differently with regard to his house in the holiday park than a Dutchman from Amsterdam. If the internal market under Article 14 EC is taken seriously in tax matters, there seems to be no justification for such different treatment.

On a similar basis one may argue that non-MFN treatment constitutes a violation if a Member State's duty of loyal cooperation under Article 10 EC.¹⁶² This provision basically requires that Member States take all appropriate measures to ensure fulfillment of the obligations arising out of the EC Treaty, facilitate the achievement of the Community's tasks, and abstain from any measure that could jeopardize the attainment of the objectives of the EC Treaty. This said, Article 10 EC could be seen as a legal basis for the conclusion that a Member State is generally required to grant all bilateral concessions concluded in an international treaty with a non-Member State to all other Community citizens outside the scope of this international treaty.¹⁶³

B. *National Treatment vs. Most Favoured Nation
Treatment: The Case law of the European Court of
Justice*

1. The "Close-To-Cases"

This said, persuasive arguments can be brought forward against and in favor of MFN treatment. Eventually it will be up to the ECJ to fit together the colliding principle of the sovereignty of the Member States and the striven for internal market. However, the ECJ has never explicitly dealt with the issue of MFN treatment in bilateral tax treaties.¹⁶⁴ However, since MFN treatment has played a background role in several income tax decisions, it seems rewarding to put a deeper focus on

161. *Id.*

162. *See, e.g.,* Eicker, *supra* note 22, at 156; *but see* Hinnekens, *supra* note 7, at 215; Hinnekens, *supra* note 10, at 297.

163. *See, e.g.,* Eicker, *supra* note 22, at 156.

164. *See, e.g.,* PISTONE, *supra* note 3, at 211.

those cases that are arguably “close” to the issue here at stake. Since up to this date the ECJ was able to solve all cases based on national treatment, it did not even issue an *obiter dictum*; no matter whether this is due to judicial self-restraint, or judicial hesitation, it may nevertheless be noted beforehand that the ECJ is clearly considering the issue very carefully.¹⁶⁵

2. The Case Law from *Humbel* to *Open Skies*

(a) *Humbel*: Different Tuition for Students from Different Member States?

Indicia towards MFN treatment based on the principle of non-discrimination may be first found in the *Humbel* case.¹⁶⁶ The Humbels were French nationals and resided in Luxembourg; their son Frédéric attended a school in Belgium. However, tuition (“minerval”) was neither charged to students with Belgian nationality nor to students with Luxembourg nationality, but was charged to the Humbels because of their French nationality; thus the question arose as to whether, insofar as Luxembourg nationals are entitled to enroll their children in Belgian educational establishments without paying any minerval whatsoever, a French worker resident in Luxembourg is entitled to claim the same treatment.¹⁶⁷

Although the case arose before the introduction of the EU citizenship in Article 18 EC, the ECJ answered the concrete question to the negative: the decision at least implies that, if the training of Frédéric were vocational training, the prohibition of discrimination on grounds of nationality contained in Article 12 EC would always apply to vocational training, whatever the circumstances.¹⁶⁸ However, since the ECJ assumed that the EC Treaty did not cover the situation of Frédéric, it decided the case based on a regulation regarding the freedom of movement for workers within the Community, which laid obligations only on the Member State in which the migrant worker resides. Thus, the ECJ’s result that such regulation “does not preclude a Member State from imposing an enrolment fee (“minerval”), as a condition for admission to ordinary schooling within its territory, on children of migrant workers residing in another Member State even when the nationals of that other Member State are not

165. See also, e.g., Farmer, *supra* note 23, at 103; Dourado, *supra* note 40, at 147; De Ceulaer, *supra* note 5, at 497.

166. Opinion of AG Sire Gordon Slynn, Case 263/86, Belgium v. Humbel, 1988 E.C.R. 5365.

167. *Id.*

168. See *id.*

required to pay such a fee,¹⁶⁹ should not be construed as a negative indication towards MFN treatment in an economic situation.

(b) *Matteucci*: The Inseparable Connection Between MFN Treatment and Non-Discrimination

Some scholars derive conclusions towards MFN treatment from the *Matteucci* case:¹⁷⁰ An Italian national, Ms. Matteucci, who was born and lived in Belgium, was denied a scholarship for further education in Germany.¹⁷¹ Belgium refused the application because Ms. Matteucci did not fulfill one main requirement under the Cultural Agreement between Belgium and Germany in the field of scholarships: the nationality of one of the contracting Member States.¹⁷² Thus the question arose as to whether the EC Treaty must be interpreted as meaning that scholarships granted by a Member State cannot be reserved for nationals of one other Member State, as is done by of the Cultural Agreement between Germany and Belgium.¹⁷³ The ECJ answered the question in favor of Ms. Matteucci by stating that Article 7 of Regulation 1612/68 – which relates to equality of treatment between national workers and workers who are nationals of other Member States – does not allow the authorities of a Member State to refuse to award a scholarship to study in another Member State to a worker residing and pursuing an activity as an employed person in the territory of the first Member State but having the nationality of a third Member State on the ground that the worker does not have the nationality of the Member State of residence.¹⁷⁴ Although this reasoning of the ECJ may indirectly indicate an inseparable connection between MFN treatment and non-discrimination,¹⁷⁵ the ECJ clearly solved the case based on national treatment and not on MFN treatment. Thus, a general statement towards the existence or the application of MFN treatment cannot be derived from this case.¹⁷⁶

169. *Id.*

170. Case 235/87, *Matteucci v. Communauté française of Belgium*, 1988 E.C.R. 5589.

171. *See id.* at paras. 2, 4.

172. *See id.* at paras. 3–4.

173. *See id.* at para. 5.

174. *See id.* at para. 23.

175. *See Tietje, supra* note 3, at 405.

176. *Id.*

(c) *Bachmann*: Rejection of a Judicial Introduction of MFN Treatment?

In the famous *Bachmann* case¹⁷⁷ a German national employed in Belgium wanted to deduct from his total occupational income contributions paid in Germany pursuant to sickness and invalidity insurance contracts and a life assurance contract concluded prior to his arrival in Belgium. The Belgian authorities denied the deduction since Belgian law required that only contributions deductible from occupational income were those paid to a mutual insurance company recognized by Belgium and pension and life insurance contributions paid in Belgium.¹⁷⁸ The ECJ basically found that this legal situation discriminates against workers who have carried on an occupation in one Member State and who are subsequently employed in another Member State, because those persons normally will have concluded their pension and life assurance contracts or invalidity and sickness insurance contracts with insurers established in the first state. However, the ECJ did hold that a discriminatory provision could be justified by the public interest in preserving the fiscal coherence of a Member State's tax system.¹⁷⁹ In the *Bachman* case the proportionality test was considered to be met and the justification was accepted on the ground that there was a need to ensure that a tax deduction granted in respect of pension or life assurance premiums was matched by ultimate taxation of the benefits paid out under the relevant policy.¹⁸⁰

Despite the outcome of the case, some scholars have derived from the *Bachman* case that the ECJ is not willing to apply MFN treatment with respect to tax treaties.¹⁸¹ It has been argued that in the *Bachman* case, the ECJ basically held that if a certain tax treaty provides for the deductibility of annuity premiums paid by a resident to an insurance company in the other state, while another treaty does not, this does not imply that the deductibility of annuity premiums also has to be granted under the latter

177. Case C-204/90, *Bachmann v. Belgium*, 1992 E.C.R. I-249.

178. *See id.* at para. 3.

179. *See id.* at paras. 8, 9, 14.

180. *Bachmann*, 1992 E.C.R. I-249. This argument has, however, been widely criticized because the ECJ did not consider the interplay between Belgian national law and the Belgian tax treaties, and the ECJ has indeed shown great reluctance to accept the fiscal coherence type of justification argument ever since. *See infra* Part III.E. The ECJ has begun to limit the scope of the fiscal coherence as an imperative requirement since 1995 and many commentators now question whether the scope of that principle remains good law. *See id.*; see also Kofler, *supra* note 123, at 406 for an overview.

181. *See generally* Kemmeren, *supra* note 34; Kemmeren, *supra* note 40; *see also* Offermanns & Romano, *supra* note 39, at 188.

38 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

treaty.¹⁸² This conclusion was derived from the Court's argumentation with regard to a possible justification under the coherence principle. The ECJ stated that it is true

that bilateral conventions exist between certain Member States, allowing the deduction for tax purposes of contributions paid in a contracting State other than that in which the advantage is granted, and recognizing the power of a single State to tax sums payable by insurers under the contracts concluded with them. However, such a solution is possible only by means of such conventions or by the adoption by the Council of the necessary coordination or harmonization measures.¹⁸³

Since the ECJ did not mention a *judicial* introduction of MFN treatment, it was derived that the MFN principle is only applicable when it is explicitly laid down in a bilateral tax treaty or in coordination or harmonization measures by the Council.¹⁸⁴ However, the context of this statement indicates quite clearly that the ECJ did not intend to express its views on MFN treatment. Thus, the prevailing opinion correctly denies the relevance of the *Bachman* case for the issue of MFN treatment.¹⁸⁵

- (d) *Halliburton*: Treaty Benefits for Residents of a Non-EU Member State which are denied Residents of another Member State

Based on the decision in the *Halliburton* case¹⁸⁶ some authors have suggested that the ECJ may well be prepared to apply Community preference to tax treaties.¹⁸⁷ The case concerned *Halliburton*, an international group in which the parent company, Halliburton Inc., was established in the US.¹⁸⁸ It held all the shares in its German subsidiary (Halliburton Co.

182. See generally Kemmeren, *supra* note 34.

183. *Bachmann*, 1992 E.C.R. at para. 26.

184. See Kemmeren, *supra* note 34, at 148; Kemmeren, *supra* note 40, at 24.

185. See, e.g., van den Hurk, *supra* note 24, at 218; CORDEWENER, *supra* note 8, at 836.

186. Case C-1/93, *Halliburton Serv. BV v. Staatssecretaris van Financien*, 1994 E.C.R. I-1137.

187. See M. Dassesse, *Fiscalité: Vers une multilatéralisation des conventions bilatérales?* L'Echo, Juli 15, 1994; see also Hinnekens, *supra* note 22, at 152; Hinnekens, *supra* note 7, at 212; De Ceulaer, *supra* note 5, at 497.

188. *Halliburton*, 1994 E.C.R. I-1137.

Germany GmbH) and Netherlands subsidiary (Halliburton Services BV).¹⁸⁹ As part of a reorganization of the activities of the Halliburton Group in Europe, the German subsidiary transferred and sold to the Netherlands subsidiary its permanent establishment in the Netherlands, which included immovable property situated in the Netherlands.¹⁹⁰ The transfer of immovable property was generally subject to tax in the Netherlands; however, relief was available if the transferor is a company incorporated under the laws of the Netherlands but was unavailable if it was a similar company incorporated under the laws of, and established in, another Member State (in this case, a German GmbH).¹⁹¹ Thus, the tax rule at issue limited exemption from the tax on transactions relating to immovable property only to transactions between certain companies incorporated under Netherlands law, to the exclusion of companies constituted in equivalent forms under the laws of other Member States.¹⁹² The ECJ held, however, that the transferor (the non-resident German subsidiary) was discriminated against via its Netherlands resident business partner.¹⁹³

Interestingly, in stating the facts of the case, the ECJ considered it important to note that, even though the exemption was, in principle, limited to transfers between Dutch companies, the Netherlands Supreme Court had already decided that, in view of the non-discrimination clause of Article 24 US-Netherlands DTC, Halliburton BV could not be deprived of the benefit of the exemption on the ground that the parent company of the Halliburton group was established under US law.¹⁹⁴ The ECJ apparently considered it relevant that a company of a non-EU country had been granted a tax benefit which was denied to a company of another Member State. In its decision, the ECJ seems to have been indirectly influenced by the consideration that, under EC Law, the Member States are not allowed to grant more preferential treatment in relations with non-Member States than with Member States. Based on this, one may argue that the ECJ would uphold the right of a company that is a resident of a Member State (Germany) to claim in its relations with another Member State (the Netherlands) the more favourable tax treatment which the Netherlands grants to residents of a non-EU

189. *Id.*

190. *Id.* at para. 5.

191. *Id.* at para. 17.

192. *Id.* at para. 23.

193. *Id.* at para. 6

194. *Halliburton*, 1994 E.C.R. at para. 6.

country (the United States) under the US-Netherlands DTC. However, the decision of the ECJ in the Halliburton case was, again, based on national treatment and one may only speculate about the ECJ's application of Community MFN if the Dutch condition would have violated the non-discrimination clause of Article 24 US-Netherlands DTC.

(e) *Schumacker*: A First Glance at the Relevance of Different Treaty Benefits

The *Schumacker* case¹⁹⁵ concerned a national and resident of Belgium who worked exclusively over the border as an employee in Germany, and who was refused family-related tax-benefits, including the so called "splitting tariff," by the German tax authorities. The German rules reflected the principle generally recognized in international tax law that it is the residence country's rather than the source country's obligation to take into account the personal and family circumstances of taxpayers.¹⁹⁶ The ECJ held that a source country is generally not obligated to grant such relief, since residents and non-residents are usually not in a comparable situation.¹⁹⁷ However, in the particular circumstances of the case, the assumption that the Belgian frontier worker would receive such relief in Belgium was not valid, since the taxpayer earned nearly all his income in Germany, thus leaving no taxable income in Belgium for which relief could be granted.¹⁹⁸ Thus the ECJ decided the case in favor of Mr. Schumacker and held that he, who earned almost all his income in Germany, should be entitled to the same tax benefits as resident individual taxpayers.¹⁹⁹

However, if Mr. Schumacker had lived in the Netherlands instead of Belgium, Germany would have granted those benefits automatically according to the German-Dutch DTC and a case would not even have existed.²⁰⁰ Thus, during the ECJ hearing, the question was put forward by the ECJ whether such result is acceptable under the principles of EC Law.²⁰¹ Regardless, this first MFN attempt was neither reflected directly in the Advocate

195. Case C-279/93, Finanzamt Köln-Altstadt v. Schumacker, 1995 E.C.R. I-225, paras. 15–17.

196. *Id.* at para. 32.

197. *Id.* at paras. 31–33.

198. *Id.* at para. 41.

199. *Id.*

200. *Id.* at para. 46.

201. See, for example, Rädler, *supra* note 36, at 66–67 for a report of this discussion; see also Tietje, *supra* note 3, at 400; Wassermeyer, *supra* note 36, at 162; Schuch, *supra* note 69, at 114; Rädler, *supra* note 11, at 7–8; Rädler, *supra* note 36, at 360.

General's opinion²⁰² nor in the non-discrimination argumentation of the judgment of the ECJ, because a referral to the German-Dutch DTC was not necessary to solve the case in favor of Mr. Schumacker. Nevertheless, the Advocate General as well as the ECJ mentioned the issue with regard to a possible justification put forward by the German government. At the hearing, the German government argued that administrative difficulties prevented the state of employment from ascertaining the income which non-residents working in its territory received in their state of residence. The ECJ pointed at the Council Directive concerning mutual assistance²⁰³ and concluded that there is no administrative obstacle to account being taken in the state of employment of a non-resident's personal and family circumstances. The Court continued, holding the mirror up to Germany:

More particularly . . . it must be pointed out that the Federal Republic of Germany grants frontier workers resident in the Netherlands and working in Germany the tax benefits resulting from the taking into account of their personal and family circumstances, including the 'splitting tariff'. Provided that they receive at least 90% of their income in Germany, those Community nationals are treated in the same way as German nationals under the German Law of 21 October 1980 implementing the additional protocol of 13 March 1980 to the Double Taxation Treaty between the Federal Republic of Germany and the Kingdom of the Netherlands of 16 June 1959.²⁰⁴

Similarly, the AG argued that Germany couldn't justify an infringement of the EC Treaty "by pleading the excessive financial consequences of making generally available a right which it has already granted to certain non-residents."²⁰⁵

202. Opinion of AG Léger, *Schumacker*, 1995 E.C.R. I-225.

203. *Schumacker*, 1995 E.C.R. I-225. See Council Directive 77/799/EEC of 19 December 1977 (concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, 1977 O.J. 1977 (L 336) 15).

204. *Schumacker*, 1995 E.C.R. at para. 46; see also Tietje, *supra* note 3, at 400; Rädler, *supra* note 11, at 8. See *infra* Part 0. for this argumentation and further implications.

