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The Application of the Fundamental Freedoms
to Member State Tax Measures:
Guarding against Protectionism or
Second-guessing National Policy Choices?

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KAREN BANKS

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Abstract

The provisions of the EC Treaty which deal with Member State tax measures clearly seem to indicate that, in the absence of provisions of secondary law harmonizing such measures, Community law provides simply for a rule against discrimination. However, in the application of the fundamental freedoms to this area, the Court of Justice does not distinguish it specifically from other types of regulation. At least on the level of language, therefore, it often appears to apply a "restriction" approach which would go well beyond a search for discrimination in national measures. This article examines the Court's caselaw in some detail in order to determine what type of analysis the Court is really engaged in. It shows that, although the Court has never found a non-discriminatory measure to be contrary to Community law, there is often an ambiguity in its analysis of tax rules which leaves this possibility open and creates legal uncertainty.

Keywords

competences, European law, free movement, judicial review, non-discrimination

Introduction*

In relation to the “fundamental freedoms” provided for by the EC Treaty, the Court of Justice has an ambitious approach. It has long rejected the idea that the provisions of the Treaty concerning the free movement of goods, services, persons and capital were simply prohibitions on discrimination based on the origin of the economic factor in question. In numerous judgments over the years, it has developed the idea that the provisions in question forbid any restriction on the freedoms they protect, and that all measures which “*prohibit, impede or render less attractive the exercise [of the freedom in question] must be regarded as such restrictions*”,¹ even if they apply without distinction based on national origin. A restriction will be unlawful unless it is justified by overriding requirements relating to the public interest, is suitable for securing the attainment of the objective it pursues and does not go beyond what is necessary in order to attain it.

Although this approach has been generally applauded, occasional voices have been raised to draw attention to certain dangers inherent in it. In the Caixa-Bank case, Advocate-General Tizzano pointed out that the Court was in danger of adopting a very broad approach to what constituted a “restriction”; if all measures rendering an economic activity less attractive were to be in principle forbidden, this would threaten all regulation, or at least all but the least restrictive. The Advocate-General pointed out that such a result would hardly be compatible with the scheme of competences envisaged by the Treaty, under which the Member States retain their competence to regulate economic activity, subject only to the Treaty’s prohibitions on discrimination and restrictions on the exercise of fundamental freedoms. In other words, an overly wide understanding of the nature of a “restriction” would have the surprising result that Member States had actually lost their regulatory competence, or at least that they had retained it only to the extent that their measures were approved by the Court of Justice.

Others have expressed similar concerns over the years². Some of these authors³ have pointed out that the scheme of the Treaty seems to indicate that the aim of the provisions on the fundamental freedoms is to outlaw protectionist State measures, and not to subject all Member State regulation to a control of its reasonableness. The broad “restriction” approach results in the latter control system, since it effectively covers all regulation⁴, and allows it to stand only to the extent that it is judged

* The author is Legal Adviser, European Commission. This paper was written while on sabbatical at the European University Institute, and its conclusions discussed at a workshop on Current Issues in Community Law concerning Member State Tax Measures organised in Florence under the aegis of the Robert Schuman Centre for Advanced Studies in May 2007. The author expresses her gratitude for comments made on an earlier version by Jukka Snell, Peter Oliver and Giuliano Marengo. Remaining errors are of course her own. Opinions expressed are personal and do not necessarily reflect the position of the Commission.

- 1 See, e.g., the judgment of the Court in Case C-442/02, Caixa – Bank France, judgment of 5 October 2004, at ground 11.
- 2 Marengo, “Pour une interprétation traditionnelle de la notion de mesure équivalente à une restriction quantitative”, *Cahiers de Droit Européen* (1984) p. 291 ; Defalque, *Commentaire Mégret – Le droit de la CEE*, 2nd Ed. (1992) Vol. 1 at 242-243; Chalmers, “Free Movement of Goods within the European Community: an Unhealthy Addiction to Scotch Whisky?”, (1993) *ICLQ*, Vol. 42, Part 2 at 269; Schima, “Equivalent Effect Revisited: the European Court of Justice and Article 30 EEC”, (1995) *Austrian Journal of Public and International Law*, Vol. 47 at 215; Snell and Andenas, « How far ? The Internal Market and Restrictions on the Free Movement of Goods and Services”, *International and Comparative Corporate Law Journal*, Vol 2, Issue 2, 2000, p. 239; Snell, “Goods and Services in EC Law – a Study of the Relationship between the Freedoms”, Oxford University Press, 2002.
- 3 Marengo, Defalque, Snell and Andenas, op.cit. footnote 2. See in the same sense A.G. Poaires Maduro in Joined Cases C-158 and 159/04 *Alfa Vita Vassilopoulos et al.* [2006] ECR I-8135.
- 4 Since all regulation, by its nature, tends to impose some constraints, and therefore to produce effects, directly or indirectly, on economic activity. A number of authors have tried to limit the impact of the broad “restriction” approach by suggesting that it should not cover measures which do not directly affect access to the market, or which are too far removed from interstate trade, or which have too slight an effect on such trade. See for instance Oliver and Roth, “The Internal Market and the Four Freedoms”, *CMLR* 41: 407-441, 2004; O’Keeffe and Bavasso, “Four Freedoms, One Market

appropriate. This raises problems of a constitutional nature, since the decision on the appropriateness of national regulation is shifted from the national to the federal level, ie to the level of the Court of Justice. These authors have proposed that the provisions on the fundamental freedoms should instead be read as prohibiting discrimination in the broadest sense: any measure which in any way, in law or in fact, puts a movement of goods, services, persons or capital between one Member State and another at a disadvantage in comparison with an equivalent operation within a Member State should be subject to scrutiny as to its justification, proportionality etc. Any measure, on the other hand, which has no such specific effect on movements across borders should be deemed to fall outside the scope of the rules on free movement.

The analysis therefore goes beyond the strict language of the Treaty, which frequently refers to discrimination based on nationality or the principle of national treatment (see Articles 39, 43 and 50). The cases which have come before the Court over the years have shown that protectionism can be implemented just as much by measures which restrict outward movements (towards other Member States) as those which protect against inward displacements. Thus, difficulties put in the way of, say, a capital movement from the legislating Member State to another are just as much of a problem for the creation of the internal market as are obstacles placed in the path of incoming capital. This double nature of the transactions to be protected was anticipated by the authors of the Treaty in relation to goods, hence the coexistence of Articles 28 and 29. Article 56 makes no distinction, in relation to the free movement of capital, between restrictions imposed by the Member State in which the capital originates and that for which it is destined. In relation to the other economic factors, however, the Court has had to interpret provisions which, on their face, appear only to deal with the inward-moving transactions in order to make them apply also to the outward⁵. This is entirely justified by the aim of the Treaty to outlaw protectionism in whatever form. It has also led to a necessary mutation in the idea of discrimination: discrimination based on nationality is of no relevance where it may be a national of the legislating Member State who is being blocked from going to establish himself in another Member State or from buying shares in a company based there. In order to cover all the operations which may fall under the four freedoms, the relevant question is therefore whether a national measure imposes a specific disadvantage on a movement between Member States in comparison with an equivalent operation on the national level.

In relation to goods, the Court has gone some way towards accepting discrimination as its touchstone. The judgment in *Keck*⁶, for all its faults⁷, subjects to automatic scrutiny only measures which, by their nature, are likely to create extra problems for goods coming from other Member States (requirements as to size, composition, packaging etc), leaving all other national provisions free from interference unless they are shown to be in some way discriminatory. As regards the other freedoms, however, the Court seems to continue on its broad "restriction" path. The traditional reference to "*all measures which prohibit, impede or render less attractive the exercise of [a fundamental freedom]*" continues to appear, with minor variations, in judgments concerning the different freedoms, and it often seems that the Court requires no more than an effect on the pursuit of an economic activity in order to consider that a national measure is a restriction requiring scrutiny as to its justification. The

(Contd.) _____

and National Competence: in Search of a Dividing Line", *Judicial Review in European Union Law, Liber Amicorum* in honour of Lord Slynn of Hadley, Kluwer Law International 2000. These ideas are however inherently vague, and give no clear guidance as to how any given measure should be assessed.

5 In relation to freedom of establishment, see Case 81/87 *Daily Mail* [1988] ECR 5483, ground 16; as regards free movement of workers, Case C-18/95 *Terhoeve* [1999] ECR I-345, grounds 26-29 ; for freedom to provide services, Case 286/82 *Luisi and Carbone* [1984] ECR 377, ground 16.

6 Joined cases C-267 and C-268/91 *Keck and Mithouard* [1993] ECR I-6097

7 The articles criticising this judgment are too numerous to be listed. The essential difficulty arises from the need to classify all measures as either rules relating to the characteristics of a product or as "selling arrangements". For a succinct criticism, see the Opinion of A.G. Poiares Maduro in Joined Cases C-158 and 159/04 *Alfa Vita Vassilopoulos et al.* [2006] ECR I-8135.

focus of the present article is on the application of this approach to the internal tax measures of Member States.

Treaty Provisions Relating to Taxation

The scheme of the Treaty clearly seems to indicate that, apart from legislation specifically regulating one or the other aspect of tax law, Community law is limited in this field to a rule against discrimination.

There are two main Treaty provisions dealing with fiscal measures, Articles 25 and 90. Article 25 prohibits customs duties on imports and exports in trade between the Member States, and charges having equivalent effect. This prohibition expressly includes customs duties of a fiscal nature. According to a long-established line of case-law⁸, Article 25 covers all charges levied at the time of, or by reason of, importation, which are imposed specifically on an imported product but not on a similar domestic product. Even a charge imposed both on imports and domestically-produced goods may be a charge equivalent to a customs duty if the money raised is used to support activities which benefit the taxed national products but not the imports. In such a case, the apparently neutral charge may in fact impose a net tax burden only on the imports, since for the domestic products it corresponds to benefits received⁹. In any event, Article 25 applies only to measures imposing a specific disadvantage on imports or exports.

Article 90, first indent, prohibits Member States from imposing on the products of other Member States “*any internal taxation of any kind in excess of that imposed ... on similar domestic products*” (emphasis added). The second indent of Article 90 bans Member States from “[*imposing*] on the products of other Member States any internal taxation of such a nature as to afford indirect protection to other products” (emphasis added). This provision is therefore concerned with discrimination in every sense, including the indirect protection of national production by the adoption of rules unfavourable to imports. The Court has had occasion to interpret Article 90 as a whole as a provision guarding against protectionism.¹⁰ In *Weigel*¹¹, it said that

Article 90 EC seeks to guarantee the complete neutrality of internal taxation as regards competition between products already on the domestic market and imported products (ground 66)¹².

The Court has consistently interpreted Article 90, in accordance with its terms, as being limited to a ban on discrimination. As in the case of the fundamental freedoms, it has expanded the notion of discrimination to cover also tax disadvantages imposed on exports¹³. It thus aims to ensure that, as the authors of the Treaty clearly intended, Article 90 should catch all potentially protectionist national measures.

It is true that the Court toyed for a while with the idea that national tax measures which were not discriminatory but which might be excessive and therefore constitute a barrier to the free movement of

8 Starting with Case 77/72, *Capolongo v Maya* [1973] ECR 611. See more recently Case C-517/04 *Visserijbedrijf D.J. Koornstra v Productschap Vis* [2006] ECR I-

9 Where the charge imposed on domestic products cannot be fully set off against benefits received, the measure will fall to be examined under Article 90 as discriminatory internal taxation. Cf *Visserbedrijf Koornstra*, op cit footnote 8.

10 See, for example, Case 15/81 *Gaston Schul* [1982] ECR 1409 at ground 26; Case 184/85 *Commission v Italy* [1987] ECR 2013 at ground 7; Joined Cases C-290 and 333/05 *Akos Nadasdi and Ilona Nemeth*, judgment of 5 October 2006, not yet reported, at ground 45

11 Case C-387/01 *Weigel v Finanzlandesdirektion für Vorarlberg* [2004] ECR I-4981

12 This was expanded on by the Court in its judgment in Case C-313/05 *Brzezinski*, judgment of 18 January 2007, not yet reported, at grounds 27-28.

13 See, for instance, Case 142/77 *Preben Larsen and Flemming Kjerulff* [1978] ECR 1543 or Case C-234/99 *Nygaard* [2002] ECR I-3657

goods could fall to be dealt with under Article 2814. However, it seems to have thought better of this idea – see its judgment in Case C-383/01, *De Danske Bilimportører*.¹⁵ In any event, it is clear since *Keck* that, even if one could overcome the considerable objections to examining under the general ban on restrictions on the free movement of goods measures for which a *lex specialis* has been inserted in the Treaty, in any event a non-discriminatory national tax measure would no longer be considered a restriction on the free movement of goods.

The focus on discrimination is maintained by the references to tax law in Article 58. This provision safeguards the application, in the context of the free movement of capital and payments, of certain fiscal measures, but specifies (in paragraph 3) that these “*shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments*”. The meaning of “arbitrary discrimination” is fairly clear¹⁶. As for the notion of a “disguised restriction on free movement”, this has to be understood in the light of the fact that certain restrictions of a fiscal nature are actually authorized by Article 58(1)(a) and (b), so that the reference to a “disguised restriction” cannot be to any kind of restriction: it must have a special meaning. The most obvious interpretation is that it refers to measures having a particular, though indirect (“disguised”) impact on the cross-frontier movements of capital or payments which are liberalised by Article 56, without being justified by the apparently legitimate aim pursued, ie measures which either are not really apt to attain the declared objective or which go beyond what is needed in order to achieve that aim.

For the rest, the Treaty provides for the possibility of the harmonization of tax laws, on the basis of either Article 93 or 94, and always on the basis of unanimity¹⁷. Fiscal provisions are specifically excluded from the possibility of harmonization by qualified majority offered by Article 95¹⁸. Furthermore, Article 293, in providing for Member States to enter into negotiations with each other with a view to securing the abolition of double taxation within the Community, makes it clear that the Treaty has not affected the basic competence of Member States to determine their respective tax jurisdictions.

In sum, the picture which emerges from the Treaty provisions is of an area of largely retained competences, subject only to certain rules against discrimination and the possibility of harmonization by unanimous vote of the Member States. Needless to say, however, the rules of the Treaty governing the four freedoms apply to all national taxation measures other than those covered by Article 90, whether these be direct taxes or indirect taxes on services. The classic statement of the Court is that

Although, as Community law stands at present, direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law¹⁹.

14 See its judgment in Case C-47/88, *Commission v Denmark* [1990] ECR I-4509

15 Judgment of 17 June 2003, at grounds 40-42.

16 The Court has explained several times that a difference in treatment will amount to arbitrary discrimination within the meaning of Article 58(3) if it applies to situations which are objectively comparable and is not justified by overriding reasons in the general interest – see, for instance, the judgment in Case C-319/02 *Manninen*, judgment of 7 September 2004, not yet reported, at ground 29.

17 It has been suggested (Triantafyllou, “La doctrine fiscale sous l’emprise du marché intérieur: vers une coordination de la fiscalité directe dans la Communauté européenne?”, *Revue de Droit fiscal* 2006, Hebdomadaire no 24) that Article 96 could provide a suitable legal base for legislation concerning tax rates, which would therefore be adopted by majority voting, but this seems doubtful – if tax harmonization measures could be adopted on the basis of Article 96, the exclusion of fiscal measures from the scope of Article 95(1) would make little sense. It seems that Article 96 has to be understood as applying to very specific situations of harmful distortion of competition rather than to simple differences between the systems, or even the tax rates, of Member States.

18 See Article 95(2).

19 Case C-279/93 *Schumacker* [1995] ECR I-225 at ground 21.

It is in the application of the fundamental freedoms in this area that the Court sometimes seems to depart from discrimination analysis. It appears on occasion to follow its usual “restriction” reasoning (hereinafter referred to as the “obstacle approach”), and to examine the justification of national tax measures without first enquiring whether they have some extra impact on cross-frontier operations as against purely national transactions. This introduces a surprising inconsistency of method, depending on the precise form of taxation examined in a given case and, hence, the provision of the Treaty which has to be applied to it (ie Article 90 or a provision concerning a fundamental freedom). It is true that, in this field more than others, the Court frequently refers to discrimination analysis, and one may often find the hallowed statement that “*discrimination arises through the application of different rules to comparable situations or the application of the same rules to different situations*”.²⁰ However, in other cases there is no reference to discrimination, and indeed it is sometimes unclear what criteria the Court has applied in arriving at its conclusion²¹. In what follows, an attempt will be made to analyse the various types of reasoning to be found in the Court’s caselaw concerning each of the rules on free movement. The purpose is to see whether there are common threads running through the different branches of the caselaw, and whether a consistent way forward can be suggested.