205. Opinion of AG Léger, *Schumacker*, 1995 E.C.R. at para. 87. The AG also considered that unequal treatment between frontier workers from different countries was even ascertained by the Bundesfinanzhof by stating that it would be contrary to Art 3 GG, i.e., the principle of equal treatment, "to treat frontier workers from other neighbouring

(f) *Gilly*: The Competence of Member State to Allocate Taxing Rights in Bilateral Tax Treaties

Another close-to case is the *Gilly* case.²⁰⁶ Mrs. Gilly was German by birth and also obtained French nationality by marriage. She lived in France, but worked as a teacher in a German state school. Since a public authority paid her wages, the frontier worker rules of the France-Germany DTC did not apply; under a special rule of this treaty her salary was taxed in Germany due to Mrs. Gilly's dual nationality, and again in France, where a credit for the German tax paid was given.²⁰⁷ However, due to the calculation of the income tax in France, the foreign tax credit was lower than the tax paid in Germany.²⁰⁸ Thus, the question arose as to whether the free movement of workers is infringed by the application of the tax treaty, because under this treaty, the tax regime applicable to frontier workers differs depending on whether they work in the private sector or the public sector. If they work in the public sector, the applicable tax regime depends on whether they have only the nationality of the State of the authority employing them.²⁰⁹

The ECJ held that this tax treatment is in compliance with the EC Treaty. The ECJ relied much upon the belief that the "Member States are competent to determine the criteria for taxation on income and wealth with a view to eliminating double taxation – by means, inter alia, of international agreements – and have concluded many bilateral conventions based, in particular, on the model conventions on income and wealth tax drawn up by the Organisation for Economic Cooperation and Development ('OECD')."²¹⁰ Not even the application of the dual nationality link in the France-Germany DTC, which is similarly contained in Article 19(1) of the OECD Model Convention,²¹¹ was regarded as constituting discrimination prohibited under Article 39 EC. As the ECJ stated, this flows – in the absence of

States differently from those from the Netherlands. See German Bundesfinanzhof BFHE 154, 38, BStBl 1990 II 701; see also Schuch, *supra* note 69, at 115.

206. Case C-336/96, *Gilly v. Directeur des Services Fiscaux du Bas-Rhin*, 1998 E.C.R. I-2793.

207. *Id.* at paras. 3, 6, 8.

208. See Peter J. Wattel, *Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why Schumacker, Asscher, Gilly and Gschwind Do Not Suffice*, 40 ET 210, 218 (2000) for an excellent discussion of this situation and of the incomplete analysis of this issue by the ECJ; Frans Vanistendael, *Case C-336/96, Mr. and Mrs. Robert Gilly*, 37 CML REV. 167, 176–77 (2000).

209. See, for example, Vanistendael, *supra* note 209, at 169 for a closer examination of the legal situation in the *Gilly* case.

210. *Gilly*, 1998 E.C.R. at para. 24.

211. See also van den Hurk, *supra* note 24, at 215.

any unifying or harmonizing measures adopted in the Community context under, in particular, the second indent of Article 293 EC – “from the contracting parties’ competence to define the criteria for allocating their powers of taxation as between themselves, with a view to eliminating double taxation.”²¹²

From these statements, which basically confirm that allocation in tax treaties is not discriminatory, some scholars have derived that the ECJ has rejected a judicial application of MFN treatment.²¹³ However, the cited statement of the ECJ in the *Gilly* case clearly does not solve the question of MFN treatment, for MFN treatment is not in contradiction to the fact that the Member States “are competent to determine the criteria for taxation on income and wealth with a view to eliminating double taxation.”²¹⁴ First, it could be argued that MFN treatment requires that this authority is exercised in a uniform manner towards all Member States.²¹⁵ Second, the *Gilly* case may be seen as a limitation of a possible application of MFN treatment; even after *Gilly* “it is arguable that the equal treatment principle does not allow reciprocal concessions which go beyond mere allocation of taxing rights, such as differences in concessions to avoid economic double taxation (refunds of imputation credits).”²¹⁶ Finally, the often-made argument that the weight given to the OECD Model Convention by the ECJ²¹⁷ is in contradiction to MFN treatment²¹⁸ is not convincing: Although it is true that the OECD Model Convention does not contain a MFN clause, this does not seem to be a valid argument against MFN treatment, since the MFN issue can only arise if at least one of the specific double taxation treaties deviate from the OECD Model Convention or any other Model Convention used by the source country.

212. *Gilly*, 1998 E.C.R. at para.. 30; see, for example, Vanistendael, *supra* note 209, at 171 for the further arguments of the ECJ on this point.

213. See, e.g., Hughes, *supra* note 40, at 332; Lehner, *supra* note 31, at 335; van den Hurk, *supra* note 24, at 216; see also Vogel, *supra* note 39, at 150; Hinnekens, *supra* note 40, at 114.

214. *Gilly*, 1998 E.C.R. at para. 24.

215. See Lang, *supra* note 25, at 435.

216. See Company Taxation in the Internal Market, PARL. EVR. DOC. (SEC 2001) 1681, 316; see *infra* Part D.

217. See, e.g., Hughes, *supra* note 40, at 332; Vanistendael, *supra* note 209, at 167.

218. See, e.g., Hughes, *supra* note 40, at 332; see *infra* Part III.D.1.

44 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

(g) *Saint-Gobain*: Treaty Benefits for Non-Resident Corporations with a Permanent Establishment in another Member State

In the landmark decision in the *Saint-Gobain* case²¹⁹ the legal question arose whether Articles 43 and 48 EC preclude the exclusion of a German permanent establishment of an EU company from enjoyment of tax concessions on the same conditions as those applicable to German companies. These concessions included benefits under a double tax treaty, i.e., a corporation tax relief for international groups, provided for by a tax treaty with a non-Member State, as well as benefits under domestic law, i.e., the crediting, against German corporation tax, of the corporation tax levied in another State other than the Federal Republic of Germany on the profits of a subsidiary established there.²²⁰ In its decision in the *Saint-Gobain* case, the ECJ held in favor of the taxpayer and ruled that permanent establishments of non-resident EU companies have the right to be taxed in the same way as resident companies if the situations are comparable, which clearly is the case as regards to liability to tax on dividend receipts in Germany from shares in foreign subsidiaries.²²¹

Furthermore, the ECJ stated in the *Saint-Gobain* case that the obligations which EC Law imposes on a Member State do not affect in any way the obligations resulting from its agreements with third countries:

The balance and the reciprocity of the treaties concluded by the Federal Republic of Germany with those two countries would not be called into question by a unilateral extension, on the part of the Federal Republic of Germany, of the category

219. Case C-307/97, *Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt*, 1999 E.C.R. I-6161, para. 32.

220. *Id.*

221. *Id.* at para. 47–63. See Josef Schuch, *Gemeinschaftsrecht verschafft beschränkt Steuerpflichtigen Abkommensberechtigung*, 1999 SWI 451 for a comprehensive discussion of the *Saint-Gobain* case; Heinz Jirousek, *Der Fall Saint-Gobain im Lichte der österreichischen DBA-Anwendungspraxis*, 1999 ÖSTZ 604; Martin Jann & Gerald Toifl, *EuGH entscheidet über Abkommensberechtigung von Betriebstätten*, 1999 SWI 488; Offermanns & Romano, *supra* note 39, at 180; H. E. Kostense, *The Saint-Gobain Case and the Application of Tax Treaties. Evolution or revolution?* 9 EC TAX REV. 220 (2000); Cees Peters & Margreet Snellaars, *Non-discrimination and Tax Law: Structure and Comparison of the various Non-discrimination Clauses*, 10 EC TAX REV. 13, 17 (2001); Hans van den Hurk, *Did the ECJ's Decision in Saint-Gobain Change International Tax Law?* 55 BIFD 152 (2001); Martín-Jiménez et al., *supra* note 8, at 243; Dourado, *supra* note 40, at 147–48.

of recipients in Germany of the tax advantage provided for by those treaties, in this case corporation tax relief for international groups, since such an extension would not in any way affect the rights of the non-member countries which are parties to the treaties and would not impose any new obligation on them.²²²

Because the ECJ explicitly referred to the reciprocity and balance of double taxation treaties, this statement could be wind in the sails of opponents of MFN treatment. However, the ECJ explained what it meant to imply by this statement, i.e., that in the *Saint-Gobain* case, it:

merely held that the extension to permanent establishments of companies having their seat in a Member State other than the Federal Republic of Germany of a tax advantage provided for by a bilateral international agreement concluded by the Federal Republic of Germany with a non-member country could be decided upon unilaterally by the former without in any way affecting the rights of the non-member country arising from that agreement and without imposing any new obligations on that non-member country.²²³

The *Saint-Gobain* case is especially interesting because the Advocate General clearly distinguished between national treatment and MFN treatment to avoid interference with the then pending *Metallgesellschaft and Hoechst* cases²²⁴: The problem which arose in the *Saint-Gobain* case is different from “the situation where a company established in Member State A asks Member State B to apply to it the provisions of a bilateral agreement concluded between Member State B and Member State C rather than that concluded between A and B.”²²⁵ While in the *Saint-Gobain* case the treatment of shareholdings in companies established in State C was in issue, the Advocate

222. *Saint-Gobain*, 1999 E.C.R. at paras. 59–60; see also Opinion of AG Mischo, *Saint-Gobain*, 1999 E.C.R. at paras. 81–92.

223. Case C-466/98, *Commission v. United Kingdom*, 2002 E.C.R. I-9427 (“open skies” case).

224. Joined Cases C-397/98 and C-410/98, *Metallgesellschaft Ltd. v. Commissioners of Inland Revenue*, 2001 E.C.R. I-1727.

225. Opinion of AG Mischo Case, *Saint-Gobain*, 1999 E.C.R. at para. 89.

General pointed out that the two cases concern claims which are fundamentally different: “In the hypothesis outlined above, the company established in Member State A does not seek to be treated by Member State B as a company established in that State but as a company established in another Member State, C. That case therefore concerns a difference in treatment between non-resident companies rather than between resident companies and non-resident companies.”²²⁶ Against the background of these statements the expectations towards the answer of the Advocate General or the ECJ in the *Metallgesellschaft and Hoechst* cases²²⁷ were high.²²⁸

(h) *Metallgesellschaft and Hoechst*: The Issue of Divergent Eligibility for Tax Credits under Different Tax Treaties

In the *Metallgesellschaft and Hoechst* cases²²⁹ two German parent companies received dividends from their UK subsidiaries. However, the British tax system did permit a so-called group income election, which allows distributions to be paid by a subsidiary to its parent without accounting for an advance corporation tax only when both the subsidiary and parent are resident in the UK.²³⁰ Thus the German parent companies maintained that their UK subsidiaries had suffered a cash-flow disadvantage in comparison with the subsidiaries of parent companies resident in the UK, since, unlike the latter, which were permitted to benefit from a group income election, no such option was available to them²³¹. The ECJ found for the taxpayers and basically held that such disadvantage constituted discrimination contrary to Article 43 EC.²³²

However, in the *Metallgesellschaft and Hoechst* case, the German taxpayers also explained in its submission to the ECJ that based on the respective tax treaties, a German parent company was taxed substantially higher by the UK than a comparable Dutch parent company due to a tax credit that only

226. *Id.* at para. 91.

227. *Metallgesellschaft*, 2001 E.C.R. I-1727.

228. *See, e.g.*, Farmer, *supra* note 36, at 152; Christian Stangl, *Schlussanträge zu den Rechtssachen Metallgesellschaft und Hoechst: Keine Aussagen zur Meistbegünstigung – weitere Präzisierung der steuerlichen Kohärenz*, 2000 SWI 559, 560; Klaus Eicker & Stefan Müller, *Entscheidung des EuGH in Sachen Hoechst/Metallgesellschaft: Erwartungen nicht erfüllt*, 47 RIW 438 (2001); *see also* Kostense, *supra* note 222, at 222.

229. *Metallgesellschaft*, 2001 E.C.R. at para. 26.

230. *Id.* at paras. 21–25.

231. *Id.* at para. 30.

232. *Id.* at paras. 39, 76.

the latter was entitled to.²³³ Based on this, the British High Court of Justice asked the ECJ whether it is consistent with Articles 12, 43 or 56 EC “for the authorities of one Member State to deny any tax credit to a company resident in another Member State when it grants such credit to resident companies and to companies resident in certain other Member States by virtue of the terms of its double taxation conventions with those other Member States?”²³⁴ The expectations towards the answer of the ECJ were high, but already the Advocate General did not consider it necessary to consider.²³⁵ The ECJ, having already solved the case in favor of the taxpayer based on the “extremely complex issues raised by the alternative claim in respect of the possible entitlement of the German parent companies, by analogy with the DTC applicable between the United Kingdom and the Netherlands, to a partial tax credit in respect of ACT paid by United Kingdom subsidiaries.” A comparison with UK parent companies found it unnecessary to reply the question regarding MFN treatment.²³⁶

- (i) *Gottardo*: Benefits under a Bilateral Social Security Treaty for Nationals of another Member State

Although the *Gottardo* case²³⁷ concerned social security issues and is not a case of clear MFN treatment, it arguably seems to point into that direction.²³⁸ Mrs. Gottardo, who was born in Italy, worked as a teacher in Italy, Switzerland, and France. She paid social security contributions in France, and she gave up her Italian citizenship when she married a Frenchman.²³⁹ Mrs. Gottardo finally wanted to obtain an Italian old-age pension pursuant to Italian social security legislation; however, even taking into account the periods of insurance completed in France, the contribution periods were not sufficient to achieve the minimum years of contributions required under Italian law.²⁴⁰ On

233. *Id.* at para. 33; see also Rädler, *supra* note 36, at 360.

234. *Metallgesellschaft*, 2001 E.C.R. I-1727; see, for example, Kofler, *supra* note 74, at 29 for a brief discussion of these treaty-based credits.

235. Opinion of AG Fenelly, *Metallgesellschaft*, 2001 E.C.R. at para. 57.

236. *Id.*; see also Eicker & Müller, *supra* note 229, at 442 for criticism of this decision. Klaus Eicker, *ECJ delivers judgement in the Cases Hoechst/Metallgesellschaft*, 29 INTERTAX 242, 243 (2001); see also Züger, *supra* note 37, at 138; Dourado, *supra* note 40, at 151; Rädler, *supra* note 36, at 360; Persoff, *supra* note 68, at 13.

237. Case C-55/00, *Gottardo v. INSPS*, 2002 E.C.R. I-413, para. 20.

238. See Rädler, *supra* note 36, at 361; see also Eicker, *supra* note 22, at 156.

239. *Gottardo*, 2002 E.C.R. at paras. 14–15.

240. *Id.* at para. 16.

the other side, if the periods of contributions in Switzerland were taken into account pursuant to the aggregation principle of the Italian-Swiss Social Security Treaty, Mrs. Gottardo would have been entitled to an Italian old-age pension.²⁴¹ However, Italian authorities rejected Mrs. Gottardo's application on the ground that she was a French national and that therefore the Italian-Swiss convention did not apply to her.²⁴²

The ECJ solved this case on the basis of national treatment in favor of Mrs. Gottardo. It held that when a Member State concludes a bilateral international convention with a non-member country, the fundamental principle of equal treatment requires that Member State to grant nationals of other Member States the same advantages as those which its own nationals enjoy under that convention unless it can provide objective justification for refusing to do so.²⁴³ Thus, the competent Italian social security authorities are required, pursuant to their Community obligations under Article 39 EC, to take account of periods of insurance completed in a non-member country (Switzerland) by a national of France in circumstances where such periods would have been taken into account had they been completed by Italian nationals pursuant to a bilateral Italian-Swiss Social Security Treaty.²⁴⁴ This conclusion reached by the ECJ in the *Gottardo* case has already been heralded by its judgment in the *Saint-Gobain* case,²⁴⁵ in which it ruled that the national treatment principle requires the Member State that is party to a bilateral tax treaty concluded with a third country to grant to permanent establishments of residents of other Member States the treaty benefits. It was quite clear that the argumentation in the case of companies in the *Saint-Gobain* case is equally valid in the case of individuals, as in the *Gottardo* case.

However, the conclusions of Advocate General Colomer in the pending *D* case²⁴⁶ indicate that the *Gottardo* case, as well as the *Saint-Gobain* case, has a direct impact on the MFN issue. As described in more detail below, the *D* case concerns different treatment of taxpayers based on the fact that, pursuant to the tax treaty concluded between the Netherlands and Belgium, residents of Belgium who have property in the Netherlands are

241. *Id.*

242. *Id.* at para. 17.