Free Movement of Workers

As with freedom of establishment and freedom to provide services²², in this area the Court’s early caselaw is based on discrimination analysis. Starting with discrimination based on nationality, the judgments move on to cover differences in treatment suffered by a worker as a consequence of the exercise of the right to free movement. Although, therefore, in an overall sense this freedom is largely analysed in discrimination terms, there are nevertheless two judgments which rely on “obstacle” reasoning. However, even these can be explained (as to their result) in terms of discrimination analysis.

Discrimination Based on Nationality

In Biehl²³, the issue at stake was the application to a German migrant worker of a Luxembourg rule according to which repayment of overpaid tax was only possible if the taxpayer was resident in Luxembourg for the whole tax year. The Court first noted that

Under Article 48(2) of the Treaty freedom of movement for workers entails the abolition of all discrimination based on nationality between workers of the Member States, particularly with regard to remuneration (ground 11),

and that

The principle of equal treatment with regard to remuneration would be rendered ineffective if it could be undermined by discriminatory national provisions on income tax (ground 12).

20 See, eg Case C-80/94, Wielockx v Inspecteur der Directe Belastingen [1995] ECR I-2493, ground 17 or Schumacker op. cit. at ground 30.

21 See in the same sense Lyal, “Non-discrimination and direct tax in Community law”, EC Tax Review 2003, p. 69; Farmer, “The Court’s caselaw on taxation: a castle built on shifting sands”, EC Tax Review 2003, p. 78; Snell, “Non-discriminatory tax obstacles in Community law”, ICLQ vol 56, April 2007 p.339. Other authors either assert or appear to assume that all of the Court’s caselaw applying the fundamental freedoms in the tax field is based on the idea of eliminating discrimination without, however, proposing any explanation for the reasoning offered by the Court, which often has little to do with discrimination analysis., cf Teixeira, “Tax systems and non-discrimination in the European Union”, Intertax, volume 34, issue 2, 2006; Kotschy, “Le ‘test discrimination’ dans les libertés fondamentales – retour en arrière ou concept bien ciblé?”, Revue du Droit de l’Union Européenne 4/2006; Lenaerts and Bernardeau, “L’encadrement communautaire de la fiscalité directe”, Cahiers de droit européen, 2007, nos 1-2 .

22 The pattern is different in the cases concerning free movement of capital. Judgments in this area commence in 1999, by which time the obstacle approach had started to make itself felt.

23 Case C-175/88, Klaus Biehl [1990] ECR I-1779

It then went on to analyse the Luxembourg rule in question as an indirect discrimination against taxpayers who were nationals of other Member States. As the Court put it,

It is often such persons who will in the course of the year leave the country or take up residence there (ground 14).

The measure was then examined as to its justification and found wanting. The Luxembourg authorities argued that the rule sought to avoid an unfair advantage being conferred on temporarily resident taxpayers who spread their annual income and thus their tax liability between two Member States, since they would then be taxed at a more favourable rate than that applied to the income of a resident taxpayer who, with the same annual income, had to declare all of it to the Luxembourg authorities, whether or not it originated in Luxembourg. However, the Court pointed out that the rule applied even where no income arose in the second Member State. It was therefore disproportionate and contrary to Article 48(2) – now 39(2).

A similar “indirect discrimination” approach was adopted by the Court in Bachmann – concerning a Belgian rule subjecting the deductibility for income tax purposes of insurance contributions to the requirement that they had been made “in Belgium” – but the measure was found to be justified²⁴.

A somewhat more sophisticated discrimination analysis is to be found in the judgment in Schumacker.²⁵ This case concerned the tax treatment of a Belgian working in Germany but living in Belgium, who was therefore subject to the régime of limited taxation in Germany, i.e. he was taxed only on that part of his income arising in that Member State. Certain tax benefits, such as the possibility of “*income splitting*” between spouses, which were available in Germany under the system of full taxation, were not enjoyed by persons subject to limited taxation. Mr. Schumacker contested this difference of treatment. The Court, consulted as to the incidence of Community law on the ensuing litigation, carried out a thorough discrimination analysis. First, it noted that disadvantages based on residence were likely to operate mainly to the detriment of nationals of other Member States. Therefore, said the Court,

tax benefits granted only to residents of a Member State may constitute indirect discrimination by reason of nationality (ground 29).

However, the Court then recalled that the same rule only has to be applied to comparable situations, and recognised that the situations of residents and non-residents are not, as a rule, comparable in relation to direct taxes. It is worth reproducing in full the Court’s reasoning in this regard, because it recurs regularly in later cases. At grounds 31-34, the Court said:

In relation to direct taxes, the situations of residents and of non-residents are not, as a rule, comparable.

Income received in the territory of a Member State by a non-resident is in most cases only a part of his total income, which is concentrated at his place of residence. Moreover, a non-resident’s personal ability to pay tax, determined by reference to his aggregate income and his personal and family circumstances, is more easy to assess at the place where his personal and financial interests are centred. In general, that is the place where he has his usual abode. Accordingly, international tax law, and in particular the Model Double Taxation Treaty of the Organization for Economic Cooperation and Development (OECD), recognizes that in principle the overall taxation of

24 Since the “Bachmann justification” has since been put forward by many Member States in defence of their tax rules, it is worth recalling what it was. The Court accepted the argument that there existed a connection between the deductibility of contributions and the liability to tax of sums ultimately payable by the insurers: the loss of revenue resulting from the deduction of the contributions from taxable income was offset by the later taxation of pensions, annuities or capital sums. Where the contributions had not been deducted, the later payments were exempt from tax. In such a system, the Court reasoned, given the difficulties for a Member State to recover tax from an insurer based in another Member State, the need to ensure the cohesion of the tax system justified the difference in tax treatment of contributions’

25 op cit footnote 15

taxpayers, taking account of their personal and family circumstances, is a matter for the State of residence.

The situation of a resident is different in so far as the major part of his income is normally concentrated in the State of residence. Moreover, that State generally has available all the information needed to assess the taxpayer's overall ability to pay, taking account of his personal and family circumstances.

Consequently, the fact that a Member State does not grant to a non-resident certain tax benefits which it grants to a resident is not, as a rule, discriminatory since those two categories of taxpayer are not in a comparable situation.

In principle, therefore, Article 48 does not preclude the application of rules of a Member State under which a non-resident working as an employed person in that Member State is taxed more heavily on his income than a resident in the same employment. However, noted the Court, in a situation such as that of Mr. Schumacker, where the taxpayer in question received no substantial income in his Member State of residence and obtained the major part of his taxable income from his activity in the State of employment, the State of residence was not in a position to take account of his personal and family circumstances, and there was no objective difference between his situation and that of a resident taxpayer engaged in comparable employment. It was therefore not justified, in such circumstances, to apply different treatment as regards the taking into account for tax purposes of personal and family circumstances, and the Court considered that such different treatment was discriminatory. Having rejected the justifications for the different treatment put forward by the German authorities, the Court concluded that Article 48 precluded the application of the national rules in question in circumstances such as those of Mr. Schumacker.

Discrimination Due to the Exercise of the Right to Free Movement

Mr. de Groot²⁶ was a Dutch national and resident, fully taxable in the Netherlands (subject to the effect of various double tax conventions which provided for taxation in the State of employment as regards income arising there). He had worked in several Member States. In 1994, he received income relating to his work in four different Member States, including the Netherlands. In assessing him for income tax, and more particularly in determining the amount of relief to which he was entitled as a result of maintenance payments and to take account of his personal circumstances more generally, the Netherlands authorities applied a “*proportionality rule*” under which the allowances in question were deducted from the tax payable in the Netherlands only in proportion to the income received by the taxpayer in that Member State. The Dutch authorities took the view that it was a matter for the legislation of the other Member States of employment to make appropriate allowances when taxing Mr. de Groot on the income arising in those States.

In its analysis of the case, the Court first recalled the obligation of the Member States to exercise their tax competence in accordance with Community law, and therefore to avoid “*any overt or covert discrimination on the basis of nationality*” (ground 75). It then went on, at grounds 76-80, to say the following:

Any Community national who, irrespective of his place of residence and his nationality, has exercised the right to freedom of movement for workers and who has been employed in a Member State other than that of residence falls within the scope of Article 48 of the Treaty....

Moreover, it is settled case-law that all of the Treaty provisions relating to the freedom of movement for persons are intended to facilitate the pursuit by Community nationals of occupational activities of all kinds throughout the Community, and preclude measures which might place Community nationals at a disadvantage when they wish to pursue an economic activity in the territory of another Member State (emphasis added).

26 Case C-385/00 de Groot v Staatsecretaris van Financien [2002] ECR I-11819

Provisions which preclude or deter a national of a Member State from leaving his country of origin to exercise his right to freedom of movement therefore constitute an obstacle to that freedom even if they apply without regard to the nationality of the workers concerned.

Thus, even if, according to their wording, the rules on freedom of movement for workers are intended, in particular, to secure the benefit of national treatment in the host State, they also preclude the State of origin from obstructing the freedom of one of its nationals to accept and pursue employment in another Member State.

Consequently, the fact that Mr. de Groot has Netherlands nationality cannot prevent him from relying on the rules relating to freedom of movement for workers as against the Member State of which he is a national, since he has exercised his right to freedom of movement and worked in another Member State”.

The Court went on to observe that the application of the Netherlands rule concerning the proportionality factor was liable to discourage a Netherlands national from taking up employment in another Member State, since it resulted in a lesser tax advantage than that which would be enjoyed if the taxpayer received all his income in the Netherlands. The court noted that

as a consequence of his exercise of his right to freedom of movement, [Mr. de Groot] forfeited part of the tax allowances provided for by Netherlands law to which he was entitled as a resident of the Netherlands (ground 91, emphasis added).

As for the fact that the proportionality factor had been applied in accordance with the rules laid down in the various double tax treaties concluded by the Netherlands, the Court acknowledged the competence of the Member States to determine, in the context of bilateral agreements, the connecting factors for the purposes of allocating powers of taxation. However, it said,

as far as the exercise of the power of taxation so allocated is concerned, the Member States must comply with the Community rules... and, more particularly, respect the principle of national treatment of nationals of other Member States and of their own nationals who exercise the freedoms guaranteed by the Treaty.

Rules such as those at issue in the main proceedings therefore constitute an obstacle to freedom of movement for workers which is, in principle, prohibited by Article 48 of the Treaty (grounds 94 and 95, emphasis added).

As to whether the obstacle (or, more accurately, the difference in treatment) was justified, the Court examined and rejected the various arguments put forward in this regard by the Netherlands authorities (and by the Belgian and German governments which intervened in support of them). Notably, it refused to accept the idea that it was for each taxing State to grant tax allowances in relation to the part of the taxpayer's income taxed by it. The Court was thus led to expand upon its previous statements²⁷ that it was, in principle, for the State of residence to take account of personal and family circumstances. It repeated that a taxpayer's ability to pay tax, determined by reference to his aggregate income and personal and family circumstances, is easier to assess at the place where his personal and financial interests are centred, and that this is generally the place where he has his usual abode. Reference was also made to the fact that international tax law recognises that, in principle, the overall taxation of taxpayers, taking account of their personal and family circumstances, is a matter for the State of residence (ground 98). The Court now took account of the possibility that a Member State might arrange, by way of a double tax convention, for its responsibility in this respect to be taken on (in part) by another Member State, or that it might find that, without any agreement, a State of employment did grant advantages, in relation to that part of a taxpayer's income taxed by it, based on his personal and family circumstances. In such a case, any possible remaining inequality of outcome would be the result, not of unequal treatment, but of the disparities in the national tax systems applicable in a given case. So long as no such situation existed however, it was for the Member State

²⁷ see, eg Schumacker op cit footnote 15, Case C-336/96 Gilly [1998] ECR I-2793, Case C-391 Gschwind [1999] ECR I-5451

of residence to ensure equal treatment as between a person earning all of his income in the Netherlands and a resident part of whose income was taxed by other Member States.

In Schilling,²⁸ the tax measure at issue was a German rule limiting the possibility of deducting from taxable income expenditure incurred in respect of a household assistant in the form of contributions to a pension fund to cases where such contributions were made to the German pension insurance scheme. Mr. and Mrs. Schilling were German nationals who had moved to Luxembourg to work as officials of the European Communities. They had three children, and employed a household assistant in Luxembourg to help in taking care of them. They paid social security contributions in respect of the household assistant to the Luxembourg pension insurance scheme.

Apart from his Community salary, which was subject to tax only under the special Community taxation system,²⁹ Mr. Schilling also had some income arising in Germany. Under the terms of Article 14 of the Protocol on the Privileges and Immunities of the European Communities, he was liable to pay German income tax on that part of his income. The German authorities refused to allow him to deduct from his taxable income the amount of his expenditure on the household assistant, on the ground that the contributions in question had not been made to the German pension scheme.

Asked for a preliminary opinion on the impact on the German rule of Article 14 of the Protocol and of Article 48 EC, the Court first recalled the considerations set out at grounds 75-80 of its judgment in de Groot. It then noted the particular taxation régime applicable to civil servants of the European Communities, and went on to say that

an official of the European Communities who is of German origin and who, while working in another Member State, maintains his habitual residence in his State of origin and employs a household assistant in that State, for whom he pays contributions to that State's statutory pension insurance scheme, is in a position to benefit from the tax deduction in issue in the main proceedings.

In contrast, persons in the situation of Mr. and Mrs. Schilling, who have left their State of origin to work as officials of the European Communities in another Member State, are not normally in a position to benefit from that tax advantage."(grounds 33-34, emphasis added).

Mr. and Mrs. Schilling were therefore being placed at a disadvantage because of their exercise of their right to free movement, and this was contrary to Article 48, in conjunction with Article 14 of the Protocol, unless the national provision in question could be justified. The Court examined a number of possible justifications, but found none of them valid. In particular, it noted that the purpose of the tax deduction in question was to help large families, to create additional employment, and to combat undeclared employment, and that there appeared to be no reason why these objectives could not just as well be achieved by allowing the tax deduction where the pension contributions had been made in another Member State.

No Breach of the Rules on Free Movement in the Absence of Discrimination

The Weigel case³⁰ concerned an Austrian tax on fuel consumption which was charged on first sale or registration of motor vehicles in Austria. The tax was made up of a basic tax, related to the value of the car at the time of the taxable event and to its fuel consumption, and of a potential 20% surcharge to compensate for the fact that certain taxable events were not subject to VAT, notably first-time registration of a vehicle in Austria. Mr. and Mrs. Weigel were German nationals who moved to Austria so that Mr. Weigel could take up paid employment there. Each of them imported a car as personal property. Having registered the cars in Austria, they were then required to pay the tax on fuel

28 Case C-209/01, [2003] ECR I-13389

29 Article 13 of the Protocol on the Privileges and Immunities of the European Communities

30 op cit footnote 7

consumption, both the base tax and the surcharge. They challenged this decision, and in the ensuing litigation the Court of Justice was asked for a preliminary ruling on the application to the case of the rules on free movement of workers, as well as of Articles 90, 23 and 25.

The Court examined only the base tax in connection with the rules on free movement. In this regard, it started its analysis by recalling that those rules forbid not only discrimination based on nationality but also any “obstacles” to freedom of movement (grounds 51-52). However, it then went on:

A rule such as that at issue in the main proceedings applies without regard to the nationality of the worker concerned to all those who register a car in Austria and, accordingly, it is applicable without distinction.

It is true that it is likely to have a negative bearing on the decision of migrant workers to exercise their right to freedom of movement.

However, the Treaty offers no guarantee to a worker that transferring his activities to a Member State other than the one in which he previously resided will be neutral as regards taxation. Given the disparities in the legislation of the Member States in this area, such a transfer may be to the worker’s advantage in terms of indirect taxation or not, according to circumstance. It follows that, in principle, any disadvantage, by comparison with the situation in which the worker pursued his activities prior to the transfer, is not contrary to Article 39 EC if that legislation does not place that worker at a disadvantage as compared with those who were already subject to it. (grounds 53-55, emphasis added).

In other words, a national tax which puts the incoming worker at no greater disadvantage than any national worker cannot be impugned on the basis of the rules on free movement only because it imposes a cost on the migrant³¹.

It should be noted that the Court also looked at the impact on the Austrian measure of Article 90. It found the basic tax to be inoffensive so long as the method of assessing the “fair value” of a second-hand imported car resulted in equal treatment with such cars already registered in Austria. It was only in relation to the surcharge that the Court identified a problem of discrimination since this charge was levied almost exclusively on imported second-hand cars, and the Court found it unacceptable to seek to eliminate in this way the competitive advantage otherwise enjoyed by such vehicles.