243. *Id.* at para. 34.

244. *Id.* at para. 39.

245. Case C-307/97, *Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt*, 1999 E.C.R. I-6161.

246. *Supra* III.B.3.b.

granted tax benefits²⁴⁷, which are not available under the tax treaty between Germany and the Netherlands. The Advocate General, who issued his opinion on October 26, 2004,²⁴⁸ did not find this situation to differ sufficiently from those in *Saint-Gobain* and *Gottardo* to warrant different conclusions. Answering the Netherland government's attempt to distinguish the situation the *D* case on the one hand from those in *Saint-Gobain* and *Gottardo*, the Advocate General noted:

Mrs. Gottardo, an Italian national by birth but of French nationality following her marriage, claimed, for the purposes of fixing the amount of her retirement pension in the country of her birth, that not only periods of insurance in those States but also contributions paid in Switzerland should be taken into account, under an Italian-Swiss social security convention which, for the calculation of pensions, recognises periods worked by Italians in Switzerland. *Saint-Gobain ZN* concerned a company established in France which, having paid taxes in Germany on the income and assets of a branch in that country, sought to enjoy the tax benefits granted to companies having their seat in Germany, under two treaties for the avoidance of double taxation with Switzerland and the United States. *D.* is a German resident subject to taxation in the Netherlands in respect of the immovable property he owns in the latter country. He seeks to enjoy the benefit granted by the law of that Member State to its property owners resident in Belgium, in accordance with an agreement with that second country. The sole difference between the foregoing cases and the one under analysis lies in the fact that, in the first two situations, the country with which the agreement has been entered into is a non-Member State.

That disparity is not, however, sufficient to

247. Neth.-Belg. DTC 1970, art 25(3). Under this non-discrimination provision "[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." *Id.*; see also, Weber & Spierts, *supra* note 37, at 67.

248. See Opinion of AG Colomer, Case C-376/03, *D v. Head of the Private Individuals/Enter./Foreign Countries/Heerlen Unit*.

produce a different outcome. First, the convention in the main proceedings differs from those at issue in *Saint-Gobain ZN* and *Gottardo*, since it falls squarely within the scope of the Treaty (Article 293 EC), so that, if there is a risk that its literal interpretation might hinder application of a provision of Community law, the Member States have an even greater duty than in the cases cited to do what is necessary to avoid such an outcome. Redundant though it may seem, I should point out once again that, in the light of the view taken by the participating governments, when Member States exercise their taxation powers, they must do so consistently with Community law, irrespective of the instrument used – a law, a regulation or an international or Community agreement or an agreement with a third country. That being so, in *Gottardo*, the Court of Justice stated that ‘when giving effect to commitments assumed under international agreements, be it an agreement between Member States or an agreement between a Member State and one or more non-member countries, Member States are required, subject to the provisions of Article 307 EC, to comply with the obligations that Community law imposes on them.’²⁴⁹

- (j) *Open Skies: Breach of EC Law by Giving a Third Country the Right to Discriminate against Residents of other Member States*

The so called “open skies” cases²⁵⁰ concerned “nationality clauses” in bilateral air transport agreements between the US and certain Member States. Although it was clear that “nationality clauses” in an intra-EU context cannot be upheld,²⁵¹ these cases could easily be distinguished from constellations where a Member State gives – in a treaty – a third country the right to discriminate against nationals or residents of other Member States. Since EC Law clearly cannot create obligations for third countries such as the US, the source of such

249. Opinion of AG Colomer, Case C-376/03, *D*, at paras. 92 to 94.

250. See, e.g., Case C-466/98, *Commission v. United Kingdom*, 2002 E.C.R. I-9427.

251. See, e.g., Case C-246/89, *Commission v. United Kingdom*, 1991 E.C.R. I-4585.

discrimination would lie in the entering into such a treaty by the respective Member State and there may be some hesitation to draw such conclusion, given, e.g., the reciprocity of a treaty.²⁵²

However, exactly this argumentation is now indicated by the recent “open skies” judgments of the ECJ. In those judgments the Court held, *inter alia*, that the “nationality clauses” in the bilateral air services agreements between the U.S. and several EU Member States, i.e., the “open skies” agreements, infringe the freedom of establishment.²⁵³ As the Court pointed out, this infringement consisted in the granting by a Member State to the U.S. of the right to revoke or limit authorizations of airlines where substantial ownership and effective control are not in the hands of nationals of the respective Member State.²⁵⁴ By concluding and applying such agreement, the Member States have breached their EC obligations, because a “nationality clause” potentially prevents EU airlines of one member state from establishing themselves in another member state and offering direct air service from that member state to the U.S.

One conclusion which can be derived from the “open skies” cases clearly is that compliance with the *Saint-Gobain* judgment is no longer a sufficiently exonerating factor. However, the “open skies” cases may also indicate some further conclusions towards MFN treatment. Rephrasing the ECJ’s result shows that a Member State has to confer the same rights on another Member State as it does on a non-Member State.²⁵⁵ Although the ECJ solved the “open skies” cases once again, on the basis of national treatment, the outcome of the decisions is arguably close to MFN treatment.

3. The *D* Case and the *Bujura* Case: Will the ECJ Solve the Issue?

(a) Chances for the ECJ to Clarify the Scope of Non-Discrimination

As already mentioned above, the Dutch Court of ‘s-Hertogenbosch has recently put preliminary questions in two cases to the ECJ: the *D* case²⁵⁶ and the *Bujura* case.²⁵⁷ In both

252. See Farmer, *supra* note 23, at 104; Michael Tumpel, *Der Einfluss der Grundfreiheiten des EG-Rechts auf die Doppelbesteuerungsabkommen*, 2003 ÖSTZ 154, 156.

253. See, e.g., Case C-466/98, Commission v. United Kingdom, 2002 E.C.R. I-9427, paras. 26–28.

254. *Id.* at para. 31.

255. See also De Ceulaer, *supra* note 5, at 497.

256. Case C-376/03, *D v. Head of the Private Individuals/Enter./Foreign*

52 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

cases German residents are basically challenging tax treatment by the Netherlands under the Netherlands-German tax treaty on the basis that it treats them less favorably than other EU residents under other Dutch treaties. It seems that the Court of 's-Hertogenbosch was able to pose the question in at least one of these cases in a way that the ECJ cannot avoid a clear answer towards the MFN issue. However, due to the increasing length of the proceedings before the ECJ, the answer will take its time.

(b) The *D* Case

On July 24, 2003, the Court of Appeal in 's-Hertogenbosch²⁵⁸, the Netherlands, has put questions before the ECJ in a trial case concerning, *inter alia*, the unequal treatment of two non-resident taxpayers within the EU and thus regarding the differences in tax treaties within the European Union.²⁵⁹ The facts of this MFN case are straightforward: A resident and national of Germany (for privacy reasons referred to as "Mr. D") who has property in the Netherlands has appealed from the Dutch tax authorities' refusal to grant him a tax benefit.²⁶⁰ The base case concerns an assessment regarding 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.²⁶¹ For the year 1998, Mr. D, under the Dutch Law on Wealth Tax 1964,²⁶² was subject to the Netherlands wealth tax as a non-resident taxpayer. Under this law, resident taxpayers always have the right to deduct the basic allowance.²⁶³ Non-resident taxpayers are not entitled to do so, unless 90% or more of their capital is invested in the Netherlands. On the other hand, non-resident taxpayers who are resident in Belgium, have always had the right to deduct the basic allowance, under Article 23(3) of the 1970 Belgium-Netherlands tax treaty.²⁶⁴ The tax treaty between the

Countries/Heerlen Unit, 2003 O.J. (C 289) 12.

257. Case C-8/04, Bujura v. Inspecteur van de Belastingdienst Limburg, 2004 O.J. (C 59) 17.

258. *D*, 2003 O.J. (C 289) 12; *see also* Weber & Spierts, *supra* note 37, at 65; Rädler, *supra* note 36, at 360.

259. *D*, 2003 O.J. (C 289) 12.

260. *Id.*

261. *See* Weber & Spierts, *supra* note 37, at 65.

262. Wet op de Vermogensbelasting 1964 [Dutch Tax Law on Wealth] (1964).

263. *See* Weber & Spierts, *supra* note 37, at 65.

264. Convention Between the Government of the Kingdom of the Netherlands and the Government of the Kingdom of Belgium for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital and for the Settlement of Some Other Questions on Tax Matters, art. 25(3), Oct. 19, 1970, Neth.-Belg., *available at*

Netherlands and Germany does not provide for such a regulation. Thus, Mr. D did not qualify for such basic allowance under Dutch national law. However, in 1998 neither Germany nor Belgium imposed a wealth tax.²⁶⁵

Based on these facts it was argued that taxpayers are treated unequally within the EU because the tax treaty concluded between the Netherlands and Belgium grants residents of Belgium who have property in the Netherlands tax benefits²⁶⁶ which are not available under the tax treaty between Germany and the Netherlands, thus creating an impermissible difference in treatment between Belgians and Germans. However, the Court of Appeal in 's-Hertogenbosch primarily asked the ECJ a question about national treatment, i.e., whether EC Law, "preclude[s] legislation under which a domestic taxpayer is always entitled to deduction of a tax allowance in respect of wealth tax, whereas a foreign 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)."²⁶⁷ Only for the case that this question were answered to the negative by the ECJ, the Court of Appeal in 's-Hertogenbosch asked the second question about MFN treatment, namely 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 (where no wealth tax is levied in Belgium either)."²⁶⁸

However, it seems likely that the ECJ will answer the first question to the positive and thus leave the second question unanswered. The first question was posed before the background of the *Schumacker* case law and the acceptance of a 90% threshold in income tax law. Together, these provide for a "switch over" of the obligation to take into account the personal situation of taxpayer from the residence to the source country if such taxpayer derives at least 90% of his overall income in the source country. The background of this case law is that with

http://online2.ibfd.org/publications/treaty/tt/docs/html/tt_be-n1_02_eng_1970_tt.html (last visited Aug. 8, 2004).

265. Weber & Spierts, *supra* note 37, at 65.

266. Neth.-Belg. DTC 1970, art 25(3). Under this non-discrimination provision "[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." *Id.*; see also, Weber & Spierts, *supra* note 37, at 67.

267. *D*, 2003 O.J. (C 289) 12.

268. *Id.*

54 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

regard to benefits resulting from the taking into account of personal and family circumstances, the situations of resident individuals and non-resident individuals are not generally comparable, unless the 90% threshold is met.²⁶⁹ However, it may be questioned whether this 90% threshold applies with regard to the wealth tax here at issue, since the ECJ did not apply this requirement in a recent inheritance tax case either.²⁷⁰

If the ECJ finds that non-residents and residents are generally in comparable situations for purposes of a wealth tax (which would seem to be consequent since only capital, and not income or residence, is relevant for such tax) the focus shifts to the question as to whether a discrimination can objectively be justified by an overriding reason of general interest. It was reported that in the *D* case that neither the taxpayer nor the government could think about such a reason. Before the background of the *Schumacker* case,²⁷¹ neither the principle of fiscal cohesion nor excessive financial consequences are such reasons, since the Netherlands have easily given to a Belgian taxpayer the favourable tax treatment which the German taxpayer invokes. This clearly shows that denying such treatment is not necessary to safeguard the coherence of the national tax system.²⁷²

On Tuesday, October 26, 2004, Advocate General Colomer handed down his Opinion in the *D* case that had recently been heard in the ECJ.²⁷³ The Advocate General suggested to solve the case based on the first question by concluding that the allowing for the free movement of capital within the Community under Articles 56 EC and 58 EC precludes national legislation which, in relation to wealth tax, grants to resident taxpayers entitlement to an allowance which it denies to non-resident taxpayers.²⁷⁴

269. See, e.g., Case C-279/93, *Finanzamt Köln-Altstadt v. Schumacker*, 1995 E.C.R. I-225, paras. 31–46; Case C-80/94, *Wielockx v. Inspecteur der Directe Belastingen*, 1995 E.C.R. I-2493, paras. 18–22; Case C-107/94, *Asscher v. Staatssecretaris van Financien*, 1996 E.C.R. I-3089, para. 41; Case C-391/97, *Gschwind v. Finanzamt Aachen-Außenstadt*, 1999 E.C.R. I-5451, paras. 22–32; Case C-87/99, *Zurstrassen v. Administration des Contributions Directes*, 2000 E.C.R. I-3337, paras. 21–37.

270. Case C-364/01, *Barbier v. Inspecteur van de Belastingdienst*, 2003 O.J. (C 47) 6; see also Eva Burgstaller & Katharina Haslinger, *Erbschaftsteuer und Gemeinschaftsrecht – Neue Entwicklungen in der europäischen Rechtsprechung*, 2004 SWI 108, 110.

271. *Schumacker*, 1995 E.C.R. at paras. 1–18.

272. *Id.* at para. 46; Opinion of AG Léger, *Schumacker*, 1995 E.C.R. at para. 87; see also Josef Schuch, *Bilateral Tax Treaties Multilateralized by the EC TREATY*, in MULTILATERAL TAX TREATIES 33, 47 (Michael Lang ed., 1998); Schuch, *supra* note 25, at 163; Schuch, *supra* note 68, at 270.

273. Opinion of AG Colomer, Case C-376/03, *D*.

274. *But see* van der Linde, *supra* note 36, at 16.

However, in his Opinion Advocate General Colomer made a number of positive comments in favor of the taxpayer on the MFN issue. He summarized the issue in paragraph 76 of his conclusions:

In 1998, as a result of the bilateral agreement referred to above, an individual established in Belgium with immovable property in the Netherlands received more favourable tax treatment in the latter Member State than a German resident with immovable assets of the same value in that country because he was entitled to keep a portion tax free, a privilege which the latter did not enjoy, whereas neither paid any tax whatsoever on assets owned in their countries of origin. As a result of the international agreement in question, Netherlands law deterred Germans from investing their savings in the Netherlands, as compared with people living in Belgium.

Thus, his primary observation is that it is contrary to Community law for a Member State to accept reciprocal obligations with another Member State if these have the effect of offending the fundamental freedoms in relation to nationals of third European States. In such situation, residents of Belgium who have property in the Netherlands are granted tax benefits which are not available to German residents who have property in the Netherlands. This creates an impermissible difference in treatment between Belgians and Germans to the extent that it renders more difficult the free movement of capital between this latter Member State and the Netherlands. It should be noted that the Advocate General focused on the fact that neither Belgium nor Germany levies a wealth tax and thereby the Dutch tax-free allowance to Belgians amounts to a unilateral benefit. However, the Advocate General stressed that he is not saying that a citizen of a Member State can automatically receive the best possible treatment, that is, the most favored tax status in another Member State. In paragraphs 95 to 97 of his conclusions the Advocate General stated:

Accordingly, on the basis that D. and a taxpayer resident in Belgium are in the same position for the purposes of payment in the Netherlands of the tax to which they are liable in respect of their

immovable property, the former is entitled to the advantages which the convention for the avoidance of double taxation between those States confers on the latter, provided its application does not involve an unjustified fetter on the free movement of capital.

I concur with the participating governments that the most-favoured-nation clause does not appear to be automatically transferable to the matter now under discussion, or, in other words, that the principle of non-discrimination on grounds of nationality, as a rule safeguarding freedoms of movement, does not require that a citizen of one Member State should receive the best possible treatment in the other, regardless of whether or not that is necessary for the establishment of the single market. That is the reasoning underlying my arguments in paragraphs 66 and 67 of my Opinion in *Gilly* where I stated, referring to income tax, that the object of a bilateral double taxation convention is to prevent income which is taxed in one State from being taxed again in the other, not to confer upon taxpayers the tax status which is most favourable to them in each case.

However, if the application of a contractual provision by a Member State hinders the free movement of capital by unjustifiably affording different treatment to residents of other Member States (who, as European citizens, are entitled not to be directly or indirectly discriminated against on the grounds of their nationality, according to the first paragraph of Article 12 EC), there is nothing to prevent Community law from rectifying that circumstance and eliminating the inequality. That is to say, in triangular situations such as that in the main proceedings, the position of the taxpayer in the taxing State can be defined on the basis not only of the most-favoured-nation clause but also of the fact that there is a restriction on free movement. The taxpayer will seek, as *D.* is doing, to have the scope of the agreement covering residents in Belgium extended to him, and that

claim can be formulated by reference to a restriction on the free movement of capital if the heavier tax burden and adverse consequences are regarded as contrary to Community law. In short, accepting reciprocal obligations to another Member State which limit the freedom of movement of the nationals of European non-member countries is contrary to Community law. The fact must not be overlooked that national provisions, which include validly concluded and ratified international treaties, must not infringe the fundamental freedoms of the European legal system.²⁷⁵

Nevertheless, the practical effect of the Advocate General's conclusions is the same as the form of MFN treatment suggested in legal writing, which is not meant to be a self-executive principle in every case either.²⁷⁶ Thus, different provisions in different tax treaties are not automatically prohibited per se, but if they constitute discriminatory treatment against others (which by their very nature they will invariably do) they are open to challenge.²⁷⁷ Obviously, the Advocate General was informed of the possible consequences of his opinion, which may be inferred from paragraph 101 of the conclusions:

I am aware of the dangers which the foregoing considerations imply for the equilibrium and reciprocity which prevail in the system of double-taxation treaties, but those difficulties must not become obstacles to the establishment of the single market. First, in setting in those agreements the criteria for allocating competence in taxation matters, the Member States must act with the utmost care, avoiding any provisions which might

275. Opinion of AG Colomer, Case C-376/03, *D*, at paras. 95 to 97.

276. See also Opinion of AG Colomer, Case C-376/03, *D*, at para. 103.

277. For a detailed discussion of the Advocate General's conclusions see Georg W. Kofler, *Generalanwalt zur Kapitalverkehrsfreiheit und Meistbegünstigung bei DBA-Anwendung*, 2004 ÖSTZ 558 et seq.; Philip Martin, *D v Rijksbelastingdienst: Case C-376/03: A Review*, TAX PLANNING INT'L EU FOCUS (Nov. 2004); Ines Hofbauer, *Erfordern die Grundfreiheiten des EG-V eine innereuropäische Meistbegünstigung? – Erste Erkenntnisse aus dem "D"-Fall*, 2004 SWI 586 et seq.; Peter Cussons, *The "D" Case: D v Rijksbelastingdienst (C-376/03)*, TAX PLANNING INT'L REV (Dec. 2004); Arne Schnitger, *Vermögensteuer-Freibeträge in Holland, weil keine Vermögensteuer in Deutschland*, 2004 IStR 793, 801 et seq.; Gerald T.K. Meussen, *The Advocate General's Opinion in the "D" Case: Most-Favoured-Nation Treatment and the Free Movement of Capital*, 45 ET 52 et seq. (2005).

hinder that objective. Second, the right to equal treatment stands alone and is independent from the principle of reciprocity and therefore, in the event of a conflict, it takes precedence over mutual commitments. If the reciprocity of the obligations in such an agreement runs counter to the fundamental ideas driving the construction of a unified Europe, the Member States in question have a duty to seek other formulae which, whilst achieving the objective sought, do not, in breach of Community law, prejudice the citizens of other Member States. The principle of proportionality so demands.²⁷⁸

However, it is likely that the ECJ will follow its Advocate General as regards the first question in the *D* case and solve the issue on grounds of national treatment – as it did in the *Metallgesellschaft and Hoechst* cases²⁷⁹ – and leave the second question about MFN treatment unanswered. Anyhow, the Court of Appeal in ‘s-Hertogenbosch has put another preliminary questions before the ECJ in the *Bujura* case which seeks an unavoidable answer to the question of MFN treatment.

(c) The *Bujura* Case

On January 8, 2004, the Court of Appeal in ‘s-Hertogenbosch²⁸⁰ again raised a preliminary question with the ECJ in a new MFN case.²⁸¹ In this case, a German national and resident owned a holiday house in the Netherlands together with his wife. Because of this holiday house, he had so called “Box III” income, which includes income from real property.²⁸² He had less than 90% of the family income in the Netherlands, he did not elect to be treated as a resident taxpayer,²⁸³ and he did not satisfy

278. Opinion of AG Colomer, Case C-376/03, *D*, at para. 101.

279. Joined Cases C-397/98 and C-410/98, *Metallgesellschaft Ltd. v. Commissioners of Inland Revenue*, 2001 E.C.R. I-1727, paras. 37–42.

280. Case C-8/04, *Bujura v. Inspecteur van de Belastingdienst Limburg*, 2004 O.J. (C 59) 17.

281. *Id.*

282. *Id.* Under Dutch law, the value of the real property is the basis for calculating a fixed notional income of 4% of the balance, which in turn is subject to tax at the fixed rate of 30%. The notional income is calculated on the average of the value of the assets at the start and at the end of a year.

283. *Id.* Under Dutch law, non-resident taxpayers can choose to be treated as resident taxpayers if they are EU or EEA nationals or nationals of another country with which The Netherlands has concluded a tax treaty that provides for the exchange of information between the contracting states. Brenda Vossenbergh, *The Choice for Non-*

the conditions of Article 1(1) of the supplementary protocol to the Netherlands-Germany tax treaty.²⁸⁴ Since he did not satisfy either of these requirements, certain tax benefits, such as the tax-free allowance and certain tax credits, were denied.²⁸⁵ On the other hand, under the then applicable tax treaty between the Netherlands and Belgium, residents of Belgium in comparable situations are granted these benefits.²⁸⁶ Before this background, the Court of Appeal in 's-Hertogenbosch has put the following question to the ECJ:

Does a foreign taxpayer resident in a Member State such as Germany, who is not entitled to the benefits afforded by the Netherlands-Germany Tax Convention because he does not satisfy the condition, laid down in that regard, that he receive at least 90% of his income in the Netherlands, have the right by virtue of EC law, to receive from the Netherlands the taxfree allowance and tax credit for income tax in the calculation of his

Resident Taxpayers, Points of Interest, ATICA HR, available at http://www.expatica.com/source/site_article.asp?subchannel_id=156&story_id=9973&name=The+choice+for+non%2Dresident+taxpayers%3A+points+of+interest.

284. *Bujura*, 2004 O.J. (C 59) 17. Under Art 1 of this protocol of Mar. 13, 1980, the source state, which is allowed by the treaty to tax salaries or pensions (Arts. 10, 11 & 12 of the DTC) of an individual who is a resident of the other state, shall, when taxing this income, upon request grant this individual at least 90% of certain allowances to which an individual who is resident in that State is entitled; if the individual is married he will be granted upon request when this income is being taxed at least 90% of such allowances to which an individual whose spouse is also a resident of the source state is entitled. These allowances are granted subject to the condition that the income which may be taxed by the first-mentioned state according to the DTC comprises at least 90% of the total income of the individual, and that, in the case of spouses who are not permanently separated, it is at least 90% of the total combined income of both spouses. The allowances are allowances on account of marriage, number of children and age of taxpayer; allowances for payments for the support of a former spouse or a spouse, from whom the taxpayer is permanently separated; allowances on account of extraordinary expenses incurred with respect to childbirth, sickness, disability and death; and allowances with respect to the professional education or training of the individual and his or her spouse. Art 1(3) of the protocol explicitly states that each state "reserves the right to grant more extensive allowances." Supplementary Protocol to the Convention between the Federal Republic of Germany and the Kingdom of the Netherlands for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital and Various Other Taxes, and for the Regulation of Other Questions Related to Taxation, art. 1, Mar. 13, 1980, F.R.G.-Neth., available at http://online2.ibfd.org/publications/treaty/tt/docs/html/tt_de-n1_02_eng_1959_tt.html (last visited Aug. 8, 2004).

285. *D*, 2003 O.J. (C 289) 12.

286. Neth.-Belg. DTC 1970, art. 25(3) (providing that under this non-discrimination provision "[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.").

income from savings and investments if a foreign taxpayer who is resident in another Member State, in this case Belgium, has the right to such benefits in the calculation of his income from savings and investments by virtue of the Netherlands-Belgium Tax Convention (and the decision of the State Secretary for Finance of 21 February 2002, No CPP 2001/2745, BNB 2002/164) despite the fact that he does not receive at least 90% of his income in the Netherlands?²⁸⁷

4. Conclusions

The case law of the ECJ has so far avoided statements towards MFN treatment, but still has given important, however varying, indicia towards a possible scope of MFN treatment and to possible grounds of justifications. Especially with regard to the latter the *Schumacker* case, the ECJ has shown that it is willing to accept that a tax treaty between Member State A and B may indirectly take effect on the protection of a resident of Member State C who makes use of the fundamental freedoms.²⁸⁸ Against this background, the questions put before the ECJ by the Court of 's-Hertogenbosch in the *D* case²⁸⁹ and the *Bujura* case²⁹⁰ are very important for (international) tax law and will certainly clarify the scope of non-discrimination under the EC Treaty. Based on the existing case law of the ECJ and the two pending cases, the following discussion attempts to identify the issues and the scope of a possible MFN treatment.

C. Does the EC Treaty Forbid Discrimination Between Two Non-Residents?

1. The Scope of Non-Discrimination in EC Law

From a legal perspective, the whole issue of MFN treatment can only reasonably be approached by taking a closer look at the breadth of the principle of non-discrimination in EC Law. Regarding the possible scope of non-discrimination, EC Law follows a wide approach that allows for a relevant comparison not only between two residents, one of whom has an economic

287. *Bujura*, 2004 O.J. (C 59) 17.

288. *Schumacker*, 1995 E.C.R. I-225.

289. *D*, 2003 O.J. (C 289) 12.

290. *Bujura*, 2004 O.J. (C 59) 17.

connection to another state,²⁹¹ but also between a resident taxpayer and a non-resident taxpayer.²⁹² The latter situation has already covered a comparison between residents and non-residents who have a presence in the source state in the form of a permanent establishment,²⁹³ a comparison between resident and non-resident (frontier) workers²⁹⁴ even if the non-resident has the nationality of the source state,²⁹⁵ as well as a comparison between residents and non-residents who earn their income directly from the source state without carrying out an employment or having a permanent establishment there.²⁹⁶ Meanwhile, the ECJ also seems to accept that a Member State's *own nationals* are not to be discriminated against as opposed to nationals of another Member State, meaning that reverse discrimination in certain constellations is also prohibited.²⁹⁷ However, the ECJ has not yet ruled on a clear case of "horizontal discrimination."²⁹⁸ It is not

291. See, e.g., Case C-204/90, *Bachmann v. Belgium*, 1992 E.C.R. I-249; Case C-1/93, *Halliburton Serv. BV v. Staatssecretaris van Financien*, 1994 E.C.R. I-1137, paras. 2–3; Case C-264/96, *ICI v. Colmer*, 1998 E.C.R. I-4695, para. 2; Case C-254/97, *Société Baxter v. Premier Ministre*, 1999 E.C.R. I-4809, para. 8; Case C-294/97, *Eurowings Luftverkehrs AG v. Finanzamt Dortmund-Unna*, 1999 E.C.R. I-7447, para. 33; Case C-55/98, *Skatteministeriet v. Bent Vestergaard*, 1999 E.C.R. I-7641, para. 2; Case C-200/98, *X AB and Y AB v. Riksskatteverket*, 1999 E.C.R. I-8261, para. 9; Case C-251/98, *Baars v. Inspecteur der Belastingdienst Particulieren*, 2000 E.C.R. I-2787, para. 41; Case C-87/99, *Zurstrassen v. Admin. des Contributions Directes*, 2000 E.C.R. I-3337, para. 23; Case C-35/98, *Staatssecretaris van Financien v. Verkooijen*, 2000 E.C.R. I-4071, para. 2; Case C-141/99, *AMID v. Belgium*, 2000 E.C.R. I-11619, para. 28; Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt*, 2002 E.C.R. I-11779, para. 42; Case C-385/00, *De Groot v. Staatssecretaris van Financien*, 2002 E.C.R. I-11819, para. 2; Case C-168/01, *Bosal Holding BV v. Staatssecretaris van Financien*, 2003 E.C.R. I-9409, para. 2.

292. See *Schuch*, *supra* note 68, at 268 for an overview; *Jann*, *supra* note 113, at 59; *Schuch*, *supra* note 69, at 109; *Schuch*, *supra* note 273, at 39; *Schuch*, *supra* note 25, at 162.

293. See, e.g., Case 270/83, *Commission v. France*, 1986 E.C.R. 273 ("*avoir fiscal*"), paras. 2, 5; Case C-330/91, *The Queen v. Inland Revenue Commrs, ex parte Commerzbank AG*, 1993 E.C.R. I-4017, paras. 8, 10, 16; Case C-250/95, *Futura Participations SA and Singer v. Admin. des contributions*, 1997 E.C.R. I-2471, paras. 1, 3, 7–9; Case C-311/97, *Royal Bank of Scotland plc v. Greece*, 1999 E.C.R. I-2651, paras. 3–4, 6; Case C-307/97, *Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt*, 1999 E.C.R. I-6161, para. 5.

294. *Schumacker*, 1995 E.C.R. at para. 31; Case C-80/94, *Wielockx v. Inspecteur der Directe Belastingen*, 1995 E.C.R. I-2493, paras. 18–19; Case C-107/94, *Asscher v. Staatssecretaris van Financien*, 1996 E.C.R. I-3089, para. 41; Case C-336/96, *Gilly v. Directeur des Services Fiscaux du Bas-Rhin*, 1998 E.C.R. I-2793, paras. 29–30; Case C-391/97, *Gschwind v. Finanzamt Aachen-Außenstadt*, 1999 E.C.R. I-5451, para. 32; see also Case C-234/01, *Gerritse v. Finanzamt Neukölln-Nord*, 2003 E.C.R. I-5933, paras. 43–44.

295. *Asscher*, 1996 E.C.R. at para. 62; *Gilly*, 1998 E.C.R. at para. 53.

296. See, e.g., Case C-80/94, *Wielockx v. Inspecteur der Directe Belastingen*, 1995 E.C.R. I-2493, para. 23; *Metallgesellschaft*, 2001 E.C.R. at para. 73.

297. Case C-224/98, *D'Hoop v. Office national de l'emploi*, 2002 E.C.R. I-06191, para. 30.

298. See *supra* Part 0.

clear why discrimination on the grounds of nationality as the result of a distinction between foreigners *would* be accepted.

2. Article 12 EC and “Horizontal Discrimination”

MFN treatment may be derived from the broad wording of the general non-discrimination provision of Article 12 EC, which forbids “*any discrimination on grounds of nationality*” within the field of application of the EC Treaty. It is argued that the comprehensive prohibition of *any* discrimination laid down in Article 12 EC may include MFN treatment, which on the other side is nothing else than another facet of non-discrimination in cross-border situations.²⁹⁹ Article 12 EC forbids not only overt forms of discrimination based on nationality, but also all covert forms of discrimination that, by the application of other criteria of differentiation, lead in fact to the same result.³⁰⁰ As in the field of the fundamental freedoms, it is in this regard settled case law that the principle of non-discrimination requires that comparable situations must not be treated differently and that different situations must not be treated in the same way.³⁰¹ Such treatment may be justified only if it is based on objective considerations independent of the nationality of the persons concerned and is proportionate to the objective being legitimately pursued.³⁰² Since Article 48 EC requires that companies formed in accordance with the law of a Member State and having their registered office, central administration, or principal place of business within the EU are to be treated in the same way as natural persons who are nationals of Member States,³⁰³ it seems clear that such companies qualify as nationals under Article 12 EC. It is furthermore nearly undisputed that the wording and the spirit of Article 12 EC also cover discrimination between two

299. See, e.g., Tietje, *supra* note 3, at 407.

300. See, e.g., Case-398/92, Mund & Fester v. Hatrex Internationaal Transport, 1994 E.C.R. I-467, para. 14.

301. See generally Case C-148/02, Carlos Garcia Avello v. Belgium, 2003 E.C.R. at para 31; Case C-279/93, Finanzamt Köln-Altstadt v. Schumacker, 1995 E.C.R. I-225, para. 30; Case C-107/94, Asscher v. Staatssecretaris van Financien, 1996 E.C.R. I-3089, para. 40; Case C-80/94, Wielockx v. Inspecteur der Directe Belastingen, 1995 E.C.R. I-2493, para. 17.

302. *D’Hoop*, 2002 E.C.R. at para. 36; Case C-148/02, Carlos Garcia Avello v. Belgium, para. 31.