The “Obstacle” Approach

A very different type of analysis to those outlined above is to be found in the Court’s judgment of 15 September 2005 in Case C-464/02, Commission v Denmark.³² This case concerned the requirement to register, and pay tax on, any vehicle to be used on Danish roads by a Danish resident, subsequently softened into a requirement to pay the tax on a pro rata basis, reflecting the proportion of time during which the vehicle was to be used in Denmark. The Commission’s complaint centred on the situation of a Danish resident employed in another Member State, and whose employer put at his disposal a company car registered in the Member State of employment. Such an employer might be deterred from taking on a Danish resident as an employee, as it would have to apply to register the car in Denmark as well as in the Member State of employment, and it would have to pay the Danish tax on top of the tax already paid in the first Member State of registration.

The Court first of all declared that, contrary to the arguments of the Danish government, the legislation at issue fell within the scope of the rules on free movement of workers. In this regard, it recited the formula reproduced above in relation to the de Groot case to the effect that measures which

31 This approach was confirmed recently in Case C-392/05 Alevizos, judgment of 26 April 2007, not yet reported, in which the Court said that the question whether taxes charged on the import into Greece of a car by a returning migrant worker were contrary to Article 39 depended, in the first place, on whether they put that worker at a disadvantage in comparison with Greek workers who had never left their country.

32 [2005] ECR I-7929

“preclude or deter” a national of a Member State from exercising his right to free movement constitute an “obstacle” to that freedom even if they apply without regard to the nationality of the worker (ground 35). It went on to say that legislation which relates to the conditions in which an economic activity is pursued may constitute such an obstacle (ground 37). The Danish legislation on the taxing of motor vehicles therefore had to be examined under the angle of the freedom of movement of workers.

Then, as to whether there was an obstacle to that freedom, the Court said the following:

It is settled case-law that Article 39 EC prohibits not only all discrimination, direct or indirect, based on nationality, but also national rules which are applicable irrespective of the nationality of the workers concerned but impede their freedom of movement....

It is clear that the original scheme, in so far as it remains applicable, could, on account of the obligation to register in Denmark a company car made available to the employee by an employer established in another Member State, deter such an employer from taking on an employee resident in Denmark ... and, consequently, impede access to such employment by residents in Denmark.

As regards employees resident in Denmark who wish to pursue their principal employment in an undertaking established in another Member State, the amended scheme also impedes freedom of movement for those workers since it imposes additional costs in the form of a temporary registration tax.

In so far as the undertaking established in another Member State bears those costs without being compensated, it is deterred from taking on an employee resident in Denmark in respect of whom the costs are higher than those borne for an employee who does not reside in that State. (grounds 45-48, emphasis added).

On this basis, the Court concluded that the Danish legislation, both in its original and in its amended version, constituted a restriction on the free movement of workers. It went on to examine the possible justification of the restriction. It found none for the original scheme, and considered the amended scheme justified only as regards cases where a car was to be used essentially in Denmark on a permanent basis. For the rest, Denmark’s claim that it was entitled to use the measure to prevent tax avoidance through the use of a company car registered in another Member State was not accepted.

As regards the manner in which the Court arrived at its conclusion that there was a restriction needing to be justified, it will be noted that there is no mention of discrimination, or of any difference in the impact of the Danish measures on cross-frontier movements of workers as compared with national employment situations. The only comparison which is made is between the costs for an employer in another Member State in taking on as an employee a Danish resident or a resident on another Member State. But Denmark could not be held accountable for this difference in costs: it was responsible only for its own tax régime. In fact, in this case the Court seems to have considered as a restriction needing justification under Article 39 the simple fact that two tax and registration systems were simultaneously applicable to a given situation, with a consequent increase in costs for those affected.

Essentially the same approach was followed by the Court in Case C-232/03, Commission v Finland.³³

These cases can be rationalized by considering that a Danish worker wishing to work in a Member State other than Denmark had to face a difficulty which did not confront an equivalent worker seeking to work for a Danish employer: whereas, in the latter situation, the employer would have to register, and pay tax on, the company car only in Denmark, in the former it would be obliged to deal with two sets of obligations. Thus, the “outward” movement of workers suffered from a specific disadvantage in comparison with an internal employment relationship. The Court could have applied classic discrimination terminology, recalling that discrimination can consist not only in treating equivalent situations differently, but also in applying the same rule to different situations: by not taking account of the specificity of the circumstances of the migrant worker, and by imposing on him, without

33 [2006] ECR I-27

sufficient reason, the same rule it applied to national work relationships, Denmark could be considered to have discriminated against workers choosing to earn their living in other Member States.

Undeclared Discrimination Analysis

Case C-152/03, Ritter-Coulais³⁴, concerned a French-German couple who worked as teachers in Germany but lived in their house across the border in France. They were liable to income tax in Germany on their total income. Under the German tax rules, in assessing the tax rate account could be taken of so-called “negative income” associated with a house in Germany (relating to the absence of positive income from the letting of real estate). Mr. and Mrs. Ritter-Coulais applied to have account taken in the setting of the tax rate applicable to them of the “negative income” associated with their house in France, but this was refused – although any positive income would have been duly taken into account! They appealed against their tax assessment, and in the course of the ensuing litigation the Court of Justice was asked to advise on the application of Community law to the circumstances of the case.

Since the national court had based its questions freedom of establishment and the free movement of capital, the Court had first to explain why the provisions relating to these freedoms were not applicable. It then went on to examine the relevance of the freedom of movement of workers. It pointed out that any Community national who, irrespective of his place of residence and his nationality, has exercised the right to freedom of movement for workers and who has been employed in a Member State other than that of his residence falls within the scope of Article 48. It followed that the situation of Mr. and Mrs. Ritter-Coulais, who worked in a Member State other than that of their actual place of residence, fell within the scope of that provision.

In analysing the impact of Article 48 on the case under examination, the Court said the following:

individuals such as the appellants in the main proceedings, who worked in Germany whilst residing in their own home in another Member State, were not entitled, in the absence of positive income, to have income losses relating to the use of their home taken into account for the purposes of determining their income tax rate, in contrast with individuals working and residing in their own homes in Germany.

Even though the national legislation is not specifically directed at non-residents, the latter are more likely to own a home outside Germany than resident citizens.

It follows that the treatment of non-resident workers under the national legislation is less favourable than that afforded to workers who reside in Germany in their own homes.

Consequently, legislation such as that at issue in the main proceedings is, as a rule, contrary to Article 48 EC (grounds 35-38, emphasis added).

The word “discrimination” never appears, nor is it clearly stated that the rule at issue creates a difficulty for a trans-national employment situation which does not exist in a purely national setting. However, the expressions underlined above make it extremely clear that it was the difference in treatment as between German residents and residents in other Member States which triggered the applicability of the rules on free movement.

As for the German government’s attempt to argue that the rule was justified by considerations of fiscal coherence, the Court gave this short shrift, noting that such considerations could hardly be relied on in the case of a tax system which took account of positive income from a dwelling situated in another Member State in order to determine the applicable rate of taxation, but failed to take into account, for the same purposes, income losses from the same source.

34 [2006] ECR I-1711

Freedom of Establishment

The cases concerned with this freedom, like those centred on free movement of workers, can first of all be broken down into cases where what is at stake is a failure to apply national treatment to nationals of other Member States (including companies having their registered office in such States) which establish themselves in the legislating Member State, and those involving a disadvantage inflicted on nationals/residents (including nationally-based companies) because of their exercise of their freedom to establish themselves in another Member State. Within each category, there are cases in which discrimination analysis is explicit in the Court's judgment, and others in which it can be discerned floating just below the level of the reasoning. Not surprisingly, it tends to be closer to the surface in the cases concerning national treatment ("inward" establishment), whereas one finds more "obstacle" language ("hindering" and "dissuading") in judgments dealing with particular difficulties encountered by those establishing themselves in Member States other than that creating the problem ("outward" establishment). Finally, there are a few cases deserving separate treatment because of the particularly ambiguous nature of the reasoning employed by the Court, which can leave a doubt as to which type of analysis was intended.

Cases of Inward Establishment

The first case in this category is the famous French "*avoir fiscal*" case³⁵ concerning a tax credit granted to shareholders receiving dividends from a French company, except where the recipient was a branch or agency of a company having its registered office in another Member State. The Court placed the case firmly on a discrimination footing, stating that

Article 52 is ... intended to ensure that all nationals of member states who establish themselves in another member state, even if that establishment is only secondary, for the purpose of pursuing activities there as a self-employed persons receive the same treatment as nationals of that state and it prohibits, as a restriction on freedom of establishment, any discrimination on grounds of nationality resulting from the legislation of the Member State. (ground 14, emphasis added).

Having noted the difference in treatment as between companies³⁶ having their registered office in France and those based in other Member States and pursuing their activities in France through a branch or an agency, the Court then examined and rejected the arguments put forward by the French government in order to justify the difference in treatment. Most importantly, the Court observed that any attempt to argue that the position of a branch or agency of a foreign company was objectively different to that of a company having its registered office in France foundered on the fact that the French tax system treated these two categories in the same way for the purposes of taxing their profits. It was therefore discriminatory to treat them differently in relation to the tax credit.

It is also important to note a further discrimination logic which is hidden in this case, since it recurs frequently (sometimes also hidden) in subsequent cases³⁷. In order to explain why the French tax system had to treat a branch or agency having no legal personality in the same way as a company established in France (including a subsidiary of a company having its registered office in another Member State which did benefit from the tax credit), the Court said the following:

freedom of establishment, which article 52 grants to nationals of another member state and which entails their right to take up and pursue activities as self-employed persons under the conditions laid down for its own nationals by the law of the country where such establishment is effected, includes, pursuant to article 58 of the EEC treaty, the right of companies or firms formed in

35 Case 270/83 *Commission v France* [1986] ECR 273

36 The case only actually dealt with insurance companies, but since the French rules examined applied to companies generally, the logic of the judgment is applicable across the board.

37 Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, Case C-307/97 *Saint Gobain* [1999] ECR I-6161, Case C-253/03 *CLT-UFA* [2006] ECR I- 1831

accordance with the law of a member state and having their registered office , central administration or principal place of business within the community to pursue their activities in the member state concerned through a branch or agency . With regard to companies, it should be noted in this context that it is their registered office in the above-mentioned sense that serves as the connecting factor with the legal system of a particular state, like nationality in the case of natural persons. Acceptance of the proposition that the member state in which a company seeks to establish itself may freely apply to it a different treatment solely by reason of the fact that its registered office is situated in another member state would thus deprive that provision of all meaning (ground 18, emphasis added).

At first glance, this seems to mean that Article 52 requires more than national treatment even in a case of “inward” establishment: since a company having its registered office in another Member State is absolutely entitled to choose its form of establishment in the legislating Member State, the latter is not entitled to distinguish in any way in the treatment it accords to a subsidiary of a foreign company and a branch of the same, irrespective of any distinctions it might make on the national level between legal entities and branches of such entities. Not a word is to be found in this judgment or the later ones concerning the same issue comparing the situation of the branch of the foreign company with that of a branch or agency of a nationally-based company. One could therefore conclude that, in these cases, the Court is applying a substantively “obstacle” approach. This does not however seem to have been the Court’s intention. The Commission had in fact based its case on the idea that there were two different aspects to it, a discrimination element concerning the differential tax treatment, and a “restriction” dimension due to the fact that the French rule put pressure on non-French companies to establish themselves in France via the creation of a subsidiary rather than by having recourse to a branch or agency. At ground 15 of its judgment, the Court gently rejected this approach, saying

[...] The two submissions put forward by the commission , namely that concerning discrimination in French law against branches and agencies of insurance companies established in other member states vis-à-vis companies established in France and that concerning the restriction of the freedom of foreign insurance companies to establish branches and agencies , are closely linked . They must therefore be considered together,

and went on to deal with both aspects using the language of equal treatment. It therefore seems fair to infer that the Court saw the less favourable treatment of a branch or agency of a company based in another Member State as compared to that accorded to a company registered in France as a species of discrimination. This may be rationalized by considering that, whereas the favourable tax treatment was available to all French companies, it was only available (indirectly) to companies having their registered office in another Member State where those companies had established a subsidiary in France, i.e. only to some of them. By the same token – and perhaps more importantly – it was not available to any company which retained its exclusively non-French “nationality”. One thus understands better the reference in ground 18 of the judgment, cited above, to the “nationality” of a company registered in another Member State.

This idea of discrimination based on the place where a company has its seat appears explicitly in the later case of Royal Bank of Scotland v Elliniko Dimosio³⁸. This case concerned the higher rate of tax applied under Greek law to the Greek branch of a UK company as compared to that applicable to Greek banks. The Court adopted an entirely discrimination-based approach in this case, referring to “*discrimination against companies having their seat in another Member State*” (ground 30). This was after it had observed that, as in the French case, the Greek legislation made no relevant distinction between the Greek branch of a foreign-based company and a company having its registered office in Greece for the purposes of determining the taxable base, so that it was impossible to claim that the two kinds of entity were not in a comparable position when it came to setting the rate of tax.

38 op cit footnote 33

The analysis is less clear-cut in Saint-Gobain.³⁹ This case also derived from a difference in treatment – this time under German tax law – of companies having their registered office in Germany and German branches of companies based in other Member States. The Court starts out on a clear discrimination track. At grounds 34-35, it says:

[Articles 52 and 58] guarantee nationals of Member States of the Community who have exercised their freedom of establishment and companies or firms which are assimilated to them the same treatment in the host Member State as that accorded to nationals of that Member State.

As far as companies or firms are concerned, their corporate seat, in the sense expressed above, serves to determine, like nationality for natural persons, their connection to a Member State's legal order.

It then notes (ground 38) that, due to the difference in treatment referred to above, the permanent establishments in Germany of companies having their corporate seat in another Member State are in “*a less favourable position than resident companies, including German subsidiaries of non-resident companies*”. However, at ground 42, it states that the tax disadvantage suffered by German branches of non-resident companies

restricts the freedom to choose the most appropriate legal form for the pursuit of activities in another Member State, which the second sentence of the first paragraph of Article 52 of the Treaty expressly confers on economic operators.

This sounds like the “obstacle” approach again. But the Court goes on (at grounds 43-44):

The difference in treatment to which branches of non-resident companies are subject in comparison with resident companies as well as the restriction of the freedom to choose the form of secondary establishment must be regarded as constituting a single composite infringement of Articles 52 and 58 of the Treaty.

The question which must be examined therefore is whether that difference in treatment may be justified in view of the provisions of the Treaty on freedom of establishment (emphasis added).

Both elements were therefore seen by the Court as aspects of differential treatment. It went on to examine whether this difference was justified and concluded that it was not, notably on the ground that, contrary to the arguments of the German government, there was no relevant difference as between resident companies and non-resident companies having a permanent establishment in Germany in relation to their liability to tax on dividend receipts in Germany from shares in foreign subsidiaries and sub-subsidiaries and on the holding of those shares. It was therefore discriminatory to introduce a difference only as regarded the tax concessions in question. Here, and in the rest of the judgment, we seem to be back on a conventional non-discrimination track.

Given the balance of emphasis in the judgment, it seems fair to conclude that the Court intended to adopt an overall “discrimination” approach, and that the reference to the absolute right of a company based in a Member State other than the host Member State to adopt the form of establishment it thought best has to be understood in the light of the fact that failure to treat a branch or an agency in the same way as a subsidiary, unless there is some objective reason for the differentiation, amounts to discrimination against a company having legal personality only according to the law of another Member State – in other words, on the basis of the “nationality” of the company.

The same analysis seems to apply to the case CLT-UFA⁴⁰ which also concerned German tax rules which, through the operation of the distinction between companies fully taxable in Germany and those paying tax only on income arising in Germany, resulted in the payment of higher taxes by companies having their head office in another MS and operating in Germany via a branch than by similar companies which had established a subsidiary in Germany. At grounds 14-15, the Court says:

39 op cit footnote 33

40 op cit footnote 33

The second sentence of the first paragraph of Article 52 expressly leaves traders free to choose the appropriate legal form in which to pursue their activities in another Member State and that freedom of choice must not be limited by discriminatory tax provisions...

Therefore, the freedom to choose the appropriate legal form in which to pursue activities in another Member State primarily serves to allow companies having their seat in a Member State to open a branch in another Member State in order to pursue their activities under the same conditions as those which apply to subsidiaries (emphasis added).

One's first reaction to ground 15 is to think "*why*"? Upon reflection, however, what the Court seems to mean is that, where a company chooses not to create a subsidiary in a Member State other than that in which it has its registered office, thus retaining the character of "foreign" company as far as the law of that Member State is concerned, it must not be discriminated against only because it has failed to create an entity having the "nationality" of the Member State of (new) establishment.

In this case, as in the others, the Court found no relevant difference between the situation of a branch and a subsidiary of a non-German company, and therefore declared the German tax rule in question incompatible with Article 52.

The judgments in the other cases on "inward" establishment all clearly hinge on the question whether an unjustified difference in treatment has been found to exist. The differences in question range from applying a higher rate of income tax to non-residents than to residents pursuing the same activity⁴¹, through failing to allow a non-resident taxpayer to deduct from his taxable income an amount set aside to form a pension reserve⁴², or the cost of tax advice⁴³ (whereas these deductions were afforded to resident taxpayers), to refusing to pay non-resident companies interest on the repayment of overpaid corporation tax⁴⁴, imposing an extra tax on dividends paid to a parent company where that company had its seat in another Member State⁴⁵, making the availability of beneficial tax treatment of the distribution of dividends to a parent company dependent on that company having its seat in the legislating Member State⁴⁶, or reserving to resident companies the availability of a tax credit on the receipt of dividends from a resident subsidiary⁴⁷. In the first five cases mentioned, the Court found no relevant difference in the situations of resident and non-resident taxpayers, and therefore declared the respective rules contrary to the principle of freedom of establishment.

In Metallgesellschaft and ACT Test Claimants, the Court had to examine different aspects of the UK tax rules applicable to the distribution of dividends by a resident subsidiary. In Metallgesellschaft, the rule at issue reserved to resident subsidiaries the parent companies of which had their seat in the UK the possibility of opting for the "group income election regime" which allowed them not to pay advance corporation tax when distributing dividends to their parent companies. The Court found that there was no relevant difference between the purely national situation and that involving a transnational dimension such as to justify the difference of treatment.

In ACT Test Claimants, the question was whether a Member State was obliged to grant to non-resident parent companies the benefit of a tax credit granted to resident companies receiving dividends from their resident subsidiaries. The purpose of the tax credit in question was to avoid double taxation (first at the level of the company making the distribution, and then at that of the parent company). The effect of the provisions in question was that profits distributed by resident companies were taxed once

41 Case C-107/94 Asscher [1996] ECR I-3089

42 Case C-80/94 Wielockx [1995] ECR I-2493

43 Case C-346/04 Conijn [2006] ECR I-6137

44 Case C-330/91 Commerzbank [1993] ECR I-4017

45 Case C-170/05 Denkavit, judgment of 14 December 2006, not yet reported.

46 Joined cases C-397 and 410/98 Metallgesellschaft [2001] ECR I-1727

47 Case C-374/04 ACT Test Claimants, judgment of 12 December 2006, not yet reported.

at company level. The Court found that the position of the non-resident company receiving dividends from a resident subsidiary was not the same as that of a resident company receiving such dividends, or rather that the Member State in which the distributed profits were derived did not stand in the same relationship to the two categories of company. To require the Member State in which the profits were generated to grant the tax credit in question to a non-resident company receiving dividends from a resident company would amount to obliging it to abandon its right to tax a profit generated through economic activity undertaken on its territory (ground 59 of the judgment), since the tax credit would cancel the benefit of the tax received from the resident company.

In all these cases, the Court's analysis of the national measures under examination is characterized by references to unjustified (or, once, justified) differences of treatment. The principle of freedom of establishment is almost always explicitly presented in terms of a prohibition of discrimination. It is true that, in *Denkavit*, after stating that the difference in the tax treatment of dividends between parent companies, based on the location of their registered office, was in principle prohibited by the rules on freedom of establishment, and before going on to examine any possible justification of the different treatment, the Court remarked, at Ground 30 of the judgment:

The tax measure at issue in the main proceedings makes it less attractive for companies established in other Member States to exercise freedom of establishment and they may, in consequence, refrain from acquiring, creating or maintaining a subsidiary in the State which adopts that measure.

The meaning of this is not very clear. In the absence of any indication as to the tax treatment of dividends in the hands of parent companies by other Member States, how can one say that the French rules could act as a disincentive to establishment in France? One could therefore see the quoted sentence as an indication of "obstacle" reasoning, suggesting that any measure which adds a burden to the operation of establishment is to be seen as a restriction, and therefore prohibited unless justified. This however would be very odd in the context of a judgment so clearly centred on a difference in treatment as between a purely national and a transnational economic relationship. It seems that one has to understand that the Court was assuming that all Member States apply rules to avoid double taxation as between parents and subsidiaries, so that for a parent company to find itself in a double taxation bind because its subsidiary was established in another Member State would amount to a discouragement of the transnational scenario. So even this reference to a measure "*making less attractive*" the exercise of a fundamental freedom has to be seen as forming part of the Court's consistent application of discrimination reasoning in this part of the caselaw.

Cases of Outward Establishment

These cases cover a wide spectrum of tax rules, ranging from penalties imposed when a taxpayer changes his tax residence to another MS⁴⁸, through an extraordinary variety of tax disadvantages suffered by parent companies having a subsidiary based in another Member State⁴⁹, or by the subsidiary itself⁵⁰, to problems encountered by individual taxpayers having a controlling holding in a company having its registered office in another Member State⁵¹. In most of the judgments, the Court starts its legal analysis by presenting the principle of freedom of establishment in an apparently very broad way. It typically says that:

48 Case C-9/02 *De Lasteyrie du Saillant* [2004] ECR I-2409, Case C-470/04 *N.* [2006] ECR I-7409

49 Case C-264/96 *ICI* [1998] ECR I-4695, Case C-196/04 *Cadbury Schweppes* [2006] ECR I-7995, Case C-471/04 *Keller Holdings* [2006] ECR I-2107, Case C-446/03 *Marks and Spencer* [2005] ECR I-10837, Case C-168/01 *Bosal* [2003] ECR I-9409, Case 446/04 *FII Test Claimants*, judgment of 12 December 2006, not yet reported, Case C-347/04 *Rewe Zentralfinanz*, judgment of 29 March 2007, not yet reported.

50 Also Case 446/04 *FII Test Claimants*

51 Case C-436/00 *X and Y* [2002] ECR I-10829, Case C-251/98 *Baars* [2000] ECR I-2787

even though, according to their wording, the provisions concerning freedom of establishment are directed mainly to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation(ICI, ground 21, emphasis added).

This sounds as if any measure imposing any burden whatsoever on the establishment of a Member State's national in another Member State will be contrary to the Treaty unless justified. However, it subsequently emerges clearly in all the judgments that it is the difference between the tax treatment of a purely national situation and one resulting from the exercise of freedom of establishment in another Member State which leads the Court to examine the justification of the national rule in question.

There are of course quite substantial variations in the ways in which the Court articulates its reasoning. Very frequently, it explains (more or less clearly) the difference in treatment as between the national and the transnational situation, and then makes a specific link between the disadvantage incurred by the person having exercised his/its right to freedom of establishment and the consequent potential discouragement of such establishment. A particularly clear explanation was given in de Lasteyrie, which concerned a French rule according to which a taxpayer who owned company securities and who transferred his tax residence abroad was taxable at that date for any increase in value in the securities between the date of acquisition and the date of transfer. At ground 46 of the judgment in that case, the Court said:

A taxpayer wishing to transfer his tax residence outside French territory, in exercise of the right guaranteed to him by Article 52 of the Treaty, is subjected to disadvantageous treatment in comparison with a person who maintains his residence in France. That taxpayer becomes liable, simply by reason of such a transfer, to tax on income which has not yet been realised and which he therefore does not have, whereas, if he remained in France, increases in value would become taxable only when, and to the extent that, they were actually realised. That difference in treatment concerning the taxation of increases in value, which is capable of having considerable repercussions on the assets of a taxpayer wishing to transfer his tax residence outside France, is likely to discourage a taxpayer from carrying out such a transfer (emphasis added).

Likewise, in X and Y, the Court presented one of the national tax rules under examination in that case in the following way:

the national provision at issue in the main proceedings entails a difference in treatment in refusing to the transferor the benefit of deferring capital gains tax made on shares transferred at undervalue, with a consequential cash flow disadvantage for him, where the transferee company in which the transferor has a holding is established in another Member State. Therefore, refusal of the tax advantage in question on the ground that the transferee company in which the taxpayer has a holding is established in another Member State, is likely to have a deterrent effect on the exercise by that taxpayer of the right conferred on him by Article 43 EC to pursue his activities in that other Member State through the intermediary of a company (ground 36, emphasis added).

Similar reasoning is to be found in the judgment in Keller (grounds 34-35) and in Rewe Zentralfinanz (grounds 30-31).

A more condensed presentation of the same logic is to be found in other judgments, such as that given in Marks and Spencer. That case centred on a UK tax rule which allowed a resident parent company to reduce its taxable income by setting off losses incurred by its subsidiaries only where the latter were also resident in the UK. Having explained the advantage to a company of the "group relief" at issue in the case, the Court went on:

The exclusion of such an advantage in respect of the losses incurred by a subsidiary established in another Member State which does not conduct any trading activities in the parent company's Member State is of such a kind as to hinder the exercise by that parent company of its freedom of establishment by deterring it from setting up subsidiaries in other Member States.

It thus constitutes a restriction on freedom of establishment within the meaning of Articles 43 EC and 48 EC, in that it applies different treatment for tax purposes to losses incurred by a resident subsidiary and losses incurred by a non-resident subsidiary (grounds 33-34, emphasis added).

In other cases, the Court focuses the key passages of its reasoning on the difference in treatment as between the national and transnational economic scenario, with only a ritual mention of “hindering” or “discouragement” of the exercise of the freedom of establishment. In ICI, the Court was asked to pronounce on the compatibility with Community law of a national tax rule which reserved “consortium relief” to companies controlling, wholly or mainly, subsidiaries having their seats in the national territory. After the passage from ground 21 of the judgment quoted above, the Court went on:

It should be noted here that, under the legislation at issue in the main proceedings, companies belonging to a resident consortium which have, through a holding company, exercised their right to freedom of establishment in order to set up subsidiaries in other Member States are denied tax relief on losses incurred by a resident subsidiary where the majority of the subsidiaries controlled by the holding company have their seat outside the United Kingdom.

Such legislation, therefore, applies the test of the subsidiaries' seat to establish differential tax treatment of consortium companies established in the United Kingdom. Consortium relief is available only to companies controlling, wholly or mainly, subsidiaries whose seats are in the national territory.

It is therefore necessary to determine whether there is any justification for such inequality of treatment under the Treaty's provisions on freedom of establishment (grounds 22-24, emphasis added).

In Baars, the national rule contested was a Dutch provision which granted a tax advantage to Netherlands residents having a holding in a company only if the company was established in the Netherlands. Mr Baars held a controlling holding in an Irish company, and accordingly was not allowed to claim the relative tax advantage. In relation to this, after the usual recital of the aims of the rules on freedom of establishment, the Court said the following:

By refusing to grant the tax advantage to nationals of Member States residing in the Netherlands who, in exercise of their right of free establishment, manage a company having its seat in a Member State other than the Netherlands, while granting that advantage to nationals of Member States residing in the Netherlands who hold a substantial holding in a company having its seat in the Netherlands, the national legislation at issue in the main proceedings provides for a difference in treatment between taxpayers by adopting as its criterion the seat of the companies of which those taxpayers are shareholders.

That difference in the treatment of taxpayers is in principle contrary to Article 52 of the Treaty (grounds 30-31, emphasis added).

Finally, in FII Test Claimants, the Court had to pronounce on the compatibility of a whole series of tax provisions with Community law. The common thread running through a long and complex judgment is its focus on discrimination. Thus, in relation to national rules aiming to avoid double taxation in the case of a distribution of dividends by a subsidiary to a resident parent company and using different mechanisms to that end according to whether the subsidiary was based in the national territory or not, the Court said:

whatever the mechanism adopted for preventing or mitigating the imposition of a series of charges to tax or economic double taxation, the freedoms of movement guaranteed by the Treaty preclude a Member State from treating foreign-sourced dividends less favourably than nationally-sourced dividends, unless such a difference in treatment concerns situations which are not objectively comparable or is justified by overriding reasons in the general interest (ground 46, emphasis added).

On the basis of this statement of principle, the Court found that it was not contrary to the Treaty for a Member State to exempt dividends from tax in the hands of the parent company when they are paid by a resident subsidiary (which is, in principle, liable for corporation tax at the same rate as the parent) while taxing such dividends when paid by a non-resident subsidiary but offsetting against the amount payable the corporation tax already paid by the subsidiary (in its home Member State) on the

underlying profits. What mattered was that the legislating Member State should genuinely avoid double taxation in both situations.

Again, with regard to a particularity of UK law consisting in the advance payment of corporation tax (“ACT”) on the payment of dividends, and the granting of a tax credit to a parent company receiving dividends on which ACT had been paid by its subsidiary so that, on a subsequent distribution of dividends by the parent to its own shareholders, it did not have to pay ACT, the Court carried out a step by step discrimination analysis. It first noted (ground 82) the differential impact of the rule in question according to whether dividends were paid to a parent by a resident or non-resident subsidiary (only resident subsidiaries being liable to pay ACT). It then observed (ground 84) that the fact of not having to pay ACT represented a cash-flow advantage, in so far as the company concerned could retain the sum which it would otherwise have had to pay by way of ACT until such time as corporation tax became payable in the normal way. The Court continued its analysis by examining the argument of the UK authorities that there was no discrimination in the case, since credit for ACT could only be given where ACT had in fact been paid, and since no non-resident company was liable for this form of tax, it was logical that the credit in question should only be given in the case of distribution of dividends by resident subsidiaries who had in fact paid it. The Court was not impressed. It considered that

[c]ontrary to what the United Kingdom Government contends, a company receiving foreign-sourced dividends is, seen in the light of the objective of preventing the imposition of a series of charges to tax which the legislation at issue in the main proceedings seeks to avoid, in a comparable situation to that of a company receiving nationally-sourced dividends, even though only the latter receives dividends on which ACT has been paid (ground 87, emphasis added).

This was because ACT is nothing other than corporation tax paid in advance, while companies having their seat outside the UK are also liable for ordinary corporation tax. It followed that

[s]ince both resident companies distributing dividends to other resident companies and non-resident companies making such a distribution are subject, in the State in which they are resident, to corporation tax, a national measure which is designed to avoid a series of charges to tax on distributed profits only as regards companies receiving dividends from other resident companies, while exposing companies receiving dividends from non-resident companies to a cash-flow disadvantage, cannot be justified by a relevant difference in the situation of those companies (ground 91, emphasis added).

Nor could the difference in treatment be justified by arguments about the coherence of the tax system. The national measure in question was therefore precluded by the rules on freedom of establishment.

The same kind of reasoning was applied systematically to various other features of UK corporate tax law, some of which were found to be discriminatory and some not.

Ambiguous cases

There are a few cases, concerning both “inward” and “outward” establishment, where the Court’s reasoning seems to hover between a discrimination-based approach and one focused on the existence of an obstacle to freedom of establishment. The Denkavit judgment has already been mentioned in this connection. The phenomenon is even more marked in Futura Participations⁵², Lankhost-Hohorst⁵³, Thin Cap Test Claimants⁵⁴ and Bosal⁵⁵.

52 Case C-250/95 [1997] ECR I-2471

53 Case C-324/00 [2002] ECR I-11779

54 Case C-524/04, Test Claimants in the Thin Cap Litigation v Commissioners of Inland Revenue, judgment of 13 March 2007, not yet reported

55 op cit footnote 45

Futura concerned the rules applicable in Luxembourg to the taxation of non-resident companies operating in Luxembourg through a branch. Such companies were taxable only on income earned by their locally-based permanent establishments. They could deduct from their net income losses carried forward from previous years provided that these were “economically related to income received locally” and that separate accounts for the local branch were kept in Luxembourg according to Luxembourg accounting rules. The Court was asked about the compatibility with Community law of both conditions. As regards the first one, it recalled the obligation of the MSS to exercise their taxation competence consistently with Community law and therefore to avoid “any overt or covert discrimination on grounds of nationality”(ground 19). It then noted that, for non-resident taxpayers, only profits and losses arising from their Luxembourg activities were taken into account in calculating the basis on which they were assessed to tax. The Court therefore concluded, at ground 22, that

Such a system, which is in conformity with the fiscal principle of territoriality, cannot be regarded as entailing any discrimination, overt or covert, prohibited by the Treaty.

However, in dealing with the second condition (the keeping of accounts), the Court arguably took another approach. It first said (ground 24) that this obligation could constitute a restriction within the meaning of Article 52. It then explained that statement in the following terms:

It means in practice that if such a company or firm wishes to carry forward any losses incurred by its branch, it must keep, in addition to its own accounts which must comply with the tax accounting rules applicable in the Member State in which it has its seat, separate accounts for its branch's activities complying with the tax accounting rules applicable in the State in which its branch is established. Furthermore, those separate accounts must be held, not at the company's seat, but at the place of establishment of its branch.

Consequently, the imposition of such a condition, which specifically affects companies or firms having their seat in another Member State, is in principle prohibited by Article 52 of the Treaty. It could only be otherwise if the measure pursued a legitimate aim compatible with the Treaty and were justified by pressing reasons of public interest. Even if that were so, 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 (grounds 24-25).