303. See, e.g., Case 270/83, Commission v. France, 1986 E.C.R. 273, para. 18 (referring to art. 58, now art. 42); Case C-330/91, The Queen v. Inland Revenue Commissioners, ex parte Commerzbank AG, 1993 E.C.R. I-4017, para. 13; Case C-264/96, ICI v. Colmer, 1998 E.C.R. I-4695, para. 20; Case C-311/97, Royal Bank of Scotland plc v. Greece, 1999 E.C.R. I-2651, para. 23; Case C-141/99, AMID v. Belgium, 2000 E.C.R. I-11619, para. 20.

non-residents.³⁰⁴ This view is also strengthened by the Advocate General's conclusions in the *D* case:

If the application of a contractual provision by a Member State hinders the free movement of capital by unjustifiably affording different treatment to residents of other Member States (who, as European citizens, are entitled not to be directly or indirectly discriminated against on the grounds of their nationality, according to the first paragraph of Article 12 EC), there is nothing to prevent Community law from rectifying that circumstance and eliminating the inequality.³⁰⁵

However, it follows from the wording of Article 12 EC – “without prejudice to any special provisions” contained in the EC Treaty – and the ECJ's case law that the general prohibition of all discrimination on grounds of nationality laid down by Article 12 of the EEC Treaty, applies independently only to situations governed by Community law for which the EC Treaty lays down no specific non-discrimination rules.³⁰⁶ Next, according to the case law of the Court, the general prohibition of discrimination on grounds of nationality laid down by Article 12 EC has been implemented, in the particular fields which they govern, by Articles 39, 43, 49, and 56 of the Treaty.³⁰⁷ Put in other words, any rule incompatible with the fundamental freedoms is also incompatible with Article 12 EC,³⁰⁸ and any rule

304. See, e.g., Tietje, *supra* note 3, at 407; Farmer, *supra* note 23, at 102; Schuch, *supra* note 25, at 162; Schuch, *supra* note 69, at 112; see also Rädler, *supra* note 11, at 7; Lang, *supra* note 25, at 433; Lang, *supra* note 25, at 80; Farmer, *supra* note 36, at 152; see also Hinnekens, *supra* note 40, at 114; Dourado, *supra* note 40, at 151; van der Linde, *supra* note 36, at 13.

305. Opinion of AG Colomer, Case C-376/03, *D*, at para 97.

306. Case C-1/93, *Halliburton Serv. BV v. Staatssecretaris van Financien*, 1994 E.C.R. I-1137, para. 12 (discussing art. 7, now art. 12); *Gilly*, 1998 E.C.R. at para. 37 (discussing art. 6, now art. 12); *Royal Bank of Scotland*, 1999 E.C.R. at para. 20 (discussing art. 7, now art. 12); Case C-55/98, *Skatteministeriet v. Bent Vestergaard*, 1999 E.C.R. I-7641, para. 16 (discussing art. 6, now art. 12); Case C-251/98, *Baars v. Inspecteur der Belastingdienst Particulieren*, 2000 E.C.R. I-2787, para. 23; *Metallgesellschaft*, 2001 E.C.R. at para. 38.

307. *Royal Bank of Scotland*, 1999 E.C.R. at para. 20 (referring to art. 48, now art. 39); see *Gilly*, 1998 E.C.R. at para. 38 (referring to art. 48, now art. 39); see also *Halliburton*, 1994 E.C.R. at para. 12 (referring to art. 52, now art. 43); *Baars*, 2000 E.C.R. at para. 24 (referring to art. 52, now art. 43); *Metallgesellschaft*, 2001 E.C.R. at para. 39 (referring to art. 52, now art. 43); Case C-55/98, *Skatteministeriet v. Bent Vestergaard*, 1999 E.C.R. I-7641, para. 17 (referring to art. 59, now art. 49); see also Lyons, *supra* note 83, at 30 (discussing art. 73b, now art. 56).

308. *Royal Bank of Scotland*, 1999 E.C.R. at para. 20 (discussing art. 6, now art. 12).

compatible with the fundamental freedoms is also compatible with Article 12 EC.³⁰⁹ Given this brief outline, it should be noted that to date the Court has solved all cases based on the fundamental freedoms and has not examined Member States' tax laws directly in the light of Article 12 EC, the general prohibition of discrimination in EC Law. However, it seems quite unlikely that the ECJ will find discrimination in an economic context, which is covered by Article 12 EC, that is not equally covered by one of the four fundamental freedoms.³¹⁰ Especially in the *Phil Collins* case,³¹¹ the ECJ made clear that Article 12 EC is to be seen as a minimal standard, because on "the rare occasions where a specific provision of the Treaty does not apply, the general principle of non-discrimination laid down by the first paragraph of Article 7 of the Treaty [now Article 12 EC], must, in any event, do so."³¹² In his conclusions in the *D* case, Advocate General Colomer confirmed this view at least partly in regards to the freedom of capital movement by stating that view of the breadth of the freedom of capital movement under Article 56 "covers all forms of unjustified inequality of treatment, including that prohibited by Article 12 EC."³¹³

This result may also be supported by Article 306 EC, under which the provisions of the EC Treaty "shall not preclude the existence or completion of regional unions between Belgium and Luxembourg, or between Belgium, Luxembourg and the Netherlands, to the extent that the objectives of these regional unions are not attained by application of this Treaty."³¹⁴ The aim

309. See, e.g., C-112/91, *Hans Werner v. Finanzamt Aachen-Innenstadt*, 1993 E.C.R. 1993, I-429, para. 20 (discussing art. 7, now art. 12); see also *Lyons*, *supra* note 83, at 32 (discussing art. 7, now art. 12).

310. Nevertheless, it has been argued that the free movement of persons and of capital under Art 39 EC and Art 56 EC, respectively, cover, just like Art 12 EC, every discrimination and thus provide for MFN treatment, while this shall not be true for the freedom of establishment and the freedom to provide services under Art 43 EC and Art 49 EC, respectively. *Herzig & Dautzenberg*, *supra* note 36, at 2522. The latter two freedoms are granted under "under the conditions laid down for its own nationals" and "under the same conditions as are imposed by that State on its own nationals", respectively; thus, it has been argued that these freedoms seem only to provide for national treatment, while the other two fundamental freedoms as well as the general non-discrimination clause of Art 12 EC provide also for MFN treatment. *Id.* Given the general standard of Art 12 EC, the development of the case law of the ECJ, and the so-called convergence of the fundamental freedoms, however, such differentiation seems not to be feasible; see also *Josef Schuch*, *supra* note 69, at 118; see also *Schuch*, *supra* note 64, at 33; see generally *CORDEWENER*, *supra* note 8, at 103.

311. Case C-92/92 and C-326/92, *Phil Collins v. Imtrat Handelsgesellschaft mbH*, 1993 E.C.R. I-5145, para. 17 (discussing art. 7, now art. 12).

312. *Id.*; see also *Josef Schuch*, *supra* note 69, at 120; *Tietje*, *supra* note 3, at 409.

313. Opinion of AG Colomer, Case C-376/03, *D*, at para. 97, n.52.

314. EC Treaty, art. 306.

of this provision is to prevent the application of EC Law from causing the disintegration of the regional union established between those three Member States or from hindering its development. It therefore enables the three Member States concerned to apply, in derogation from the Community rules, the rules in force within their union insofar as it is further advanced than the Common Market.³¹⁵ Thus, Article 306 EC explicitly permits provisions based on agreements between the Benelux countries which effects on integration between those countries exceeds the standard of integration in the rest of the Community.³¹⁶ Put in other words, these agreements create special benefits for a certain circle of EU residents, which are explicitly immunized from the application of EC Law. Given the explicit allowance by Article 306 EC, one may argue, *e contrario*, that all other agreements between Member States must not create special benefits for residents of certain Member States.³¹⁷ Thus, all other agreements have to be judged under Article 12 EC.

3. The Implications of Article 17 EC

Further arguments for this result may be derived from Article 17 EC: This provision introduces the citizenship of the EU and confers the status of citizen of the Union on every person holding the nationality of a Member State.³¹⁸ Union citizenship is destined to be the fundamental status of nationals of the Member States, enabling those who find themselves in the same situation to enjoy within the scope *ratione materiae* of the Treaty the same treatment in law irrespective of their nationality, subject to such exceptions as are expressly provided for.³¹⁹ Under the case law of the ECJ the non-discrimination principle of Article 12 EC must be read in conjunction with the provisions of the Treaty concerning citizenship of the Union in order to determine its sphere of application.³²⁰ Thus, a citizen of the EU can rely on Article 12 EC in all situations that fall within the scope *ratione materiae* of EC Law. Those situations include those involving the exercise of the fundamental freedoms guaranteed by the EC

315. Case 105/83, *Pakvries BV v Minister van Landbouw en Visserij*, 1984 E.C.R. 2101, para. 11.

316. EC Treaty, art. 306.

317. See also Tietje, *supra* note 3, at 406.

318. EC Treaty, art. 17.

319. Case C-224/98, *D'Hoop v. Office national de l'emploi*, 2002 E.C.R. I-6191 – Par. 28; see, e.g., Case C-184/99, *Grzelczyk v. Centre public d'aide sociale d'Ottignies-Louvain-la-Neuve*, 2001 E.C.R. I-6193, para. 31; Case C-148/02, *Carlos Garcia Avello v. Belgium*, 2003 E.C.R., at para. 23.

320. *Grzelczyk*, 2001 E.C.R. at para. 30.

Treaty.³²¹ Put in other words, a citizen of the EU can rely on Article 12 EC in the case of a cross-border economic engagement within the EU and thus invoke equal treatment with any other national of a Member State in the same situation. Articles 12, 17 EC thus prohibit discrimination between two non-residents, which is clearly in line with the understanding of the internal market laid down in Article 14 EC.

4. Are Two Non-Residents in Comparable Situations?

It must also be noted that the main prerequisite for the issue of comparability (a relationship to the tax system of one and the same country)³²² is clearly fulfilled in the case of two non-residents with economic contacts to one and the same source country. However, as mentioned above, discrimination within the meaning of EC Law arises through application of different rules to comparable situations or the application of the same or a similar rule to different situations.³²³ Since the source country's domestic tax law usually treats all non-residents equally, the question arises as to whether the treatment in the source country alone is decisive for determining if two non-residents are in comparable situations, or alternatively, whether their treatment in their country of residence has to be considered.

While some authors strongly hold to the view that the fact that the countries of residence of the two non-residents apply different methods of avoiding double taxation may mean that the two non-residents are not in a similar situation,³²⁴ the prevailing opinion is that such inquiry has to be made solely with regard to the treatment by the source country.³²⁵ While the former view may have its merits for determining if a situation is disadvantageous for the taxpayer, the latter view must be upheld for the inquiry into whether situations are *per se* comparable. Support for this can easily be found in the ECJ's case law: In the *avoir fiscal* case, a tax credit (the so-called "avoir fiscal") was

321. See *id.* at paras. 32–33; Case C-148/02, *Carlos Garcia Avello v. Belgium*, 2003 E.C.R., at para. 24.

322. See also *Lyons*, *supra* note 83, at 35; *Schuch*, *supra* note 68, at 269; *Schuch*, *supra* note 25, at 162.

323. Case C-279/93, *Finanzamt Köln-Altstadt v. Schumacker*, 1995 E.C.R. I-225, para. 30; Case C-80/94, *Wielockx v. Inspecteur der Directe Belastingen*, 1995 E.C.R. I-2493, para. 17; Case C-107/94, *Asscher v. Staatssecretaris van Financien*, 1996 E.C.R. I-3089, para. 40; *Royal Bank of Scotland*, 1999 E.C.R. at para. 26; Case C-391/97, *Gschwind v. Finanzamt Aachen-Außenstadt*, 1999 E.C.R. I-5451, para. 21; Case C-431/01, *Mertens v. Belgium*, 2002 E.C.R. I-7073, para. 32.

324. See, e.g., *Hughes*, *supra* note 40, at 127; see also *De Ceulaer*, *supra* note 5, at 500.

325. See, e.g., *Schuch*, *supra* note 25, at 162; *Schuch*, *supra* note 68, at 269; *van der Linde*, *supra* note 36, at 13; *contra Gammie & Brannan*, *supra* note 10, at 403.

denied to a French branch of a foreign company but was available to French subsidiaries. The ECJ found that French tax law does not distinguish, for the purpose of the determining the tax base, between companies having their registered office in France and French branches of foreign companies: "By treating the two forms of establishment in the same way for the purposes of taxing their profits, the French legislature has in fact admitted that there is no objective difference between their positions in regard to the detailed rules and conditions relating to that taxations which could justify different treatment."³²⁶ The same source-state-oriented inquiry was made, for example in the *Royal Bank of Scotland* case³²⁷ and the *Saint-Gobain* case.³²⁸

This view is strengthened by the Advocate General's conclusions in the *D* case.³²⁹ There, AG Colomer concluded that comparability of situations of taxpayers does not depend on whether the source country has concluded different double taxation conventions with other Member States, which are the result of negotiations based on the different national tax systems involved:

[The governments which have submitted observations in the proceedings] maintain that D.'s circumstances cannot be compared with those of a taxpayer resident in Belgium. Agreements concluded under Article 293 EC are, in their view, the fruit of negotiations which include assessment of the framework and content of their respective tax systems and therefore, in order to make a finding as to equal treatment in relation to a specific factual situation, account cannot be taken of an isolated provision, or even of the entire convention, but the national taxation system as a whole must be considered. As the Commission very graphically demonstrates, different treaty arrangements create different situations, which are not comparable.

The foregoing maximalist reasoning would have precluded the rulings given in *Gottardo* and *Saint-*

326. Case 270/83, *Commission v. France*, 1986 E.C.R. 273, para. 20.

327. See *Royal Bank of Scotland*, 1999 E.C.R. at para. 28.

328. See Case C-307/97, *Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt*, 1999 E.C.R. I-6161, para. 47.

329. See Opinion of AG Colomer, Case C-376/03, *D*, at paras. 99–100.

Gobain ZN, or any test of equal treatment, since if, in addition to similarity between the factual circumstances and the applicable provisions, there must be similarity between the reasons, the grounds and the procedure followed for their approval and between the legal systems which incorporate the provisions being compared, it would never be possible to make a finding and there would never, or almost never, be comparable situations. In reality, assessment of equality is simpler and more limited, in so far as it is a matter of identifying whether two individuals in comparable factual circumstances are subject without justification to disparate rules and, in comparing those rules, the sole pertinent inquiry is whether their application leads to differing effects to the detriment of either of them.³³⁰

D. *Different Treatment Due to Different Tax Treaties: Discrimination?*

1. The Allocation of Taxing Rights: What Gilly Means for the Issue of MFN Treatment

Having found that EC Law in principle also forbids “horizontal discrimination” between two non-residents,³³¹ the pressing question becomes whether, and to what extent, different treatment because of different tax treaties between the source state and the two respective partner states can amount to such a forbidden discrimination. This inquiry thus raises the important question about the scope of MFN treatment, for which important implications can be derived from the ECJ’s judgment in the *Gilly* case.³³² As already mentioned above,³³³ in the *Gilly* case the ECJ considered that the “Member States are competent to determine the criteria for taxation on income and wealth with a view to eliminating double taxation – by means, inter alia, of international agreements – and have concluded many bilateral conventions based, in particular, on the model conventions on income and wealth tax drawn up by the Organisation for

330. *Id.*

331. *See supra* Part 0.

332. Case C-336/96, *Gilly v. Directeur des Services Fiscaux du Bas-Rhin*, 1998 E.C.R. I-2793, paras. 2, 4.

333. *See supra* Part 0.

Economic Cooperation and Development ('OECD').³³⁴ Differentiations with regard to the allocation of taxing rights, even when based on nationality, therefore do not amount to a forbidden discrimination. A forbidden discrimination flows (in the absence of any unifying or harmonizing measures adopted in the Community context under, in particular, the second indent of Article 293 EC) "from the contracting parties' competence to define the criteria for allocating their powers of taxation as between themselves, with a view to eliminating double taxation."³³⁵

Thus, the allocation of taxing rights³³⁶ between Member States in their bilateral tax treaties is considered to be "neutral" and thus non-discriminatory,³³⁷ regardless of whether such bilateral tax treaty is based on the OECD Model Convention.³³⁸ Although the ECJ gives much weight to the OECD Model Convention,³³⁹ it seems that it can be derived from the decision in the *Saint-Gobain* case that any allocation of taxing rights is considered to be neutral.³⁴⁰ This said, there seem to be two ways to argue with the *Gilly* case in respect of MFN treatment: First, it could be argued that MFN treatment requires that the authority to allocate taxing rights is exercised in a uniform manner towards all Member States.³⁴¹ Second, the *Gilly* case may be seen as a limitation of a possible application of MFN treatment, excluding the "neutral" allocation of taxing rights from the scope of "horizontal discrimination."³⁴² The latter view is, for good reasons, the prevailing one and is also held by the Commission which considers that "it is arguable that the equal treatment principle does not allow reciprocal concessions which

334. *Gilly*, 1998 E.C.R. at para. 24.