The Court went on to recall (ground 31) that the effectiveness of fiscal supervision constitutes an overriding requirement of general interest capable of justifying a restriction on the exercise of a fundamental freedom, and to state that

A Member State may therefore apply measures which enable the amount of both the income taxable in that State and of the losses which can be carried forward there to be ascertained clearly and precisely.

However, it was excessive to require a non-resident company, which normally had no reason to keep separate accounts for (and at) its Luxembourg branch to have done so in a given year in order to be allowed to carry forward losses relating to that year. The Luxembourg authorities were therefore obliged to accept any clear and precise demonstration of the amount and relevance of the losses concerned, and were not entitled to insist on the “proper” accounts having been kept during the relevant period.

The reasoning in grounds 24-25 can be seen as belonging to the “obstacle” approach⁵⁶, in so far as no mention is made of a difference in treatment as between resident and non-resident companies, and indeed we know from the recital of the Luxembourg provisions earlier in the judgment (ground 6) that the requirement to keep proper accounts applies equally to both categories of taxpayer. One could therefore understand the Court to be saying that this requirement, as applied to non-resident companies, is a “restriction” simply in the sense that it constitutes a burden for them. It is submitted, however, that this is not the correct reading of these passages of the judgment. It would indeed be

56 See, in this sense, Hinnekens, “Recent Trends in the Case-Law of the ECJ in Matters of Direct Taxation”, ERA Forum 2006-2, p. 284 and Farmer, op cit footnote 17.

strange for the Court, having based its first finding on clear discrimination analysis, to then switch to “obstacle” reasoning in relation to the second issue before it. In reality, the words “in addition to its own accounts” in ground 25, and “which specifically affects companies or firms having their seat in another Member State” in ground 26, shows that the Court bases its reasoning on the fact that, in practice, the requirement to have kept accounts constitutes, for non-resident companies, a heavier burden than that borne by resident companies, which are obliged in any case to keep accounts according to Luxembourg rules. It is this effectively different treatment which leads the Court to examine the justification and proportionality of the measure.

In Lankhorst-Hohorst, the contested measure was a German rule concerning the repayment by a resident company of loan capital received from shareholders. If the repayment was to a parent company “not entitled to corporation tax credit” (generally, a non-resident company), any interest paid on the loan was treated as a covert distribution of profits and taxed more heavily than interest on a similar repayment to a company entitled to the tax credit in question (generally, a resident company). These provisions were targeted at the practice known as “thin capitalisation”, under which a group of companies may seek to reduce the taxation of profits made by one of its subsidiaries by electing to fund that subsidiary by way of loan capital, rather than equity capital, thereby allowing that subsidiary to transfer profits to a parent company in the form of interest which is deductible in the calculation of its taxable profits, and not in the form of non-deductible dividends. Where the parent company is resident in a State in which the rate of tax is lower than that which applies in the State in which the subsidiary is resident, the tax liability may thus be transferred to a State which has a lower tax rate. The reason for differentiating between payments made to resident and non-resident parents is obviously that such a strategy can only work in a transnational situation.

Having referred to the obligation of the Member States to avoid any discrimination in the tax field on grounds of nationality (ground 26), the Court observed that, because resident parent companies generally receive the tax credit whereas, as a general rule, non-resident parent companies do not, the contested measure

introduces a difference in treatment between resident subsidiary companies according to whether or not their parent company has its seat in Germany(ground 27).

Then however, before going on to examine – and reject – the various grounds of justification put forward in defence of the measure, the Court said:

Such a difference in treatment between resident subsidiary companies according to the seat of their parent company constitutes an obstacle to the freedom of establishment which is, in principle, prohibited by Article 43 EC. The tax measure in question in the main proceedings makes it less attractive for companies established in other Member States to exercise freedom of establishment and they may, in consequence, refrain from acquiring, creating or maintaining a subsidiary in the State which adopts that measure (ground 32, emphasis added).

What does this mean? The tax treatment would be just as unattractive if it applied to all parent companies, including those based in Germany. To know whether it was really unattractive, one would need information on the tax treatment of similar operations in other Member States, in particular that of establishment of the parent company, but no such information is to be found in the judgment. Surely the Court does not believe that the fact of being discriminated against (whatever the other available options may be) is a deterrent to the establishment by a company of a subsidiary in a given Member State. And why should the Court make such an odd statement in a judgment which otherwise makes perfect sense? One is led to suspect that the Court was trying to “cover both bases”, in the sense of carrying out a discrimination analysis but maintaining at the same time that the “obstacle” approach could also be applied. Or is this just a case in which the Court falls into the trap of its own rhetoric, applying well-worn formulas even in cases where they do not fit?

If so, the Court fell into the same trap in Thin Cap Test Claimants, a UK case involving legislation similar to that at stake in Lankhorst-Hohorst. Although it referred repeatedly to the difference in

treatment according to the place of establishment of the parent, and although it is clear from the operative part of the judgment that such difference in treatment is a key element in the finding of a restriction⁵⁷, nevertheless at ground 61 of the judgment it essentially reproduced ground 32 of its judgment in Lankhorst-Hohorst, adding (at ground 62) that

in order for such legislation to be considered to be a restriction on freedom of establishment, it is sufficient that it be capable of restricting the exercise of that freedom...

The question remains unanswered as to how such legislation can be regarded as having such a capability in the absence of a more attractive option elsewhere.

Rather different to the two cases just described is the case of Bosal Holding. This is a case of “outward” establishment, and there is therefore no preliminary reference to the rules on freedom of establishment forbidding discrimination based on nationality. In this case, a little effort is needed in order to understand that it is the difference in treatment between a person or company resident for tax purposes in the legislating Member State and that accorded to a non-resident which is at the root of the Court’s analysis. Bosal concerned a Dutch rule which allowed a resident parent company to deduct from its taxable income costs incurred in relation to a holding in the capital of a subsidiary only if those costs were “indirectly instrumental” in giving rise to profits taxable in the Netherlands. Bosal Holding asked for account to be taken of costs incurred in relation to its holdings in companies established in nine Member States other than the Netherlands. It was the refusal of the Dutch tax authorities to allow the deduction sought which was challenged before the national courts and which led to a reference to the Court of Justice. A particularity of the case was that the national rule at issue seemed to be authorised by Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States⁵⁸. However, the Court declared that the directive had to be interpreted in the light of the Treaty provisions on freedom of establishment, and proceeded to say the following:

As the referring court has pointed out, the limitation laid down in [the contested provision] of the deductibility of costs incurred by the parent company established in the Netherlands in connection with the capital of subsidiaries established in other Member States to cases where the latter generate, even if only indirectly, profits which are taxable in the Netherlands constitutes a hindrance to the establishment of subsidiaries in other Member States. In the light of that limitation, a parent company might be dissuaded from carrying on its activities through the intermediary of a subsidiary established in another Member State since, normally, such subsidiaries do not generate profits that are taxable in the Netherlands (ground 27, emphasis added).

No specific mention here of the fact that resident subsidiaries typically do generate such profits, or of the interest of comparing the situations of resident and non-resident subsidiaries. However, the word “limitation” which introduces this passage presumably reflects the Court’s awareness that the former group did fall within the privileged category. And, logically, a parent company will only be dissuaded from establishing a subsidiary outside the Netherlands precisely because it can obtain more favourable treatment in relation to a nationally-based subsidiary. A further clue is to be found in the next ground of the judgment, which reads as follows:

57 It should be mentioned that, although the Court found a restriction, it also showed a great deal of openness towards such a restriction being justified by the concern of a Member State to preserve its ability to exercise its tax jurisdiction in relation to activities carried out on its territory. Unlike in Lankhorst-Hohorst, the Court specifically acknowledged that thin cap legislation is an appropriate means of preventing practices the sole purpose of which is to avoid the tax that would normally be payable on profits generated by such activities. The Court insisted, however, on the need for proportionality in such measures, in the sense that it must be possible for the taxpayer to show that its arrangements are in fact bona fide and not entered into for tax avoidance purposes only and that, even where they are in reality wholly artificial, the interest paid must be treated as a distribution only in so far as it exceeds what would have been agreed upon at arm's length.

58 OJ 1990 L225, p. 6

Moreover, such a limitation goes against the objective set forth by the directive, spelt out in the third recital of its preamble, according to which it is necessary to introduce a common system and eliminate the disadvantage due to the application of tax provisions governing relations between parent companies and subsidiaries of different Member States which are less advantageous than those applicable to parent companies and subsidiaries of the same Member State (ground 28, emphasis added).

In other words, the Court was perfectly aware – and attached importance to – the fact that the rule at issue differentiated in the way it treated relations between parent and subsidiary according to the place of establishment of the subsidiary. It is true that the use of the word “moreover” could allow one to think that this consideration was purely ancillary to another – “obstacle” – type of reasoning, but it would seem perverse to attribute such thinking to the Court in a case so obviously involving different treatment based on the place of establishment of the subsidiary. It has to be admitted, however, that the strict wording of the judgment is ambiguous, and can be seen as lending itself to an “obstacle” interpretation.

Differentiation between Different Kinds of Transnational Transaction

Finally, mention must be made of two cases involving a difference of treatment, not as between national transactions and those involving a transnational dimension, but between national and assimilated transnational scenarios and other transnational situations considered by the national legislator as deserving different treatment.

In X AB and Y AB⁵⁹, the Court had to consider a Swedish rule which granted a tax advantage to intra-group transfers if it was made by a Swedish company to another Swedish company which was wholly owned either by the first company directly or by that company together with a wholly-owned Swedish subsidiary or subsidiaries. The same treatment was given if one or more of the wholly-owned subsidiaries was foreign provided they had their seats in the same Member State and that Sweden had concluded with that State a double-taxation agreement containing a non-discrimination clause. The advantage was refused – on the basis of the caselaw of the Swedish Supreme Administrative Court - where the wholly-owned subsidiaries had their seats in different Member States with which Sweden had likewise concluded double taxation agreements containing non-discrimination clauses. In relation to this rule, the Court said:

such legislation entails a difference of treatment between various types of intra-group transfers on the basis of the criterion of the subsidiaries' seat. In the absence of justification, that difference of treatment is contrary to the provisions of the Treaty concerning freedom of establishment. It does not make any difference in this regard that the case-law of the [Swedish Supreme Administrative Court] allows type B transfers [those assimilated to purely national situations] to be given the same treatment accorded to type A transfers [purely national scenario] (ground 28).

Since the Swedish government had made no attempt to justify the difference in treatment, the Court went on to declare arrangements such as the Swedish tax rules in question to be contrary to the Treaty provisions on freedom of establishment.

Cadbury Schweppes⁶⁰ concerned a UK tax rule providing that (subject to certain exceptions), where a resident company had a controlling holding in a subsidiary established in a State where it was subject to a level of taxation lower than three quarters of that applying in the UK, the profits of the subsidiary were attributed to the parent company and taxed in its hands, subject to a credit given for the tax already paid by the subsidiary in its State of establishment. The Court observed that

the legislation.... involves a difference in the treatment of resident companies on the basis of the level of taxation imposed on the company in which they have a controlling holding(ground 43).

59 Case C-200/98 [1999] ECR I-8261

60 op cit footnote 45

It further noted that this rule did not lead to the paying of more tax than that which would have been payable on the same profits if they had been made by a subsidiary established in the UK. However, said the Court,

under such legislation the resident company is taxed on profits of another legal person. That is not the case for a resident company with a subsidiary taxed in the United Kingdom or a subsidiary established outside that Member State which is not subject to a lower level of taxation (ground 45, emphasis added).

It went on:

the separate tax treatment... and the resulting disadvantage for resident companies which have a subsidiary subject, in another Member State, to a lower level of taxation are such as to hinder the exercise of freedom of establishment by such companies, dissuading them from establishing, acquiring or maintaining a subsidiary in a Member State in which the latter is subject to such a level of taxation. They therefore constitute a restriction on freedom of establishment within the meaning of Articles 43 EC and 48 EC (ground 46, emphasis added).

As for justification of the measure, the Court repeated previous rulings to the effect that the need to prevent reduction of tax revenue cannot be accepted as a matter of overriding general interest which could justify a restriction on a Treaty freedom. Nor could the fact that a resident company sets up a subsidiary in another Member State justify a general presumption of tax evasion. However, a national measure may be justified where it specifically relates to “wholly artificial arrangements” aimed at circumventing the application of the legislation of the Member State concerned. The Court was therefore prepared to accept legislation the purpose of which was

to thwart practices which have no purpose other than to escape the tax normally due on the profits generated by activities carried on in national territory(ground 59),

so long as it went no further than was necessary in order to achieve that purpose. That meant, in effect, that the legislation in question must apply only where the subsidiary carried out no genuine economic activity. It was not sufficient that the main motivation in establishing the subsidiary was to benefit from more favourable tax rates than those prevailing in the Member State of the parent company.

For present purposes, the main point of interest in both cases is the fact that the Court treated as a restriction on freedom of establishment a measure which created a disadvantage only for establishment in certain Member States. It can be argued that these cases support the view that the Court favours the “obstacle” approach even in tax cases. Thus, no comparison is made between the legal treatment of national and transnational situations because such a comparison is irrelevant: all that matters is that there is an obstacle to certain cases of establishment in other Member States. These judgments can, however, be rationalized in a different way, by considering that the favourable tax treatment in each case was always available in the purely national situation, whereas it was only granted in certain cases of establishment in another Member State. Thus, in effect, the disadvantageous treatment was reserved to (certain kinds of) transnational operations. Seen in this way, these cases too can be brought within the mainstream of the Court’s caselaw on taxation.

Freedom to Provide/Receive Services

The Court’s caselaw applying this freedom to Member State tax measures has dealt with a vast array of taxes. Particularly noticeable in this area is the presence of a large proportion of cases concerning indirect taxes. Oddly enough, given the obvious analogy between indirect taxes on goods and those on services, it is in these cases that the most unexpected developments have taken place. Whereas, with very few exceptions, the judgments dealing with direct taxation are clearly based on an idea of discrimination, in the indirect tax cases the Court has varied its approach considerably, going so far in

one case as to declare discrimination to be irrelevant⁶¹ and in another to deeming it indispensable to the application of the freedom in question⁶². However, as will appear in what follows, all the cases can in fact be explained as to their result on the basis of discrimination analysis.

Indirect Taxes

The earliest judgments applying the Treaty rules on freedom to provide/receive services to national tax measures concern indirect taxes. Thus, in Corsica Ferries⁶³ and Case C-381/93 Commission v France⁶⁴, the taxes in question were tariffs imposed for port services. Strictly speaking, in both cases the Court had to interpret Regulation 4055/86 applying the principle of freedom to provide services to maritime transport.⁶⁵ However, as the Court said in Commission v France, this regulation in effect rendered applicable to the sphere of maritime transport between Member States the totality of the Treaty rules governing the freedom to provide services⁶⁶. In both cases, therefore, the Court's analysis was based on the interpretation of those rules.

In Corsica Ferries, the problem was that the Decree fixing the tariffs in question fixed lower tariffs than that generally applicable for various categories of vessel entitled to carry on maritime cabotage. At the time, only vessels flying the Italian flag could obtain permission to engage in maritime cabotage. The plaintiff in the main proceedings was a company established under Italian law but its vessels flew the Panamanian flag, so that it did not qualify for the lower tariffs. In deciding whether the resulting situation was compatible with Community law, the Court took considerable pains to bring the case within the scope of the rules on freedom to provide services. It first observed that

the freedom to provide maritime transport services between Member States, and in particular the prohibition of discrimination on grounds of nationality, may be relied on by an undertaking as against the State in which it is established, if the services are provided for persons established in another Member State (ground 30, emphasis added).

It then went on to observe that

the [Italian] system gives preferential treatment to vessels permitted to engage in maritime cabotage, in other words, those flying the Italian flag.

Such a system indirectly discriminates between economic operators according to their nationality, since vessels flying the national flag are generally operated by national economic operators, whereas transport undertakings from other Member States as a rule do not operate ships registered in the State applying that system.

That finding is not affected by the fact that the class of less favourably treated economic operators may also include national transport undertakings which operate vessels not registered in their State, or by the fact that the class of operators given favourable treatment may include transport undertakings from other Member States which operate vessels registered in the aforesaid State, since the class receiving favourable treatment consists essentially of nationals of that State (grounds 32-34, emphasis added).

An Italian company was therefore allowed to rely on the fact that the rule which placed it at a disadvantage was, generally speaking, a discriminatory rule.

61 Joined cases C-430 and 431/99 Sea-Land Service Inc and Nedlloyd Lijnen BV [2002] ECR I-5235

62 Joined cases C-544 and 545/03 Mobistar SA and Belgacom Mobile SA [2005] ECR I-7723

63 Case C-18/93 [1994] ECR I-1783

64 [1994] ECR I-5145

65 Council regulation of 22 December 1986 applying the principle of freedom to provide services to maritime transport between Member States and between Member States and third countries, OJ 1986 L 378, p. 1.

66 ground 13

In Commission v France, the judgment was equally centred on unequal treatment, although it includes an apparent reference to the obstacle approach. In that case, the Commission criticised France for applying a system of port charges which discriminated according to the destination or place of origin of passengers: the tax was lower for the transport of passengers whose destination was a French port than for those being transported to a port of another Member State, and tax was levied both on embarkation and disembarkation for passengers travelling between Member States whereas it was only charged on the embarkation of passengers travelling between French ports. Having determined that the principle of freedom to provide services applies to maritime transport services between Member States, the Court went on:

Once the provision of services at issue in the present action is established as falling within Article 59 of the Treaty, under the Court's consistent case-law Article 59 precludes the application of any national legislation which without objective justification impedes a provider of services from actually exercising that freedom...

In the perspective of a single market and in order to permit the realization of its objectives, that freedom likewise precludes the application of any national legislation which has the effect of making the provision of services between Member States more difficult than the provision of services purely within one Member State.

Consequently, the provision of maritime transport services between Member States cannot be subject to stricter conditions than those to which analogous provisions of services at domestic level are subject (grounds 16-18, emphasis added).

In the quoted passages, the Court seems to indicate that there is a cumulative rule, first prohibiting any “impediments” to the free provision of services, and also (“likewise”) forbidding discrimination. This seems a little odd⁶⁷: if all impediments were prohibited, there would be no need for an additional ban on discriminations. Given the conclusion reached in the last paragraph quoted, it seems that the Court's main focus was on discrimination. That appears to be confirmed by a later passage in the judgment in which the Court sums up its position by emphasising the anti-protectionist aim of the rule on freedom to provide services:

Where national legislation, though applicable without discrimination to all vessels whether used by national providers of services or by those from other Member States, operates a distinction according to whether those vessels are engaged in internal transport or in intra-Community transport, thus securing a special advantage for the domestic market and the internal transport services of the Member State in question, that legislation must be deemed to constitute a restriction on the freedom to provide maritime transport services (ground 21, emphasis added).

A tariff imposed on maritime transport services was also the subject of the judgment in Sea-Land Service⁶⁸. In that case, the charge was presented by the Dutch legislation which imposed it as payment for vessel traffic services rendered by the State in certain ports and waterways. However, it was payable only by sea-going vessels longer than 41 metres, to the exclusion therefore of inland waterway vessels, although the services in question were also used (to a somewhat lesser extent) by the latter. Asked to pronounce on the compatibility of such a system with Community law, the Court first of all rejected the contention (which was supported by the Commission) that, since inland waterway vessels using the services in question were almost exclusively vessels flying the Netherlands flag, and therefore predominantly operated by Dutch enterprises, their exemption from the obligation to pay the tariff amounted to indirect discrimination based on nationality. In this regard, the Court said:

While it is true that Article 59 and the third paragraph of Article 60 of the EC Treaty (now the third paragraph of Article 50 EC) prohibit all forms of disguised discrimination which, although based on criteria which appear to be neutral, in practice lead to the same result.... , it is also true

67 but the formula reappears in other cases, see eg Case C-118/96 Jessica Safir [1998] ECR I-1897 at grounds 22-23 or Case C-150/04 Commission v Denmark, judgment of 30 January 2007, not yet reported, at grounds 37-38.

68 op cit footnote 55

that a difference of treatment cannot constitute discrimination unless the circumstances in question are comparable ...

As is apparent from the orders for reference, there are in this case objective differences between sea-going vessels longer than 41 metres and inland waterway vessels, in particular as concerns their respective markets - differences which reveal, moreover, that those two categories of means of transport are not comparable” (grounds 36-37).

In other words, because sea-going and inland waterway vessels were only to a limited extent in competition with each other, any cost difference imposed on them would not affect their respective market positions, and could not be considered discriminatory. However, the Court then went on:

None the less, the VTS system at issue in the main proceedings, in that it requires the payment of a tariff by sea-going vessels longer than 41 metres, is liable to impede or render less attractive the provision of those services and therefore constitutes a restriction on their free circulation (ground 38).

On this basis, every tax is a restriction on free circulation, and can only survive scrutiny under Community law if it is, in the eyes of the Court of Justice, a justified tax. Such was the case here. The Court noted that the tariff in question was applied to all operators in an equivalent position. It further considered that vessel traffic services constituted a nautical service essential to public security, and that:

the VTS tariff to which sea-going vessels longer than 41 metres are subject, as users of that service, contributes to the general interest in public security in those waters (ground 42).

Lastly, as regards proportionality the Court was satisfied that there was “a correlation” between the cost of the service provided and the amount of the tariff (ground 43).

Here then we see the Court, having excluded all arguments of protectionism, nevertheless examining the justification of a national tax measure on the basis of its own views about the requirements of national security and the right way to finance them. Had it considered that vessel traffic services were not important enough to warrant a restriction on the free provision of maritime transport services, or that the tariff imposed on certain users was not the most effective way of raising the necessary revenue, it would have been obliged to declare such taxes incompatible with the Treaty rules.

In other areas the Court has been more circumspect, even if its language has sometimes included broad references to the “obstacle” approach. In De Coster⁶⁹, the tax which led to a preliminary reference was a tax on satellite dishes introduced by the Belgian municipal authority of Watermael-Boitsfort. Having identified the tax as a possible restriction on the provision of television services, the Court then went on in the following terms:

It must also be noted that, according to the case-law of the Court, Article 59 of the Treaty requires not only the elimination of all discrimination on grounds of nationality against providers of services who are established in another Member State, but also the abolition of any restriction, even if it applies without distinction to national providers of services and to those of other Member States, which is liable to prohibit or further impede the activities of a provider of services established in another Member State where he lawfully provides similar services....

Furthermore, the Court has already held that Article 59 of the Treaty precludes the application of any national rules which have the effect of making the provision of services between Member States more difficult than the provision of services purely within one Member State (grounds 29-30, emphasis added).

Here we have the same logical oddity as that already noted in relation to Commission v France, with the added dimension of the reference to “further impeding”, which seems to indicate that the Court considers that national legislation which imposes on a provider of services any obligation going beyond those to which he is subject in his Member State of establishment is *ipso facto* a restriction

69 Case C-17/00 [2001] ECR I-9445

which is, in principle, prohibited by the rules on free movement. However, in the rest of its reasoning in this case, the Court makes no further reference to such an idea and, on the contrary, bases itself entirely on discrimination analysis. It thus notes that the tax on satellite dishes

has the effect of a charge on the reception of television programmes transmitted by satellite which does not apply to the reception of programmes transmitted by cable, since the recipient does not have to pay a similar tax on that method of reception (ground 31),

and that while unlimited access to cable distribution is available to broadcasters established in Belgium, this is not the case for broadcasters established in many other Member States, the programmes of which can be received only by satellite (ground 32). The Court sums up the effect of the tax measure in question as follows:

the tax on satellite dishes introduced by the tax regulation is liable to impede more the activities of operators in the field of broadcasting or television transmission established in Member States other than the Kingdom of Belgium, while giving an advantage to the internal Belgian market and to radio and television distribution within that Member State (ground 35, emphasis added).

On this basis, the Court goes on to examine – and reject – the environmental justification for the measure put forward by the municipality of Watermael-Boitsfort. It considered that, even if the aim of preventing the uncontrolled proliferation of satellite dishes could justify a restriction of freedom to provide services, in any event the measure adopted went further than was necessary in order to achieve protection of the environment. Other methods were available which would be less restrictive of the free movement of television services, such as rules concerning the size of dishes, their positioning or the use of communal dishes.

In Stylianakis⁷⁰, the contested measure was a Greek airport tax which imposed on flights of more than 750 kilometres a charge double that imposed on shorter flights. Having observed that the principle of freedom to provide services had been applied to the air transport sector by Regulation 2408/92⁷¹, the Court went on as follows:

That freedom precludes the application of any national legislation which has the effect of making the provision of services between Member States more difficult than the provision of services purely within one Member State, irrespective of whether there is discrimination on the grounds of nationality or residence...

As regards the tax at issue in the main proceedings, those air journeys which cover a distance of more than 750 km from a Greek airport, on which the most onerous tax is imposed, are all journeys between Member States or to third countries, whereas those covering a distance of less than 750 km, which are subject to the lower tax, are, with one exception, all domestic flights within Greece. It must therefore be held that, despite the ostensible neutrality of the criterion used to differentiate the amount of tax imposed, the most onerous tax specifically concerns non-domestic flights (grounds 25-26, emphasis added).

The Court goes on to observe that there appears to be no cost element in the tax which could explain the difference in level according to the length of the flight concerned. Curiously enough, in the light of its judgment in Sea-Land, it does not enquire at all whether there is any substantial level of competition between international flights and flights within Greece, but seems to take it for granted that the two categories are comparable. In this regard, it says

since airport taxes directly and automatically influence the price of the journey, differences in the taxes to be paid by passengers will automatically be reflected in the transport cost, and thus, in the case in the main proceedings, access to domestic flights will be favoured over access to intra-Community flights (ground 28).

70 Case C-92/01 [2003] ECR I-1291

71 Council Regulation (EEC) No 2408/92 of 23 July 1992 on access for Community air carriers to intra-Community air routes *OJ L 240, 24.8.1992, p. 8-14*

Whatever the accuracy of this may be from an economic standpoint, it is clear that the Court's conclusion - that a tax such as the airport tax in question is precluded by Community law - is motivated by a protectionist view of such measures.

Two further cases on indirect taxes show the Court moving towards a clear consciousness of the need to adopt a discrimination-based approach. In Viacom⁷², the Court was asked to pronounce on the compatibility with the rules on freedom to provide/receive services of a local tax on the posting of bills. The background to the case was a dispute between a French property company and an Italian provider of advertising services which had been asked to place advertisements within the territory of the municipality of Genoa on behalf of the French company. The latter then refused to pay that part of the bill of the advertising company which reflected the tax it had been obliged to pay the municipality in order to be allowed to put up advertising posters in public places.

In her Opinion, Advocate General Kokott pointed out to the Court that it had to choose between obstacle and discrimination analysis (though she called them "the justification solution" and "the definition-based solution"). She pointed out that, under the first approach, because all taxes may make an economic activity more expensive and therefore less attractive, they may be seen as restrictions of fundamental freedoms. It would then be necessary to examine their justification. However, since the raising of revenue is an essential requirement for State action, taxes would have to be regarded as justified in principle, which would leave the Court little scope for its enquiry. In favour of the second approach, the Advocate General argued that the notion of "restriction", indicating a measure presumed contrary to Community law unless justified, was quite unsuitable to tax measures, which should be regarded as legitimate in principle, falling within the category of forbidden measures only if discriminatory. The Advocate General seems to have seen a residual rôle for "the justification solution" in cases where a tax was so high as to amount to a prohibition on carrying on a given activity (paragraph 63 of her Opinion).

The Court seems to have taken the Advocate General's advice to heart, but to have hesitated to make a radical choice in its analysis of the case. In its judgment, after reciting the usual formula about the rules on freedom to provide services requiring the elimination of any "restriction" which is "*liable to prohibit or otherwise impede*" the activities of a provider of services, the Court went on as follows:

With regard to the question of whether the levying by municipal authorities of a tax such as the advertising tax constitutes an impediment incompatible with Article 49 EC, it must first of all be noted that such a tax is applicable without distinction to any provision of services entailing outdoor advertising and public bill-posting in the territory of the municipality concerned. The rules on the levying of this tax do not, therefore, draw any distinction based on the place of establishment of the provider or recipient of the bill-posting services or on the place of origin of the goods or services that form the subject-matter of the advertising messages disseminated.

Next, such a tax is applied only to outdoor advertising activities involving the use of public space administered by the municipal authorities and its amount is fixed at a level which may be considered modest in relation to the value of the services provided which are subject to it. In those circumstances, the levying of such a tax is not on any view liable to prohibit, impede or otherwise make less attractive the provision of advertising services to be carried out in the territory of the municipalities concerned, including the case in which the provision of services is of a cross-border nature on account of the place of establishment of either the provider or the recipient of the services(grounds 37-38, emphasis added).

The Court therefore interprets the rules on free movement as not prohibiting the type of tax under consideration both because it contains no discrimination and because it seems like an unobjectionable measure which, in view of the modest amount involved, is unlikely in practice to act as a barrier to trade. The words "including the case" in ground 38 show that the Court is still engaged in an assessment of the reasonableness of the tax as a whole, and not only of its particular effects on

72 Case C-134/03 [2005] ECR I-1167

exchange of services between Member States. In other words, the Court has given unusual prominence to the idea of discrimination, but has not yet bitten the bullet of adopting discrimination analysis as its only guide.

This changes entirely in Mobistar⁷³. This case raised the issue of the compatibility with the Treaty rules on freedom to provide services of two taxes raised by Belgian local authorities, one on transmission pylons, masts and antennae for GSM, and the other on external antennae. The measures were contested by mobile telephony operators established in Belgium, and the Belgian Conseil d'Etat asked for the Court's help in interpreting the applicable provisions of Community law. As regards freedom to provide services, the Court first recalled its usual positions according to which all restrictions are prohibited, and also ("furthermore") any measure making the provision of services between Member States more difficult than equivalent transactions on a national level (grounds 29-30). The Court then went on:

By contrast, measures, the only effect of which is to create additional costs in respect of the service in question and which affect in the same way the provision of services between Member States and that within one Member State, do not fall within the scope of Article 59 of the Treaty.

As regards the question whether the levy by municipal authorities of taxes such as those in question in the main proceedings amounts to a restriction incompatible with Article 59, it is necessary to point out that such taxes apply without distinction to all owners of mobile telephone installations within the commune in question, and that foreign operators are not, either in fact or in law, more adversely affected by those measures than national operators.

Nor do the tax measures in question make cross-border service provision more difficult than national service provision. Admittedly, introducing a tax on pylons, masts and antennae can make tariffs for mobile telephone communications to Belgium from abroad and vice versa more expensive. However, national telephone service provision is, to the same extent, subject to the risk that the tax will have an impact on tariffs.

It is appropriate to add that there is nothing in the file to suggest that the cumulative effect of the local taxes compromises freedom to provide mobile telephony services between other Member States and the Kingdom of Belgium (grounds 31-34, emphasis added).

In the first ground quoted, the Court clearly states that a tax on services is only caught by the rules on freedom to provide services (needing therefore to be justified in order to be allowed) if it creates extra difficulties for cross-border trade than for internal transactions. The final consideration (introduced by the words "*It is appropriate to add*") is ambiguous: has the idea that an over-large tax might have to be examined as to its justification even if non-discriminatory been abandoned or not? The quoted sentence can be read either as a comforting rider without legal significance or as a signal that, in an exceptional case, the Court could revert to the "restriction" approach. However, it seems safe to say that this judgment indicates that discrimination has finally been adopted by the Court as the guiding criterion of the legality of indirect tax measures adopted by the Member States.

Direct Taxes

The situation is less clear as regards direct taxes; although most of the Court's judgments applying the rules on freedom to provide services in this area are either based on, or include, discrimination considerations, there is at least one (rather recent) judgment which explicitly applies obstacle analysis⁷⁴.

73 op cit footnote 56

74 Case C-433/04 Commission v Belgium, judgment of 9 November 2006, not yet reported

The first case in which the Court applied the principle of freedom to provide/receive services in the context of a direct tax rule was that of Jessica Safir⁷⁵. This case arose out of Swedish rules governing the taxation of savings in the form of capital life assurance. These rules differed considerably according to whether the insurance was taken out with a company established in Sweden or in another country. The Court began its analysis with the same “impediment and likewise discrimination” discourse which we have already seen in relation to Commission v France. The Court then declared (ground 25) that it had to determine

whether such legislation creates obstacles to the freedom to provide services and whether, should this be the case, such obstacles are justified on the grounds relied on by the Swedish Government.

Throughout the rest of the judgment, however, what the Court does is to compare the two relevant sets of tax rules and to point out the various ways in which the rules applicable to the relationship with a foreign life assurance company were less favourable than those applying to a purely internal situation, or at least were likely to create uncertainty as to the amount of tax payable, with obvious effects in terms of dissuading individuals from taking out capital life assurance with companies not established in Sweden and the latter from offering their services on the Swedish market (see especially ground 30). On this basis, the Court examines the reasons put forward by the Swedish government to explain its tax provisions, and concludes that its objectives could be achieved by alternative arrangements less restrictive of freedom to provide services. In spite of the ambiguities in the language of the judgment, therefore, the schema followed corresponds to discrimination analysis.