335. *Id.* at para. 30; see also *Saint-Gobain*, 1999 E.C.R. at para. 56; see Vanistendael, *supra* note 209, at 171 for the further arguments of the ECJ on this point.

336. See generally OECD Model Convention with Respect to Taxes on Income and Capital, Jan. 28, 2003, arts. 6–22, available at <http://www.oecd.org/dataoecd/52/34/1914467.pdf> [hereinafter OECD Model Convention 2003].

337. See also Opinion of AG Colomer, *Gilly*, 1998 E.C.R. at para. 44; Lehner, *supra* note 31, at 334; Klaus Eicker, *Tax Treaties and EC Law: Comment on the Gilly Case*, 38 ET 322, 325 (1998).

338. See van den Hurk, *supra* note 24, at 216.

339. See, e.g., *Gilly*, 1998 E.C.R. at para. 31; see also, e.g., Hughes, *supra* note 40, at 332; van den Hurk, *supra* note 24, at 216; Vanistendael, *supra* note 209, at 167.

340. See *Saint-Gobain*, 1999 E.C.R. at para. 56.

341. See Lang, *supra* note 25, at 435.

342. See, e.g., Hughes, *supra* note 40, at 332; Lehner, *supra* note 31, at 335; van den Hurk, *supra* note 24, at 216; Farmer, *supra* note 26, at 152; Hinnekens, *supra* note 40, at 114; CORDEWENER, *supra* note 8, at 837; see Weber & Spierts, *supra* note 37, at 67; van der Linde, *supra* note 36, at 14.

70 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

go beyond mere allocation of taxing rights, such as differences in concessions to avoid economic double taxation (refunds of imputation credits).”³⁴³

This finding is of great importance with regard to the practical scope of a precept regarding MFN treatment because as a consequence, treaty provisions that merely provide for an allocation of taxing rights are “neutral” and thus does not amount to “horizontal discrimination.”³⁴⁴ If two non-residents are treated differently after such “neutral” allocation, a discrimination does not exist as long as such different treatment is attributable to the disparities, e.g., different tax rates, between the tax systems of the Member States of residence and source because in the absence of any Community legislation in this field, the determination of the tax base or the tax rates is a matter for those Member States.³⁴⁵

The basic holding in the *Gilly* case has much in common with a line of argumentation made before the *Gilly* case, namely whether the treatment of taxpayer in his country of residence has to be considered in order to determine a discrimination in the country of source.³⁴⁶ It seems that this line of argumentation, for which further implications may be derived from the recent *De Groot* case,³⁴⁷ supplements the finding of the *Gilly* case because it also puts the focus on the interplay between the allocation of taxing rights and the provisions on avoiding double taxation. However, the *De Groot* case seems to take an even broader approach because it recognized the permissibility to shift positive EC obligations from one to another Member State.

2. The Influence of the Tax Situation of a Non-Resident in Its Country of Residence: From the Legal Merits of an “Overall Tax Burden” Inquiry to the Permissibility of Shifting an Obligation under EC Law

It is generally unclear whether discrimination may be carved out – or at least justified – by taking into consideration the overall tax burden the taxpayer has to bear. Thus, the focus may

343. See Company Taxation in the Internal Market, *supra* note 20, at 316.

344. CORDEWENER, *supra* note 8, at 837; Weber & Spierts, *supra* note 37, at 67; van der Linde, *supra* note 36, at 14.

345. See, e.g., *Gilly*, 1998 E.C.R. at paras. 24, 47–48; Case C-385/00, *De Groot v. Staatssecretaris van Financiën*, 2002 E.C.R. I-11819, paras. 75–111, 114–115; see also Opinion of AG Colomer, *Gilly*, 1998 E.C.R. at paras. 1, 7, 43, 47; see also Hughes, *supra* note 40, at 332; van den Hurk, *supra* note 24, at 216.

346. See *infra* Part 0.

347. *De Groot*, 2002 E.C.R. at para. 75.

shift on the taxation in another country in order to destroy the verdict of discrimination in one country. The issue is especially important in the context of bilateral tax treaties because less favorable treatment in one country is usually compensated in the other country. Simplifying, if one state is granted the right to tax an item of income, the other state is simultaneously obligated to grant relief, i.e., either to exempt such income or to give a credit for the taxes paid in the partner state.

Thus, if the treatment in the other country were to be considered, the practical importance of MFN treatment would basically be reduced to benefits granted under a treaty for which no offsetting treatment is provided. However, the case law on this issue is not completely clear: Although the judgments in the *Schumacker* case³⁴⁸ and in the *Wielockx* case³⁴⁹ take into consideration the treatment of a taxpayer in his country of residence to evaluate whether an unjustified discrimination took place in the country of source, these relevance of these inquiries is limited to the question as to whether the country of source is factually able to grant certain benefits or whether this obligation “switches over” to the source country. Furthermore, other cases, such as the *Commerzbank* case,³⁵⁰ clearly point to an isolated evaluation of discrimination.³⁵¹

However, legal scholarship on this issue is split down the middle. While some argue that the treatment in the residence country must be considered to evaluate whether there is a discrimination in the source country,³⁵² others reject this opinion and support the view that the overall tax burden is irrelevant in determining a discrimination or to justify such discrimination.³⁵³ From an abstract perspective, the latter view is clearly preferable. First, the case law of the ECJ goes into this

348. Case C-279/93, *Finanzamt Köln-Altstadt v. Schumacker*, 1995 E.C.R. I-225.

349. Case C-80/94, *Wielockx v. Inspecteur der Directe Belastingen*, 1995 E.C.R. I-2493.

350. Case C-330/91, *The Queen v. Inland Revenue Commissioners, ex parte Commerzbank AG*, 1993 E.C.R. I-4017, paras. 17–22.

351. Jann, *supra* note 113, at 77; Gerald Toifl, *Can a discrimination in the state of residence be justified by the taxable situation in the state of source?*, 5 EC TAX REV. 165 (1996); Martin Jann, *How does Community law affect benefits available to non-resident taxpayers under tax treaties?*, 5 EC TAX REV. 168, 171 (1996).

352. See, e.g., Hughes, *supra* note 40, at 126; Avery Jones, *supra* note 40, at 97; Wassermeyer, *supra* note 148, at 24; but see also Wassermeyer, *supra* note 78, at 163.

353. See, e.g., Michael Lang, *Die Bindung der Doppelbesteuerungsabkommen an die Grundfreiheiten des EU-Rechts*, in *DOPPELBESTEUERUNGSABKOMMEN UND EU-RECHT* 25, 36 (Wolfgang Gassner et al. eds., 1996); Jann, *supra* note 113, at 77; Schuch, *supra* note 69, at 130; Schuch, *supra* note 25, at 164; Toifl, *supra* note 352, at 165; Jann, *supra* note 352, at 170; Lang, *supra* note 25, at 81.

direction.³⁵⁴ Second, since discrimination is to be evaluated from the perspective of one country, that is, the prerequisite for the comparability of situations is a relationship to the tax system of one and the same country, it would be asymmetrical to consider taxation in another state to justify discrimination in another.³⁵⁵ Third, if the tax situation in the other country were taken into account without reservation, the conformity with EC Law would depend on legislation and administrative acts in such other country, which would not be compatible with the sovereign status of national tax legislators still existing in the EU.³⁵⁶

This said, the issue nevertheless seems to be different with regard to bilateral treaties, and especially with regard to the question of MFN treatment. If the problem were approached in a very abstract manner, it may be argued that a Member State, which has a certain obligation under EC Law, should be able to shift this obligation to another Member State in a bilateral agreement. If this were the case, a Member State could create a legal situation in compliance with EC Law by sharing an obligation with another Member State, as long as the EU citizen in question is in no worse position than before. Such option is introduced by the recent *De Groot* case.³⁵⁷

The *De Groot* case revolved around the question as to whether the state of residence *always* has to take into account its residents' general personal and family circumstances in the full amount, as opposed to an amount proportional to the percentage of income earned in the residence state if some of the income is earned in another country. The ECJ basically held so, but also stated:

Member States are of course free, in the absence of unifying or harmonising measures adopted in the Community, to alter, by way of bilateral or multilateral agreements for the avoidance of double taxation, that correlation between the total income of residents and residents' general personal and family circumstances to be taken into account by the State of residence. The State of residence

354. It may also be noted that, although not completely on point, the ECJ has repeatedly rejected a "compensatory" taxation, without considering an overall treatment of the taxpayer in both countries. See Case C-294/97, *Eurowings Luftverkehrs AG v. Finanzamt Dortmund-Unna*, 1999 E.C.R. I-7447, paras. 43–46; Case C-136/00, *Danner*, 2002 E.C.R. I-8147, para. 56; *De Groot*, 2002 E.C.R. at para. 97.

355. See also Schuch, *supra* note 69, at 131; Schuch, *supra* note 25, at 164.

356. See Toifl, *supra* note 351, at 167; Lang, *supra* note 25, at 81.

357. *De Groot*, 2002 E.C.R. I-11819.

can therefore be released by way of an international agreement from its obligation to take into account in full the personal and family situation of taxpayers residing in its territory who work partially abroad.³⁵⁸

The ECJ also held:

The mechanisms used to eliminate double taxation or the national tax systems which have the effect of eliminating or alleviating double taxation must permit the taxpayers in the States concerned to be certain that, as the end result, all their personal and family circumstances will be duly taken into account, irrespective of how those Member States have allocated that obligation amongst themselves, in order not to give rise to inequality of treatment which is incompatible with the Treaty provisions on the freedom of movement for workers and in no way results from the disparities between the national tax laws.³⁵⁹

The method considered by the ECJ in the *De Groot* case is that the Member States would agree in a bilateral agreement and in deviation from the ECJ's case law to allocate the personal deductions in the same proportion as when the taxpayer earns his income in the state of residence and the state of employment.³⁶⁰ Thus, for instance, 30% income in the state of residence and 70% in the state of employment would lead to also the same ratio of the personal deductions.³⁶¹ In principle, the ECJ rejects such a pro rata allocation under EC Law, but it does allow the Member States to agree to such an allocation by way of a bilateral or multilateral treaty. If this idea were transferred to the issue of MFN treatment it would mean that a Member State might shift an EC obligation to another Member State, as long as the other Member State factually takes over such obligation.³⁶²

358. *Id.* at para. 99; see also Georg W. Kofler, *De Groot: Arbeitnehmerfreizügigkeit gebietet eine volle steuerliche Berücksichtigung der persönlichen und familiären Situation im Wohnsitzstaat*, 2003 ÖSTZ 184, 186.

359. *De Groot*, 2002 E.C.R. at para. 101.

360. See Weber & Spierts, *supra* note 37, at 69.

361. The comment the ECJ made in the *De Groot* case was a response to the argument of the Netherlands government that a fair division of the personal deductions can only be achieved by such a *pro rata* division. See, e.g., Kofler, *supra* note 359, at 185.

362. However, the latter Member State must be able to take over such obligation; a

Thus, the *De Groot* case also confirms that the interplay between the allocation of taxing rights and the provisions on avoiding double taxation has to be taken into account – a result already indicated by the *Gilly* decision.

3. Example: The Issue of Withholding Taxes

Coming back to the initial example of different withholding tax rates in the source state, the question arises as to whether the treatment in the respective residence state has to be considered. This inquiry is obvious in the case of withholding taxes because the true nature of a withholding tax is that both countries – the source and the residence country – share the “tax pie” in a way that the tax imposed by the source state should be offsetable in the residence state. Thus, the usual way to avoid double taxation with regard to withholding taxes on dividends, interest, and royalties is for residence country to give a tax credit for the tax withheld by the source country.³⁶³

This said, the argument could be made that withholding taxes should not be considered as discriminatory, since they effectively wash out in computing the overall tax-burden of a multinational group, for example. Based on the argumentation in the *De Groot* case,³⁶⁴ a Member State thus simply shifts its obligation under EC Law, for example, by granting a 0% withholding tax rate as a consequence of MFN treatment to the Member State in which the taxpayer resides. The former Member State imposes a withholding tax in excess of 0% but simultaneously obliges the latter Member State by means of a bilateral tax treaty to grant a credit for such tax. Thus, it may be argued that a discrimination does not exist.

With regard to the “classical” MFN situation,³⁶⁵ this may be illustrated by the following simplified example:³⁶⁶ Two corporations, residents of the Netherlands (A) and Belgium (B),

nice example for the opposite situation where is the pending *D* case. See *supra* Part 0. Since the wealth tax in question is not levied in Belgium, and thus Belgium can not take over the granting of a basic allowance which is denied by the Netherlands. See also Weber & Spierts, *supra* note 37, at 69.

363. See, e.g., OECD Model Convention 2003, *supra* note 337, at arts. 23A(2), 23. OECD, *Commentaries to the Model Tax Convention on Income and on Capital 2003*, Arts. 23A and 23B, paras. 47–81. See Hughes, *supra* note 40, at 128 for a brief overview over “treaty trade-offs” in respect of withholding taxes.

364. *De Groot*, 2002 E.C.R. at paras. 93, 97, 99, 101.

365. See Hughes, *supra* note 40, at 129 (providing an example for this issue from the view of MFN treatment with regard to the residence country).

366. It is assumed that the Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, 2003 O.J. (L 157) 6, does not apply to the following example.

respectively, each wholly own a subsidiary in Ireland (C). Each of the subsidiaries has €100 of income and pays the same amount as interest payments to its respective parent company. With regard to these payments, the tax treaty between the Netherlands and Ireland forbids to levy withholding tax on interest payments,³⁶⁷ while the tax treaty between Belgium and Ireland allows the latter to withhold a tax of 15% on such payments.³⁶⁸ Assuming an identical corporate tax rate of 30% in Belgium and in the Netherlands,³⁶⁹ full taxability of the received interest payments in both countries, and full deductibility of interest payments in Ireland, the calculation of the economic outcome of these transactions may be illustrated as follows:

		Dutch-Irish Group	Belgian-Irish Group
Subsidiary Level	Income of Irish Subsidiary	100	100
	Interest Payment (Deduction)	(100)	(100)
	Irish Corporate Income Tax	(0)	(0)
	Irish Withholding Tax	(0)	(15)
Parent Level	Cash-Flow to Parent Company	100	85
	Gross Income for Tax	100	100
	Corporate Income Tax	(30)	(30)
	Foreign Tax Credit	0	15
	Tax Liability	(30)	(15)
	Overall Tax Burden	(30)	(30)
	Cash after Tax	70	70

From an overall perspective, this simplified example shows that the actual difference in withholding tax rates does not affect the group's final tax burden. This means that the final amount that can be distributed to the shareholders of the respective parent company is not reduced by the withholding tax levied in the subsidiary's country of residence because such withholding tax is fully offsetable against the parent's corporation tax liability in its country of residence. Thus, it can be argued that the differences in withholding tax rates do not affect the taxpayer's

367. Convention for the Avoidance of Double Taxation & the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, Feb. 11, 1969, Neth.-Ir., art. 9(1), available at http://www.revenue.ie/services/tax_info/dtas.nether.htm.

368. Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Jun. 24, 1970, Ir.-Belg., art. 11, available at http://www.revenue.ie/tax_info/dtas/belgium.htm

369. This simplification can easily be made, since different tax rates are an inevitable result of the lack of harmonization in the field of direct taxation and thus within the discretion of each Member State. See, e.g., Case C-336/96, Gilly v. Directeur des Services Fiscaux du Bas-Rhin, 1998 E.C.R. I-2793, paras. 1, 23-24, 30, 34.

final outcome; instead, they divide the “tax pie” between the two involved countries.³⁷⁰ It may therefore be concluded that the source state does not discriminate against the Belgian-Irish Group, since Ireland is obligated, under the tax treaty, to credit the Belgian withholding tax.³⁷¹ There seems to be no difference whether this conclusion is reached by declaring the allocation of taxing rights as “neutral,” as the ECJ did in the *Gilly* case,³⁷² and considering the applicable percentage of withholding tax as such allocation of taxing rights,³⁷³ or by allowing a Member State to negotiate an obligation of its treaty partner to take over its EC obligation, which the ECJ permitted in the *De Groot* case.³⁷⁴ Thus, at least since *Gilly* and *De Groot* it seems that the application of different withholding tax rates, as provided for by the relevant tax treaty, are not incompatible with the EC Treaty as EC Law stands today.³⁷⁵ The question of a state’s taxation rights under a tax treaty thus is a question of “*allocation not discrimination*.”³⁷⁶ The only issue that may arise in such a situation is the disadvantage in liquidity arising from tax being withheld at the moment of distribution and credited later in the residence state. Although the ECJ has ruled, for example in the *Metallgesellschaft and Hoechst* cases³⁷⁷, that such liquidity disadvantage may amount to forbidden discrimination, there seem to be good arguments that the *Gilly* and *De Groot* case law permits such differences to arise in the area of an allocation of taxing rights between two Member States.

However, the credit method, as laid down in the OECD Model Convention and taken over into many tax treaties, just provides for a so-called “ordinary credit” which may result in different absolute tax burdens.³⁷⁸ Coming back to the above

370. This becomes clear from the above example: While in the case of the Dutch-Irish Group all the tax of 30 is collected in, and kept by, the Netherlands, in the case of the Belgian-Irish Group the revenue of 30 is shared equally between Ireland and Belgium.

371. See Avery Jones, *supra* note 40, at 97 for this result.

372. See *supra* Part D.

373. See also Hughes, *supra* note 40, at 332; van der Linde, *supra* note 36, at 14.

374. See *supra* Part 0.

375. Thus, the prevailing opinion before the *Gilly* case, i.e., that different withholding tax rates should be subject to MFN treatment, seems to be outdated by *Gilly* and *De Groot*. See also Hughes, *supra* note 40, at 332; van den Hurk, *supra* note 24, at 216; van der Linde, *supra* note 36, at 14; but see also De Ceulaer, *supra* note 5, at 500. See Rädler, *supra* note 36, at 67 for the earlier prevailing opinion; Schuch, *supra* note 68, at 267.

376. Hughes, *supra* note 40, at 333; see also CORDEWENER, *supra* note 8, at 598.

377. Joined Cases C-397/98 and C-410/98, *Metallgesellschaft Ltd. v. Commissioners of Inland Revenue*, 2001 E.C.R. I-1727, paras. 44, 54.

378. See OECD Model Convention 2003, *supra* note 337, at arts. 23A(2), 23B. See

example, Belgium will in any event grant an “ordinary” tax credit, which is limited by the amount of Belgian corporate tax on such income.³⁷⁹ Modifying the facts above and now assuming an identical corporate tax rate of 10% in Belgium and in the Netherlands, the calculation of the economic outcome of these transactions may be illustrated as follows:

		Dutch-Irish Group	Belgian-Irish Group
Subsidiary Level	Income of Irish Subsidiary	100	100
	Interest Payment(Deduction)	(100)	(100)
	Irish Corporate Income Tax	(0)	(0)
	Irish Withholding Tax	(0)	(15)
Parent Level	Cash-Flow to Parent Company	100	85
	Gross Income for Tax Purposes	100	100
	Corporate Income Tax	(10)	(10)
	Foreign Tax Credit	0	10
	Tax Liability	(10)	(0)
	Overall Tax Burden	(10)	(15)
	Cash after Tax	90	85

Leaving aside disadvantages in liquidity, this modified example shows that the insufficient relief by an “ordinary credit” may lead to situations where the combination of a withholding tax and a credit does not have a neutral impact on cross-border economic activities. In this example, the Dutch-Irish Group clearly has a tax advantage due to the fact that Ireland does not impose a withholding tax on interest payments to Dutch recipients. However, it may be doubted whether such result renders the Irish treatment of interest payments to Belgian recipients discriminatory,³⁸⁰ since the real question here seems to be whether the application of the credit method by the country of

also Commentaries to the Model Tax Convention on Income and Capital 2003, arts. 23A, 23B, para. 47 (discussing the application and the consequences of the credit system).

379. Under Art 23(1)(ii) of the Belgium-Ireland Double Taxation Convention, double taxation of interest shall be relieved in Belgium by reducing “the Belgian tax charged thereon by a deduction in respect of the tax borne in Ireland. The deduction shall be allowed against the tax chargeable on the net amount of . . . interest . . . arising in Ireland which have been taxed there; the deduction shall be the fixed proportion of the foreign tax for which provision is made in existing Belgian law, subject to any subsequent modification – which, however, shall not affect the principle hereof.” Convention between Ireland and Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Jun. 24, 1970, Ir.-Belg., *available at* http://www.revenue.ie/services/tax_info/dtas/belgium.htm.

380. *But see* De Ceulaer, *supra* note 5, at 500.

residence (Belgium) is in compliance with EC Law.³⁸¹ Similar issues may arise if the country of residence can not credit the withholding tax levied by the source country.³⁸² In such a situation it still may be argued that the residence country should allow the carry-forward or carry-back of relief for the withholding tax and that therefore again the issue is one of allocation not discrimination.³⁸³ This result is appealing, since from the point of view of the source country the argument is the same: It negotiated with the residence country the obligation for the latter to grant relief for the withholding taxes levied by the former.³⁸⁴ Thus, against the background of the *Gilly* case and the *De Groot* case, it seems that the allocation provisions of a bilateral treaty still are “neutral” in such cases and the question of an infringement of the fundamental freedoms, if any, has to be posed on the level of domestic tax law of the residence state.³⁸⁵ As the ECJ,³⁸⁶ echoing its AG,³⁸⁷ found in the *Gilly* case, the object of a double taxation treaty “is simply to prevent the same income from being taxed in each of the two States.”

4. Remaining Issues

As mentioned above, there is an overlap between the outcome of the *Gilly* decision, which basically declared the allocation of taxing rights in bilateral tax treaties as “neutral,” and the permissibility of shifting an EC obligation to another Member State in a bilateral tax treaty under the *De Groot* decision. Both ways provide for a considerable limitation of the

381. See, e.g., Vogel, *supra* note 39, at 150.

382. An example of this is when no corporation tax levied in the residence country because of losses. However, especially with regard to dividends, there are several situations in which the withholding tax levied by one Member State can not be credited by another Member State. In this respect basically two different situations can be identified: First, the residence country of a parent company may use the exemption method under national law in combination with an “ordinary” credit for the withholding tax under the tax treaty; in such situation the foreign withholding tax levied on the distribution by the subsidiary may usually not be credited, since the distribution itself is tax free in the parent company’s country of residence under domestic law, leaving no tax base to credit foreign taxes against. Second, if the parent company’s country of residence grants an indirect credit for the corporation tax paid by the subsidiary – and thus provides for relief from economic double taxation –, however, the indirect credit may already offset the corporation tax due in the parent company’s country of residence, leaving no more tax left to credit the foreign withholding tax against.

383. See Hughes, *supra* note 40, at 130.

384. On the other hand, it can be argued that there is an obligation under the fundamental freedoms for the residence country to grant a carry-forward or carry-back of relief, which is currently not granted e.g., by Austria.

385. See also, e.g., Vanistendael, *supra* note 209, at 176.

386. *Gilly*, 1998 E.C.R. at para. 46.

387. Opinion of AG Colomer, *Gilly*, 1998 E.C.R. at para. 66.

scope of MFN treatment, removing e.g., different allocation rules, different withholding tax rates, and different definitions with regard to the allocation of taxing rights, from the potential verdict of “horizontal discrimination”. This result is also suggested by the Commission which states that “it is arguable that the equal treatment principle does not allow reciprocal concessions which go beyond mere allocation of taxing rights, such as differences in concessions to avoid economic double taxation (refunds of imputation credits).”³⁸⁸

These limitations found, it seems that basically two groups of provisions in double taxation treaties are open for the MFN inquiry. The first group consists of provisions that do not provide for an avoidance of juridical double taxation, but merely for a reduction of singular taxation in one Member State. Such rules may provide for exemptions, deductions, or tax-free allowances.³⁸⁹ The second group may cover provisions which serve the avoidance of *economic* double taxation by a measure of the source country,³⁹⁰ as it is, for example, the case in the selective refund of imputation credits under the current UK corporate tax system,³⁹¹ if such provisions do not constitute *per se* a forbidden discrimination between residents and non-residents.³⁹² The conclusions of Advocate General Colomer in the *D* case may also strengthen this view:

The legitimate use of a [Member State’s power to tax] depends on its being exercised within the limits for which it is conferred, so that any overstepping of those limits is illegal. On the other hand, as I have suggested, the purpose of the Member States’ competence to enter into bilateral agreements, such as that referred to in the main proceedings, is to allocate taxation powers, with the result that, where there is nothing to share out, the agreement becomes meaningless. In relation to the wealth tax, since at the material time there was no such tax in Belgium,

388. See Company Taxation in the Internal Market, *supra* note 20, at 316.

389. See discussion and cases cited *supra* Parts III.B.3.(b)-(c).

390. See Company Taxation in the Internal Market, *supra* note 20, at 316.

391. See Kofler, *supra* note 74, at 29 for a brief overview; see Rädler, *supra* note 11, at 10 for this issue with regard to MFN treatment; Farmer, *supra* note 36, at 152; Newey, *supra* note 74, at 292.

392. See, for example, Opinion of AG Kokott, Case C-319/02, Manninen (finding the Finnish imputation system to be incompatible with the freedom of capital movement) for the strained relationship between imputation systems and the fundamental freedoms.

Article 25(3) of the agreement with the Netherlands, to the extent to which it extends to Belgian residents entitlement to the allowance it grants to Dutch residents, becomes a mere privilege for which no consideration is given and for which there is no reciprocal basis, and the test of its 'Community compatibility' must therefore be much more rigorous. The somewhat alarmist arguments and consequences outlined by the Governments participating in the proceedings, to which I shall refer briefly below, vanish into thin air, because the provision under analysis is completely unrelated to the specific substance of the arrangements intended to abolish international double taxation.³⁹³

E. *Justification under the "Rule of Reason"?*

Once a forbidden discrimination between two non-residents (a "horizontal discrimination") is identified, this discrimination can be justified only if that provision pursues a legitimate aim compatible with the EC Treaty and is justified by pressing reasons of public interest.³⁹⁴ But even in such case, it would still have to be of such a nature as to ensure achievement of the aim in question and not to go beyond what was necessary for that purpose.³⁹⁵ Based on the brief overview given above,³⁹⁶ it seems clear that most thinkable grounds of justification are not valid in the case of MFN treatment: It is generally agreed that neither the lack of harmonization of direct taxation,³⁹⁷ principles of international tax law,³⁹⁸ the legal form of DTCs,³⁹⁹ nor budgetary

393. Opinion of AG Colomer, Case C-376/03, *D v Head of the Private Individuals/Enter./Foreign Countries/Heerlen Unit*, para. 82.

394. See Case C-204/90, *Bachmann v. Belgium*, 1992 E.C.R. I-249, paras. 21, 32, 35; Case C-300/90, *Commission v. Belgium*, 1992 E.C.R. I-305, para. 14, 16–17, 20–21; Case C-107/94, *Asscher v. Staatssecretaris van Financien*, 1996 E.C.R. I-3089, para. 49–51; Case C-136/00, *Danner*, 2002 E.C.R. I-8147, paras. 33, 44.

395. Case C-250/95, *Futura Participations SA and Singer v. Admin. des contributions*, 1997 E.C.R. I-2471, para. 26; Case C-436/00, *X, Y v. Riksskatteverket*, 2002 E.C.R. I-10829, para. 49.

396. See *supra* Part 0.

397. See, e.g., Schuch, *supra* note 68, at 270; Schuch, *supra* note 64, at 34.

398. See, e.g., Lang, *Die Bindung der Doppelbesteuerungsabkommen an die Grundfreiheiten des EU-Rechts*, in *DOPPELBESTEUERUNGSABKOMMEN UND EU-RECHT* 25, 34 (Wolfgang Gassner et al. eds., 1996).

399. See Schuch, *supra* note 68, at 269; Klaus Eicker, *Cases Hoechs/Metallgesellschaft before the European Court of Justice*, 27 *INTERTAX* 173, 174 (1999).

considerations⁴⁰⁰ may justify such “horizontal discrimination”. However, justification may be possible under the principles of reciprocity and fiscal coherence.

This said, a common argument against MFN treatment is the special nature of tax treaties, which are the result of a negotiation process between two states by which the rights and obligations are laid down in a *quid pro quo* deal on the basis of the reciprocity principle, thus creating a balance between benefits and concessions in the closed frame of the bilateral relationship. Based on this, some authors suggest that the need to safeguard the balance of essential reciprocal tax concessions – and thereby the coherence of the bilateral tax system itself – justifies a purported discrimination,⁴⁰¹ while others oppose this opinion.⁴⁰² The proponents of the latter view especially argue with the case law of the ECJ: The Court has repeatedly held that “the right to equal treatment laid down in Community law may not be made dependent on the existence of reciprocal agreements concluded by the Member States.”⁴⁰³ Thus, a Member State cannot deny the application of MFN treatment based on the argument that a benefit will be allocated based on reciprocity alone.⁴⁰⁴

It may, however, be doubted whether this case law is completely on point for the question of MFN treatment because it recently addressed a bilateral relationship and not a possible extension to residents of a third country. More concretely, the ECJ has already recognized that a tax treaty is concluded through a process of give and take and thus explicitly discussed such a ground of justification in the *Saint-Gobain* case,⁴⁰⁵ and later more clearly in the *Gottardo* case,⁴⁰⁶ with regard to bilateral treaties with non-Member States. In *Gottardo*, the Court held, “Disturbing the balance and reciprocity of a bilateral international convention concluded between a Member State and a non-member country may, it is true, constitute an objective justification for the refusal by a Member State party to that

400. Schuch, *supra* note 68, at 270.

401. *So, e.g.*, Hinnekens, *supra* note 7, at 213; Kemmeren, *supra* note 34, at 147; Kemmeren, *supra* note 40, at 23; Lehner, *supra* note 31, at 470; Hinnekens, *supra* note 40, at 114; *see also* Wattel, *supra* note 32, at 252; van den Hurk, *supra* note 24, at 216; van der Linde, *supra* note 36, at 15.

402. *So, e.g.*, Tietje, *supra* note 3, at 410; Wassermeyer, *supra* note 148, at 27; Schuch, *supra* note 273, at 46; *see also* Farmer, *supra* note 23, at 103.

403. *See, e.g.*, Case C-20/92, Hubbard, 1993 E.C.R. I-3777.

404. *See also* Weber & Spierts, *supra* note 37, at 68.

405. Case C-307/97, *Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt*, 1999 E.C.R. I-6161, paras. 58–60.

406. Case C-55/00, *Gottardo*, 2002 E.C.R. I-413, paras. 1, 32–34.

82 HOUSTON BUSINESS AND TAX LAW JOURNAL [Vol. V

convention to extend to nationals of other Member States the advantages which its own nationals derive from that convention.”⁴⁰⁷ With regard to the MFN issue not much is gained from this statement. Although the ECJ has recognized the importance of the principle of reciprocity, at least in bilateral relationships between a Member State and a non-Member State, the Court has also limited the scope of a possible justification. In the *Gottardo* case the Court explicitly stated that it must, in order to justify discrimination, be established that the obligations that Community law imposes on them would compromise those resulting from the commitments that a Member State has entered into vis-à-vis a non-Member State.⁴⁰⁸ Thus, the unilateral extension of benefits would never compromise the rights which the rights which a non-Member State derives from such treaty and would not impose any new obligations on such country.⁴⁰⁹ The ECJ itself explained that in the *Saint-Gobain* case,

[The Court] merely held that the extension to permanent establishments of companies having their seat in a Member State other than the Federal Republic of Germany of a tax advantage provided for by a bilateral international agreement concluded by the Federal Republic of Germany with a non-member country could be decided upon unilaterally by the former without in any way affecting the rights of the non-member country arising from that agreement and without imposing any new obligations on that non-member country.⁴¹⁰

Put in other words, a discrimination which consists in the non-granting of unilateral beneficial treatment may most likely not be justified by the principle of reciprocity: By implementing the MFN principle, no obligations are forced on the treaty partner.⁴¹¹

Another argument made in favor of a justification is that a tax treaty creates a coherent tax system and thus the non-application of MFN treatment is justified under the principle of

407. *Id.* at para. 36; see also *Saint-Gobain*, 1999 E.C.R. at para. 60.