Even clearer are most of the judgments which follow. Eurowings⁷⁶ concerned German tax rules which gave less favourable treatment to the leasing of aircraft from an undertaking established outside Germany than to an equivalent transaction with a German-based company. Having recalled the obligation of the Member States to exercise their tax competence consistently with Community law (ground 32), the Court went on to present the rules on freedom to provide services as follows:

since leasing is a service within the meaning of Article 60 of the EC Treaty (now Article 50 EC), it should be noted that the Court has held that Article 59 of the Treaty requires not only the abolition of any discrimination on account of nationality against a person providing services but also the abolition of any restriction on the freedom to provide services imposed on the ground that the person providing service is established in a Member State other than the one in which the service is provided (ground 33, emphasis added)⁷⁷.

The Court then noted the differences in the tax rules under examination (ground 36) and their dissuasive effect on German undertakings leasing goods from lessors established in other Member States (ground 37). It summed up the position as follows:

any legislation of a Member State which, like that at issue in the main action, reserves a fiscal advantage to the majority of undertakings which lease goods from lessors established in that State whilst depriving those leasing from lessors established in another Member State of such an advantage gives rise to a difference of treatment based on the place of establishment of the provider of services, which is prohibited by Article 59 of the Treaty (ground 40, emphasis added).

The Court then examined – and rejected – the alleged justification of the measure.

In Danner⁷⁸, the rule at issue was a Finnish measure which substantially disallowed deductions from taxable income of contributions to voluntary pension schemes operated by institutions

75 Case C-118/96 [1998] ECR I-1897

76 Case C-294/97 [1999] ECR I-7447

77 The same reference to restrictions imposed “on the ground” that the person providing the service is established in a Member State other than the one in which the service is provided is to be found in Case C-290/04, Scorpio v Finanzamt Hamburg-Eimsbuettel [2006] ECR concerning (inter alia) an obligation for a recipient of services from a service provider established outside Germany to deduct at source the tax for which the service provider was liable. Cf ground 31.

78 Case C-136/00 [2002] ECR I-8147

established outside Finland while allowing such deductions where the contributions were made to Finnish-based pension providers. The Court's introductory statement as to the meaning of the Treaty rules on freedom to provide services was the following:

In the perspective of a single market and in order to permit the attainment of the objectives thereof, Article 59 of the Treaty precludes the application of any national legislation which has the effect of making the provision of services between Member States more difficult than the provision of services purely within one Member State" (ground 29, emphasis added).

As in Stylianakis, it thus reproduced the "discrimination" part of the formula in Commission v France without the preliminary "restriction" part⁷⁹.

The Court then observed that

in view of the important role played, at the time when a pension insurance contract is taken out, by the possibility of obtaining tax relief under that head, such legislation is liable to dissuade individuals from taking out voluntary pension insurance with institutions established in a Member State other than Finland and to dissuade those institutions from offering their services on the Finnish market (ground 31).

The Court thus concluded that the Finnish rules in question constituted a restriction on freedom to provide/receive insurance services, and went on to examine (and reject) the arguments in their defence which had been put forward by the Finnish government (and by the Danish government, intervening). It is interesting to note that the Court refused to accept a Bachmann-style defence on the basis (*inter alia*) that, under the Finnish tax system, pensions payable by foreign institutions to Finnish residents are taxed, irrespective of whether the insurance contributions paid to build up such pensions were or were not deducted from the taxable income of their recipients (ground 38). The fiscal coherence argument therefore did not operate.

In Gerritse⁸⁰, the Court deployed discrimination analysis in order to declare unlawful a national rule which allowed only residents (fully taxable) to deduct business expenses from their taxable income. Mr Gerritse was a Dutch national and resident who earned some of his income in other Member States through his performances as a drummer. He challenged the refusal of the German tax authorities to allow him to deduct from that part of his income taxable in Germany the business expenses incurred in connection with earning that income. Asked about the applicability of the Community rules on freedom to provide services, the Court noted that

the business expenses in question are directly linked to the activity that generated the taxable income in Germany, so that residents and non-residents are placed in a comparable situation in that respect(ground 27).

The Court went on:

In those circumstances, a national provision which, in matters of taxation, refuses to allow non-residents to deduct business expenses, whereas residents are allowed to do so, risks operating mainly to the detriment of nationals of other Member States and therefore constitutes indirect discrimination on grounds of nationality, contrary in principle to Articles 59 and 60 of the Treaty (ground 28, emphasis added).

Since no clear argument had been put forward to justify the tax rule at issue, the Court declared such a measure contrary to the rules on free movement of services. However, on the basis that the situations of resident and non-resident taxpayers are not comparable in many respects, the Court decided that it was legitimate for a Member State to reserve the benefit of tax-free allowances having a social purpose to resident taxpayers, and that the fact that different methods were used to calculate and

79 (Almost) the same formulation of the rule on freedom to provide services is to be found in Case C-334/02 Commission v France [2004] ECR I-2229 concerning a less favourable tax regime applied to investment income where the investment company was not established in France. Cf ground 23.

80 Case C-234/01 [2003] ECR I-5933

recover the tax due was not unlawful so long as a non-resident was not, in effect, taxed more heavily than a resident.

Laboratoires Fournier⁸¹ concerned a French rule under which a tax credit for research was available to resident companies only if the research was carried out in France. The Court described the situation as follows:

the legislation of a Member State, such as that at issue in the main proceedings, by restricting the benefit of a tax credit for research only to research carried out in that Member State, makes the provision of services constituted by the research activity subject to different tax arrangements depending on whether it is carried out in other Member States or in the Member State concerned....

Such legislation differentiates according to the place where the services are provided, contrary to Article 49 EC (grounds 15-16, emphasis added).

None of the arguments put forward by the French government to justify this difference in treatment being found acceptable, the Court declared such discrimination contrary to the rules on freedom to provide services.

In the cases examined so far, the criteria used by the Court to determine the existence of a restriction range from indirect discrimination based on the nationality or the place of establishment of the service provider to the notion of making the provision of services between Member States more difficult than an equivalent operation in a purely national context. All these criteria fit perfectly within discrimination analysis. There seems to be only one judgment in which the Court has applied a frontally “obstacle” approach, and one other in which the reasoning is ambiguous.

The first judgment is that handed down in Case C-433/04, Commission v Belgium⁸². In that case, the Commission criticised a Belgian tax measure aiming to deal with tax fraud in the construction sector. For various activities in this sector, it was required to use registered contractors. Principals and contractors which had recourse to unregistered contractors or subcontractors were obliged to withhold 15% of payments, which had to be handed over to the Belgian tax authorities. The principal or contractor was also made jointly and severally liable for the tax debts of the unregistered contractor or subcontractor, up to a certain amount. Obviously many legitimate service providers established outside Belgium would not be registered in Belgium, and it was the effect on them of this measure which led the Commission to start infringement proceedings. Given the limited liability to Belgian tax of foreign-based service providers in the building sector, the Commission regarded the measure as unjustified and disproportionate. It did not attempt however to present the case in terms of indirect discrimination, and the Court followed suit.

The Court began its analysis of the Belgian measure by recalling that

the Court has consistently held that Article 49 EC requires not only the elimination of all discrimination on grounds of nationality against service providers who are established in another Member State, but also the abolition of any restriction on the freedom to provide services, even if it applies without distinction to national providers of services and to those of other Member States, which is liable to prohibit, impede or render less advantageous the activities of service providers from other Member States who lawfully provide similar services in their Member State of origin (ground 28, emphasis added).

The Court went on:

measures which are capable of deterring an operator from exercising his freedom to provide services are covered by the prohibition thus laid down in the EC Treaty(ground 29).

81 Case C-39/04 [2005] ECR I-2057

82 op cit footnote 68

Given the disadvantage for unregistered service providers of not being able to dispose immediately of part of their income (which they could only recover at the end of an administrative procedure), those of them which were not established in Belgium were likely to be deterred from accessing the Belgian market (ground 30). Moreover, the joint liability for tax debts of the unregistered service provider which was imposed on the principal or contractor was liable to dissuade the latter from having recourse to the services of providers established in other Member States (ground 31). In this regard, the Court added:

Even if joint liability applies without distinction when an unregistered service provider is used, regardless of whether he is established in Belgium or in another Member State, it must nevertheless be stated that, while it does not deprive service providers who are not registered and not established in Belgium of the ability to supply their services there, the disputed provision does make access to the Belgian market difficult for them (ground 31, emphasis added).

On the basis then that the measure created difficulties of access to the Belgian market for service providers established in other Member States, and without a word of comparison regarding the position of nationally-based service providers, the Court concluded that the withholding obligation and joint liability constituted a restriction on the freedom to provide services (ground 32). It went on to examine the arguments of the Belgian government concerning the justification of the measures, but found that they were disproportionate in view of the limited cases in which foreign-based service providers in the building sector were liable to pay Belgian taxes. Belgium was therefore declared to be in breach of its obligations under the Treaty.

It is noteworthy that this judgment was handed down more than a year after the judgment in Mobistar. Can it possibly be that the Court has decided that discrimination is the key to illegality as regards indirect, but not direct, taxes⁸³? This seems unlikely. Possibly the Court, faced with a choice between accepting or rejecting the case as presented by the Commission (in a direct action), preferred to accept it precisely because it could have been based on discrimination analysis. It could thus have been pointed out that the measures in question created difficulties only for Belgian-based operators of doubtful legitimacy, whereas they affected all building contractors established in other Member States and wishing to provide services in Belgium. Alternatively, the Commission's case could have put on the ground that the obligation to register (and the somewhat draconian measures to enforce this obligation) was, as a practical matter, a heavier burden for builders established in other Member States, for which Belgium represented only a fraction of their potential market, or that it was discriminatory to apply the same measure to situations which were not comparable, ie to those normally liable for Belgian taxes, and to those only exceptionally so. None of these approaches having been adopted by the Commission, the Court may have had to choose between accepting the case as presented or rejecting it on the ground that no differential impact had been demonstrated in the impact of the measure on national and transnational transactions. However that may be, the outcome is a judgment which casts doubt on the direction of the Court's caselaw.

Finally, there is the judgment handed down on 30 January 2007 in Case C-150/04, Commission v Denmark. This case concerned the deductibility from taxable income, or exemption from taxation, of contributions to pension schemes. The Danish measures criticised by the Commission limited such favourable treatment to payments made to pension institutions established in Denmark. In considering whether the Danish rules constituted a restriction on freedom to provide services, the Court first made the statement we have already seen in Commission v France and Mobistar about the provisions on free movement of services forbidding national measures which were impediments to service providers and "also" national rules which make the provision of services between Member States more difficult than the same operation on a national level (grounds 37-38). Having noted that the tax advantages at issue were available only to pension institutions having an establishment in Denmark, the Court then went on:

83 It is true that unpaid VAT may have been one of the concerns of the Belgian government in this case, but the bulk of the taxes concerned were direct taxes.

With regard to Article 49 EC, two categories of situation in which such a requirement is liable to have a dissuasive effect must be distinguished. In the first, service providers are dissuaded from establishing themselves in Denmark because of the costs involved. Such a situation constitutes, of itself, a denial of that freedom... In the second, the recipients of those services are dissuaded from becoming members of a pension scheme with a pension institution established in another Member State, in view of the important role played, at the time when a pension insurance contract is taken out, by the possibility of obtaining tax relief under that head (ground 40).

The first part of this is not easy to understand. The fact that service providers might be dissuaded from establishing themselves in Denmark is irrelevant to a restriction on freedom to provide services, which presumes no establishment. Anyway, the rule could not possibly operate to dissuade establishment since the latter precisely confers the advantage. The Court must have meant that service providers established in other Member States would be dissuaded from providing services in Denmark. As for “the costs involved”, this is perhaps a shorthand reference to the competitive disadvantage at which service providers found themselves under the Danish measures.

In any event, this is all the Court says about freedom to provide services before concluding (at ground 45) that the contested legislation constitutes an “obstacle” to that freedom. In trying to determine what kind of analysis has led to the conclusion, one has to admit that there is no explicit reference in the legal reasoning to a comparison between the treatment of pension institutions established in Denmark and those established in other Member States. On the other hand, the difference in treatment emerges so clearly from the description of the facts of the case, and those facts are so similar to those at issue in Danner, that it is difficult to believe that the Court could have intended to adopt an approach different to that set out in its judgment in the latter case. Moreover, the second “dissuasive effect” referred to by the Court (in terms closely echoing the judgment in Danner) is posited precisely on the fact that the tax advantage is available only to pension institutions established in Denmark. On balance, therefore, and in spite of the ambiguities of the judgment, the better view seems to be that the thinking underlying the conclusion as to the existence of a restriction on freedom to provide services is based on the unequal treatment of equivalent economic transactions depending on the place of establishment of the service provider.

As a footnote on this case, it is interesting to observe that, in examining and rejecting the arguments of the Danish government attempting to justify the difference in treatment, the Court finally abandons its Bachmann doctrine on the cohesion of the tax system. It points out that the element which could threaten the cohesion of the Danish tax system is not the fact that a pension is taken out with a pension institution established in another Member State, but the possibility that the scheme member leaves Denmark to live in another Member State between the time of making his contributions and the time of receiving his pension. It is in those circumstances that Denmark is likely to lose its power to tax the pension, wherever the pension institution may be. Where, on the other hand, the pensioner continues to live in Denmark, the latter will be competent to tax his pension, again irrespective of the country of establishment of the pension scheme. There is therefore an insufficient connection between the place of establishment of the pension institution and the perceived danger to the cohesion of a Member State’s tax system to justify the unequal treatment which has been practised by several Member States.

Free Movement of Capital

The great majority of judgments in the cases concerning this freedom include an examination of whether cross-border transactions suffer from a disadvantage in comparison with purely national investments. Only one judgment seems to depart from this pattern, with a couple of others showing signs of uncertainty as to which path of reasoning they are following. The main problem in the cases dealt with under this freedom is a certain ambiguity as to whether discrimination is the criterion for identifying a restriction in the first place, or whether it comes into play only at a second stage, after a restriction has already been identified, in the context of the examination of the justification of the

measure in question. As in the case of the other freedoms, all the judgments in this area seem to be explicable, as to their outcome, by way of discrimination analysis.

Restriction without Discrimination

The one case in which the Court appears unambiguously to have indicated that a restriction on the free movement of capital can exist without any difference of treatment between national and transnational situations is also the first case in which the Court had to apply the Treaty provisions on free movement of capital in the context of a Member State tax measure. Sandoz⁸⁴ concerned two provisions of Austrian law. The first simply decreed that all loan agreements (including those entered into with a lender established outside Austria) were subject to stamp duty of 0.8% of the value of the loan. The second treated a loan contracted with a lender not established in Austria in such a way that this loan would be subject to the tax even in circumstances in which a loan by an Austrian lender would not. The Court was asked to pronounce on the compatibility with Community law of both types of provision, as they applied to a loan contracted with a lender in another Member State.

As regards the first provision, the Court determined that its application to a loan contracted in another Member State was a restriction on the free movement of capital because it

deprives residents of a Member State of the possibility of benefiting from the absence of taxation which may be associated with loans obtained outside the national territory (ground 19).

Accordingly, said the Court,

such a measure is likely to deter such residents from obtaining loans from persons established in other Member States (also ground 19).

The Court went on, however, to decide that this type of measure was justified as a “requisite measure to prevent infringements of national law and regulations” within the meaning of Article 73d(1)(b) of the treaty (now Article 58(1)(b)). It arrived at this result by considering that the aim of the measure was to ensure equality of taxation for all Austrian residents who entered into a loan agreement, and that

[s]ince the effect of such a measure is to compel such persons to pay the duty, it prevents taxable persons from evading the requirements of domestic tax legislation through the exercise of freedom of movement of capital guaranteed by Article 73b(1) of the Treaty (ground 24).

The Court went on to note that the measure entailed no “arbitrary discrimination” since the tax applied to all borrowers resident in Austria without distinction as to nationality or the place where the loan was contracted.

Here then we have the oddity of the Court first drawing into the net of potential illegality a perfectly neutral tax measure, only to let it out again essentially because it was neutral, and moreover with the strange argument that the simple imposition of a duty had the effect of compelling people to pay it, thus transforming it into a measure *designed to prevent infringements* of national tax law. This somewhat tortured approach is evidence of the fact that the drafters of the Treaty provisions on free movement of capital never envisaged entirely neutral tax measures being treated as restrictions, and therefore provided no suitable “let-out” clause for them.

Even more remarkable, in the light of the foregoing, is the Court’s approach to the second (discriminatory) provision of Austrian law. The Court described the difference in treatment of the national and transnational situation. It continued:

It follows that that provision discriminates according to the place where the loan is contracted. Discrimination of that nature is likely to deter residents from contracting loans with persons

84 Case C-439/97 Sandoz GmbH v Finanzlandesdirektion für Wien, Niederösterreich und Burgenland [1999] ECR I-7041

established in other Member States and therefore constitutes a restriction on the movement of capital within the meaning of Article 73b(1) of the Treaty”(ground 31, emphasis added).