408. *Gottardo*, 2002 E.C.R. at para. 37.

409. See also CORDEWENER, *supra* note 8, at 934.

410. See, e.g., Case C-466/98, *Commission v. United Kingdom*, 2002 E.C.R. I-9427 (“*open skies*”), para. 54.

411. See *Weber & Spierts*, *supra* note 37, at 69.

fiscal cohesion. Although the boundary between such “cohesion” argument and the principle of reciprocity is vague and the arguments made in either respect seem somewhat redundant, it is nevertheless rewarding to take a closer look at the principle of fiscal cohesion, or synonymously, fiscal coherence. In two earlier cases the Court held that a discriminatory provision could be justified by the public interest in preserving the fiscal coherence of a Member State’s tax system.⁴¹² In these cases concerning Belgian tax rules, the proportionality test was considered to be met and the justification was accepted on the ground that there was a need to ensure that a tax deduction granted in respect of pension or life assurance premiums was matched by ultimate taxation of the benefits paid out under the relevant policy – the deductibility of the premiums matched the taxability of the benefits.⁴¹³ However, those two cases have been widely criticized because they were decided upon a wrong factual and legal determination of the facts,⁴¹⁴ and the ECJ has subsequently shown great reluctance to accept the fiscal coherence type of justification and ever since denied a justification on the ground of the cohesion of the tax system.⁴¹⁵

Under the tightened prerequisites for such justification, the applicability of the coherence defense is limited to situations where a discriminatory rule refusing a deduction for a payment is justified by inability to tax the recipient of the payment. Hence, a justification of a discriminatory measure on the grounds of “fiscal coherence” requires the existence of a direct link between deduction and taxation within the same tax system. The ECJ has repeatedly held that the aim of ensuring coherency of

412. *Bachmann*, 1992 E.C.R. at paras. 21–22; Case C-330/90, *Commission v. Belgium*, 1992 O.J. (C 44) 16.

413. *Joined Opinions of AG Mischo*, Cases C-204/90 and C-300/90, *Bachmann*, *Commission v. Belgium*, 1992 E.C.R. I-249, paras. 7, 24; Case C-330/90, *Commission v. Belgium*, 1992 O.J. (C 44) 16.

414. *See, e.g.*, *Knobbe-Keuk*, *supra* note 113, at 79; *Kofler*, *supra* note 123, at 406.

415. *See, e.g.*, Case C-279/93, *Finanzamt Köln-Altstadt v. Schumacker*, 1995 E.C.R. I-225, paras. 40–43; Case C-80/94, *Wielockx v. Inspecteur der Directe Belastingen*, 1995 E.C.R. I-2493, paras. 13–19, 23, 25; Case C-484/93, *Svensson and Gustavsson v. Ministre du Logement et de l’Urbanisme*, 1995 E.C.R. I-3955, paras. 14–19; Case C-55/98, *Skatteministeriet v. Bent Vestergaard*, 1999 E.C.R. I-7641, para. 24; Case C-264/96, *ICI v. Colmer*, 1998 E.C.R. I-4695, para. 29; Case C-294/97, *Eurowings Luftverkehrs AG v. Finanzamt Dortmund-Unna*, 1999 E.C.R. I-7447, paras. 41–46; Case C-251/98, *Baars v. Inspecteur der Belastingdienst Particulieren*, 2000 E.C.R. I-2787, paras. 37–41; Case C-35/98, *Staatssecretaris van Financiën v. Verkooijen*, 2000 E.C.R. I-4071, paras. 49–58; *Joined Cases C-397/98 and C-410/98, Metallgesellschaft Ltd. v. Commissioners of Inland Revenue*, 2001 E.C.R. I-1727, paras. 67–71; Case C-136/00, *Danner*, 2002 E.C.R. I-8147, paras. 33–39; Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt*, 2002 E.C.R. I-11779, paras. 40–42; Case C-422/01, *Ramstedt v. Riksskatteverket*, 2003 E.C.R. I-6817, paras. 30–37; *see CORDEWENER, supra* note 8, at 958 for an extensive discussion.

taxation is not sufficient to justify a difference in treatment between residents and non-residents unless the tax disadvantage resulting for a national of a Member State is compensated for by a corresponding tax advantage for the same person, with the result that he suffers no discrimination.⁴¹⁶ Thus, the existence of a merely indirect link between the tax advantage accorded to one taxable person and the unfavorable tax treatment of another cannot justify discrimination.⁴¹⁷ As the case law of the ECJ indicates, in national rules there is rarely a strict correlation between deductions and benefits. This is even less so if one takes account of bilateral conventions. As the Court noted in the *Wielockx* case, “the effect of double-taxation conventions which follow the OECD model is that the State taxes all pensions received by residents in its territory, whatever the State in which the contributions were paid, but, conversely, waives the right to tax pensions received abroad even if they derive from contributions paid in its territory which it treated as deductible.”⁴¹⁸ Thus, fiscal cohesion may be secured by a bilateral convention concluded with another Member State and may therefore not be invoked on the level of domestic tax law. Hence, the existence of a bilateral tax treaty shifts the question shifted to another level, “that of the reciprocity of the rules applicable in the Contracting States.”⁴¹⁹

However, invoking the principle of cohesion in situations of horizontal discrimination lacks of persuasive power: The fact that one and the same Member State has easily given to a taxpayer in another state the favourable tax treatment which the taxpayer invoking the MFN standard is seeking clearly shows that denying such treatment is not necessary to safeguard the coherence of the national tax system.⁴²⁰ Furthermore, a purported coherence on the level of the bilateral tax treaty itself is not persuasive either. The argument would be that the granting of a certain benefits to residents of one treaty partner but not to residents of another treaty partner may be justified by the fact that the former treaty partner made up for this benefit by also granting a certain tax advantage during the treaty negotiations. However, the validity of such argumentation must be

416. See, e.g., *Eurowings Luftverkehrs*, 1999 E.C.R. at para. 20; *Ramstedt*, 2003 E.C.R. at paras. 30–37.

417. See, e.g., *Eurowings Luftverkehrs*, 1999 E.C.R. at para. 20.

418. *Wielockx*, 1995 E.C.R. at para. 24.

419. *Id.*

420. *Schumacker*, 1995 E.C.R. at para. 46; Opinion of AG Léger, *Schumacker*, 1995 E.C.R. at para. 87; see also Schuch, *supra* note 273, at 47; Schuch, *supra* note 25, at 163.

questioned.⁴²¹ First, this is no more than an assumption. Second, although the assumption might be correct in this case – it might be clear from the minutes concerning the treaty negotiations – settled ECJ case law shows that when certain fiscal advantages compensate disadvantages, this is not a justification for violation of the Treaty freedoms.⁴²² Third, and here the circle to the argumentation based on the principle of reciprocity closes, the ECJ does not generally allow such an equal treatment to be made dependent on a reciprocal treatment.

IV. CONCLUSIONS

A. MFN Treatment and the Implications for National Treatment

EC Law requires, in principle, the application of MFN treatment to double taxation treaties. However, the scope of such application is very limited. Under the *Gilly* and the *De Groot* cases the allocation of taxing rights, and thus, for example, the issue of different withholding tax rates,⁴²³ is arguably excluded from possible MFN treatment. This limitation is what the Commission obviously has in mind when it considers that non-MFN treatment may infringe the non-discrimination principle when reciprocal concessions “go beyond mere allocation of taxing rights.”⁴²⁴ These limitations basically leave two groups of provisions open for the application of MFN treatment. The first group consists of provisions in tax treaties that merely serve the reduction of singular taxation in the Member State of source, such as, for example, exemptions, deductions, or tax-free allowances. The second group covers provisions that serve the avoidance of *economic* double taxation by a measure of the source country, such as imputation credits for foreign shareholders. However, in such cases, justification of a “horizontal discrimination” under the “rule of reason” is unlikely against the background of the existing case law.

Given these restrictions and limitations of a potential application of MFN treatment, it seems that in virtually all remaining cases, the same or even more advanced results can be

421. See also Weber & Spierts, *supra* note 37, at 69.

422. See, e.g., Case C-307/97, *Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt*, 1999 E.C.R. I-6161, para. 53.

423. The same is true for differing definitions of permanent establishments, the calculation of the 183-day-clause, or the taxation of artists. See, e.g., Schuch, *supra* note 68, at 267; Wassermeyer, *supra* note 78, 162.

424. See Company Taxation in the Internal Market, *supra* note 20, at 316.

achieved by way of national treatment. A resident of a Member State need not be satisfied in a “vertical” perspective with a treatment another Member State gives to residents of a third Member State if the former falls behind national treatment, even if it is more beneficial in a “horizontal” perspective.⁴²⁵ On the other hand, it seems that a non-resident may not invoke a treatment better than national treatment by way of a MFN inquiry. Thus, the treatment of a resident may be seen as having the function of a connecting link between the “vertically” oriented national treatment and the “horizontally” oriented MFN treatment. It is the object of comparison for the former, if such comparison is possible, and the limitation of rights for the latter.⁴²⁶ Accordingly, for situations in which a comparison between a resident and a non-resident is possible, there is no need for MFN treatment because the former is the more advanced stage of integration than the latter because “the most-favoured-nation clause assumes that discriminatory treatment is possible, whereas discrimination is forbidden under EC law.”⁴²⁷ This also seems to be the approach of the ECJ in the *Metallgesellschaft and Hoechst* cases,⁴²⁸ where it solved the issue based on national treatment by way of comparison between German and UK parent companies, rather than by a comparison between German parent companies and their favorably treated Dutch equivalents.

Thus, focusing on national treatment, if it is found that a non-resident is treated less beneficial than a resident, it is for the respective Member State to show appropriate criteria of differentiation, and justification, and to proof the proportionality of the measures. However, if it is the case that such Member State has already, in a tax treaty, given to residents of another Member State rights that are comparable to rights of its own residents, it may not be able anymore to argue grounds of differentiation or justification with regard to less beneficial treatment of residents of a third Member State. This is made clear by the ECJ⁴²⁹ and the AG in the *Schumacker* case. A Member State can not justify an infringement of the EC Treaty, for example, “by pleading the excessive financial consequences of

425. CORDEWENER, *supra* note 8, at 839.

426. *Id.*

427. Martín-Jiménez et al., *supra* note 8, at 250; *see also* CORDEWENER, *supra* note 8, at 836.

428. Joined Cases C-397/98 and C-410/98, *Metallgesellschaft Ltd. v. Commissioners of Inland Revenue*, 2001 E.C.R. I-1727, para. 60.

429. *Schumacker*, 1995 E.C.R. at para. 46; *see also*, Tietje, *supra* note 3, at 400; Rädler, *supra* note 11, at 8.

making generally available a right which it has already granted to certain non-residents.”⁴³⁰ Thus, a tax treaty between Member State A and B may in any event indirectly take effect on the protection of a resident of Member State C who makes use of the fundamental freedoms.

B. *A Brief Glance at the Perspectives: Multilateral Tax Treaty, EC Model Convention, or Work on Specific EU Concepts?*

The tension between the Member State’s bilateral tax treaties and EC Law is undeniable. Even if a judicially introduced MFN clause were applied, the unharmonized field of bilateral tax treaties does not always cater for the complex multinational character of economic relations or the requirements of the Internal Market, such as triangular problems.⁴³¹ In this respect, the Commission has identified three main approaches to resolve the problems of double taxation in the Internal Market and incompatibilities with EC law that are not currently being adequately addressed by bilateral tax treaties. These are,⁴³² a) the conclusion of a multilateral tax treaty between all EU Member States; b) the development of an EU Model Treaty based on the OECD Model but taking account of the requirements of the EC Treaty, which could be used by Member States in their future tax treaty negotiations with each other and with third countries; and c) within the OECD framework, work on specific EU concepts (such as the definition of “residence” and “non-discrimination”) culminating in a recommendation to Member States or an agreement by Member States to reflect these concepts in their relations with each other and with third countries.⁴³³

The idea of a multilateral tax treaty between EU Member States is not new.⁴³⁴ The EC first produced a draft for such a treaty dealing with taxes on income and capital over thirty years ago and it was discussed, albeit unsuccessfully, with the then six Member States in a Commission working group.⁴³⁵ It is

430. Opinion of AG Léger, *Schumacker*, 1995 E.C.R. at para. 87.

431. See Michael Lang & Josef Schuch, *Europe on its way to a Multilateral Tax Treaty*, 9 EC TAX REV. 39 (2000).

432. Company Taxation in the Internal Market, *supra* note 20, at 357; see also PISTONE, *supra* note 3, at 207.

433. See Company Taxation in the Internal Market, *supra* note 20, at 357.

434. *Id.* at 358; see also RUDING REPORT, *supra* note 54; MULTILATERAL TAX TREATIES (Michael Lang ed. 1998) (including a draft of such multilateral treaty); see also, Lang & Schuch, *supra* note 417, at 39.

435. See Lang & Schuch, *supra* note 432, at 39; Manuel Pires, *A Multilateral Tax*

nevertheless commonly agreed that such multilateral treaty – which would replace all existing bilateral treaties between the Member States – should be based on the OECD Model Convention.⁴³⁶ Such multilateral tax treaty would clearly be capable of dealing with several issues that cannot be sufficiently covered by bilateral treaties.⁴³⁷ In addition, from a practical viewpoint, with the increase in the number of bilateral tax treaties, tax law becomes increasingly complicated and, although many bilateral tax treaties are quite old, the process of revision is time-consuming because of the number involved. However, the experience with other multilateral conventions,⁴³⁸ procedural issues, and the significant number of differences in Member States' tax systems may hinder such task.⁴³⁹ The second suggested approach would be for Member States to agree to an EC Model Treaty, or, synonymously, an EC Model Convention, for use in their tax treaty negotiations with each other and with third countries.⁴⁴⁰ This long term approach would have the advantage that it would leave Member States free to continue to reflect strictly bilateral concerns in bilateral tax treaties.⁴⁴¹ It could also, unlike a multilateral convention but like the OECD Model Convention, be adopted in a non-legally binding form and supplement the OECD Model Convention. The third approach is the work on specific EU concepts towards certain aspects of tax treaties.⁴⁴² This approach would be limited to fields that are of major interest to the Community, such as instances in which case law has clearly interpreted Treaty provisions. Thus, guidance could, for example, be provided on issues of residence and non-discrimination.

Based on comprehensive evaluation of the advantages and disadvantages of these approaches, the Commission has recently indicated that it views as the most promising way forward for the long term is to agree an EU version of the OECD model and

Convention for the European Union? 12 EC TAX REV. 43, 43 (2003).

436. See, e.g., Michael Lang, *The Concept of a Multilateral Tax Treaty*, in MULTILATERAL TAX TREATIES, 187, 192 (Michael Lang ed., 1998); see also Pistone, *supra* note 10, at 129.

437. See, e.g., Guglielmo Maisto, *Shaping EU Company Tax Policy: The EU Model Tax Treaty*, 42 ET 303, 304 (2002).

438. *Id.* at 303.

439. See *Company Taxation in the Internal Market*, *supra* note 20, at 222, 359; Pistone, *supra* note 10, at 132; Maisto, *supra* note 438, at 306.

440. See *Company Taxation in the Internal Market*, *supra* note 20, at 360; see also, Kemmeren, *supra* note 34, at 149; PISTONE, *supra* note 3, at 235 (including an example of a draft of such convention); Pistone, *supra* note 10, at 129.

441. See Pistone, *supra* note 10, at 132.

442. See *Company Taxation in the Internal Market*, *supra* note 20, at 360.

commentary (or of certain articles) which meet the specific requirements of EU membership, which would also leave intact the existing bilateral system.⁴⁴³ Since the double-taxation agreements of Member States will continue to be subject to review by the ECJ and the problems resulting from the current lack of co-ordination in this area, notably in triangular situations and with regard to third countries, will increase even further, without Community action, there may be important political and economic repercussions for Member States' policies in this area. Against this background it seems desirable for Member States as well as for taxpayers that the Commission's approach of gradual and measured co-ordination of treaty policies by way of a EU model tax convention will eventually gain support and meet with a constructive attitude from Member States.

443. See Towards an Internal Market without Tax Obstacles: Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee, COM (01)582 final at 14.