The Court went on to reject the justifications for the measure advanced by the Austrian Government, and to declare the provision contrary to the Treaty rules on free movement of capital.

Thus, discrimination was irrelevant to the Court’s first finding of a restriction, but key to the second. It can perhaps be argued that, for the Court, discrimination was a sufficient, but not a necessary, condition for the existence of a restriction. In any event, the two approaches present in the Sandoz judgment continue to appear in the Court’s caselaw.

Discrimination as Criterion of Restriction

As with the cases examined under the other freedoms, even where differences in treatment clearly play a major rôle in the Court’s analysis, there are certain differences between the judgments as to how bluntly discrimination is presented as key to the Court’s reasoning. Thus, in Verkooijen⁸⁵, where the Court had to consider a Dutch rule restricting an income tax exemption on dividends to cases in which the dividends were paid by a company established in the Netherlands, it did not use unambiguous “discrimination” terminology throughout the judgment. At ground 34, it started off by saying that

A legislative provision such as the one at issue in the main proceedings has the effect of dissuading nationals of a Member State residing in the Netherlands from investing their capital in companies which have their seat in another Member State.”

This could be taken for “obstacle” language if it were not obvious that the only reason Netherlands residents would be dissuaded from investing in other Member States was that they could obtain better tax treatment by investing at home. Then the Court went on:

It is also clear from the legislative history of that provision that the exemption of dividends, accompanied by the limitation of that exemption to dividends on shares in companies which have their seat in the Netherlands, was intended specifically to promote investments by individuals in companies so established in the Netherlands in order to increase their equity capital.

This sounds like a fairly clear indication that the Court is concerned with protectionism, but it would of course be clearer if a specific reference were made to it, or if the Court had mentioned the comparative situation of companies established in other Member States. However, the matter does become clearer in the next ground of the judgment. Here the Court says:

Such a provision also has a restrictive effect as regards companies established in other Member States: it constitutes an obstacle to the raising of capital in the Netherlands since the dividends which such companies pay to Netherlands residents receive less favourable tax treatment than dividends distributed by a company established in the Netherlands, so that their shares are less attractive to investors residing in the Netherlands than shares in companies which have their seat in that Member State (ground 35, emphasis added).

The Court therefore concludes that

It follows that to make the grant of a tax advantage, such as the dividend exemption, relating to taxation of the income of natural persons who are shareholders subject to the condition that the dividends are paid by companies established within national territory constitutes a restriction on capital movements (ground 36, emphasis added).

The Court was more straightforward in Manninen⁸⁶, which is a Finnish version of Verkooijen except that in this case the effective exemption from tax in the hands of the shareholder was designed to prevent double taxation of company profits distributed to shareholders by setting off the corporation

85 Case C-35/98 Staatssecretaris van Financiën v BGM Verkooijen [2000] ECR I-4071

86 Case C-319/02 Petri Manninen [2004] ECR I-7477

tax due from the company distributing dividends against the tax due from the shareholder by way of income tax on revenue from capital. The end result was that dividends were no longer taxed in the hands of the shareholder, so long as the dividends in question were paid by a company established in Finland. In Manninen, the Court focused immediately in the difference in treatment as between dividends received from a Finnish and a non-Finnish company. At grounds 20-22 of its judgment it said:

Since the tax credit applies solely in favour of dividends paid by companies established in Finland, that legislation disadvantages fully taxable persons in Finland who receive dividends from companies established in other Member States...

It follows that the Finnish tax legislation has the effect of deterring fully taxable persons in Finland from investing their capital in companies established in another Member State.

Meilicke⁸⁷ concerned a German version of the Finnish tax credit system discussed in Manninen. In determining whether that system constituted a restriction on the free movement of capital within the meaning of Article 56, the Court said:

Since the tax credit applies solely in respect of dividends paid by companies established in Germany, that legislation disadvantages persons who are fully taxable in that Member State for income tax purposes and receive dividends from companies established in other Member States. Such persons, for their part, are taxed without being entitled to set off the corporation tax payable by those companies in their State of establishment against the tax on the income from capital...

It follows that the tax legislation at issue in the main proceedings could deter persons who are fully taxable in Germany for income tax purposes from investing their capital in companies established in other Member States.

Conversely, that legislation is liable to have a restrictive effect as regards those companies, in that it constitutes an obstacle to their raising capital in Germany. Since dividends of non-German origin receive less favourable tax treatment than dividends distributed by companies established in Germany, the shares of companies established in other Member States are less attractive to investors residing in Germany than shares in companies which have their seat in that Member State (grounds 22-24, emphasis added).

Similarly, in Case C-334/02, Commission v France, which we have already seen in connection with freedom to provide services, the Court dealt with free movement of capital as follows:

The legislation in question also has a restrictive effect as regards companies established in other Member States as it prevents them from raising capital in France, given that the proceeds of contracts taken out with those companies are treated less favourably from a tax point of view than proceeds payable by a company which is established in France. This means that their contracts are less attractive to investors residing in France than those of companies which are established in that Member State (ground 24, emphasis added).

In other cases, the reference to discrimination as the criterion for the existence of a restriction on the free movement of capital is even more explicit. In D. v Inspecteur van de Belastingdienst⁸⁸, the Court had to consider a Dutch tax rule which allowed only resident taxpayers a tax-free allowance for wealth tax purposes. Mr D was a German resident 10% of whose wealth consisted of real estate situated in the Netherlands. The Court interpreted Article 56, banning restrictions on the movement of capital, in the light of Article 58 which, as we have seen, makes it clear that Member States may apply their tax rules differentiating between resident and non-resident taxpayers in so far as the distinction drawn does not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital (ground 25 of the judgment). The Court went on to examine the differences between the situation of a resident and a non-resident taxpayer in the context of wealth tax, and concluded that:

87 Case C-292/04 Wienand Meilicke et al v Finanzamt Bonn-Innenstadt, judgment of 6 March 2007, not yet reported.

88 Case C-376/03 D v Inspecteur van de Belastingdienst [2005] ECR I-5821

As in the case of income tax, the view is to be taken as regards wealth tax that the situation of a non-resident is different from that of a resident in so far as not only the major part of the latter's income but also the major part of his wealth is normally concentrated in the State where he is resident. Consequently, that Member State is best placed to take account of the resident's overall ability to pay by granting him, where appropriate, the allowances prescribed by its legislation.

It follows that a taxpayer who holds only a minor part of his wealth in a Member State other than the State where he is resident is not, as a rule, in a situation comparable to that of residents of that other Member State and the refusal of the authorities concerned to grant him the allowance to which residents are entitled does not discriminate against him (grounds 37-38, emphasis added).

The background to Kerckhaert-Morres⁸⁹ was a Belgian measure subjecting dividends to a uniform tax rate whether they were paid by resident companies or companies resident in another Member State. Mr and Mrs Kerckhaert-Morres, who had received dividends from a French company, claimed to be taxed less in Belgium in order to take account of the tax which had been deducted at source in France. The Court dealt with this claim by pointing out that, under Belgian law, there was no difference in treatment according to the source of the dividends (ground 17 of the judgment). It further excluded the argument that it amounted to discrimination to treat in the same way dividends received from a Belgian company and those paid by a company established in another Member State which also levied tax on them. The Court pointed out that the difference in outcome was due simply to the parallel exercise by two Member States of their fiscal sovereignty (ground 20). The *leitmotif* of the judgment is a search for, and exclusion of, discrimination.

FII Test Claimants has already been described in relation to freedom of establishment, but it also raised a number of issues relating to free movement of capital. In relation to the provision of UK law which, as regards resident companies receiving dividends from companies in which they held less than 10% of the voting rights, reserved exemption from corporation tax to nationally-sourced dividends, the Court said:

Such a difference in treatment has the effect of discouraging United Kingdom-resident companies from investing their capital in companies established in another Member State. In addition, it also has a restrictive effect as regards companies established in other Member States in that it constitutes an obstacle to their raising of capital in the United Kingdom. In so far as income arising from foreign-sourced capital is treated less favourably from a tax point of view than dividends paid by companies established in the United Kingdom, shares in companies established in other Member States are less attractive to United Kingdom-resident investors than those of companies having their seat in that Member State ...

It follows that the difference in treatment arising from legislation such as that at issue in the main proceedings as regards dividends received by resident companies from non-resident companies in which they hold fewer than 10% of the voting rights constitutes a restriction on the free movement of capital which is, in principle, prohibited by Article 56 EC (grounds 64-65, emphasis added).

In relation to the rule according to which a resident company receiving dividends from another company which had paid ACT was entitled to a tax credit relating to that payment so that, when it paid dividends to its own shareholders, it could offset the ACT already paid against the ACT due on that distribution, whereas a company receiving foreign-sourced dividends was obliged to account for ACT in full on a subsequent distribution, the Court said:

It should be noted in that regard that resident companies receiving foreign-sourced dividends are treated differently, inasmuch as they suffer a cash-flow disadvantage which is not justified by a relevant difference in their situation.

Such a difference in treatment has the effect of discouraging United Kingdom-resident companies from investing their capital in a company established in another Member State and also has a restrictive effect as regards companies established in other Member States in that it constitutes an obstacle on their part to the raising of capital in the United Kingdom (grounds 96-97, emphasis added).

89 Case C-513/04 Mark Kerckhaert and Bernadette Morres v Belgische Staat [2006] ECR I-10967

In connection with the provision of national law which stipulated that any relief in respect of tax paid abroad given to a resident company receiving foreign-sourced dividends would reduce the amount of corporation tax against which it could offset ACT, the Court excluded any breach of the Treaty provisions on free movement of capital on the basis that

such a measure does not discriminate against companies receiving foreign-sourced dividends”(ground 128, emphasis added).

Discrimination Examined Only under Justification Heading

In several other cases, however, although discrimination is mentioned, this happens convincingly only in the context of the examination of the justification of the measure, ie after it has already been determined that a “restriction” within the meaning of Article 56 exists, and that the national measure in question is therefore in principle unlawful.

In Blanckaert⁹⁰, the measure under consideration was an odd feature of Netherlands law allowing certain reductions in social security contributions to be used as tax reductions. This possibility was obviously only available to those who were, in principle, liable for social security contributions in the Netherlands, ie Netherlands residents working in that Member State or others so working. Mr Blanckaert was a Belgian national and resident who owned a holiday home in the Netherlands. He was subject to tax there on his notional income from that investment. Not being subject to the Netherlands social security system, he could not benefit from the relative tax reduction. He argued that this was an unjustified difference in treatment as between residents and non-residents, since his situation was no different from that of a Netherlands resident who had only income from savings and investments and who therefore did not pay social security contributions.

In considering whether such a situation gave rise to a restriction on free movement of capital, the Court first said:

It is thus appropriate to examine whether the national rule in question in the main proceedings involves a restriction on capital movements between the Member States inasmuch as it has a restrictive effect with regard to persons resident in a Member State other than the Netherlands who wish to invest in property in that State (ground 36, emphasis added).

It then went on to note that, under the applicable rules,

reductions in contributions in respect of national insurance, which, where appropriate, are deducted from the tax due on income in the year concerned - of which income from property investments is part - are allowed only to taxpayers who are insured under the Netherlands social security system.

The criterion of insurance chosen by the Netherlands legislation favours, in the majority of cases, persons resident in that Member State. Taxpayers who are not insured under that system are more often than not non-residents.

Less favourable tax treatment for non-residents only might deter the latter from investing in property in the Netherlands. That legislation is therefore capable of hindering the free movement of capital (grounds 37-39, emphasis added).

At first glance, one might think that the various references to differences of treatment in the grounds quoted bear witness to a discrimination approach. However, when one analyses more carefully what the Court says, the situation is less than clear. In reality, it makes little sense to say that less favourable tax treatment for non-residents might deter the latter from investing in the Netherlands: is it really credible that someone would hesitate to buy a holiday home in a certain Member State only because an advantage enjoyed by locals was not available to him? An investment decision depends logically, not on what others enjoy, but on what one’s own options are. If then we accept that the

90 Case C-512/03 Blanckaert v Inspecteur van de Belastingdienst [2005] ECR I-7685

difference in treatment is irrelevant to the “deterrence”, and that the latter seems to be key to the Court’s reasoning, we are left with obstacle analysis: a restriction is any measure which might deter an investment, irrespective of the relative situation on the national market.

It is only in examining the possible justification of the national rule that the Court really enters into a discussion of unequal treatment, comparing both the treatment and the objective situation of the two groups considered. It does this because of the specific wording of Article 58. The Court’s reasoning runs as follows:

It is ... necessary to examine whether such a restriction on the free movement of capital may be justified in the light of the Treaty provisions.

In that respect, it is important to note that, under Article 58(1)(a) EC Article 56 shall be without prejudice to the right of Member States ... to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence ...’.

However, unequal treatment permitted under Article 58(1)(a) EC must be distinguished from arbitrary discrimination, which is prohibited under Article 58(3) EC. According to case-law, a national provision such as that at issue in the main proceedings could be regarded as compatible with the provisions of the Treaty on the free movement of capital provided that the difference in treatment applies to situations which are not objectively comparable or is justified by overriding reasons in the general interest ...

The question is therefore whether, as regards the grant of tax credits in respect of national insurance, there is an objective difference between the objective situation of a non-resident such as Mr Blanckaert and that of a resident who, in the same way as the applicant in the main proceedings, receives in the Netherlands only income from savings and investments (grounds 40-43).

The Court goes on to find that there is such a difference, on the basis (largely) that the situation of someone who is covered by a social security system is intrinsically distinguishable from that of someone who is not.

The Court’s approach was similar in Bouanich⁹¹. This case concerned Swedish rules on the taxation of payments to shareholders on the occasion of a repurchase of shares in connection with a reduction in a company’s share capital. The rules differed according to whether the shareholder was a resident or a non-resident taxpayer. Only a resident taxpayer could deduct the cost of acquisition of the shares in calculating his gain, whereas the non-resident was taxed on the full value of the shares. The Court noted the reservation of the more favourable treatment to residents. It went on:

It is not disputed that such a tax advantage is, for those who enjoy the benefit of it, a form of tax relief and has the effect that non-resident shareholders, who are not able to enjoy that advantage, are taxed more onerously and therefore find themselves in a less favourable position than resident shareholders.

...the effect of such legislation is to make cross-frontier transfer of capital less attractive both by detering investors who are not resident in Sweden from buying shares in companies resident in Sweden and also, consequently, by restricting the opportunities available to Swedish companies to raise capital from investors who are not resident in Sweden.

In those circumstances, it must be held that a refusal to allow a non-resident shareholder, on the occasion of a share repurchase, to deduct the cost of acquisition of the shares constitutes a restriction on the movement of capital within the meaning of Article 56 EC” (grounds 33-35, emphasis added).

Like in Blanckaert, therefore, in determining the existence of a restriction, the Court mentions the difference in treatment as between the national and the transnational transaction, but appears (at least arguably) to give more weight to a deterrence argument which, as we have seen, has little to do with discrimination. Only at the justification stage of the analysis does it unambiguously adopt a

91 Case C-265/04 Margaretha Bouanich v Skatteverket [2006] ECR I-923

discrimination approach, noting the difference in treatment (ground 37), and observing that residents and non-residents are in a comparable position as regards the cost of acquisition of shares, so that the different treatment amounts to arbitrary discrimination (grounds 40-41).

The same structure may be observed in the judgment in Centro di Musicologia Walter Stauffer⁹² which concerned a German tax rule limiting an exemption from corporation tax in respect of rental income received in its territory to charities liable, in principle, to unlimited tax in Germany, ie established in that country. The case arose from the refusal of the German tax authorities to apply the exemption to a charitable foundation the seat of which was in Italy, and which had no presence in Germany apart from its ownership of commercial property which it let. In considering whether the German rule at issue constituted a restriction on the free movement of capital, the Court said the following:

it is necessary to examine whether the application of that article has a restrictive effect on charitable foundations established in other Member States in so far as rental income received in national territory does not qualify for the exemption enjoyed by other foundations of the same kind which have unlimited tax liability in that territory.

The fact that tax exemption for rental income applies only to charitable foundations which, in principle, have unlimited tax liability in Germany places foundations whose seats are in another Member State at a disadvantage and may constitute an obstacle to the free movement of capital and payments (grounds 26-27, emphasis added).

As in the other two cases, one has the impression here that the unequal treatment is mentioned as interesting background information, but that what really counts for the Court is the “obstacle” put in the path of the non-resident, an obstacle, as we have seen, the reality of which is somewhat elusive. Again, it is at the stage of examining the justification of the measure that the Court embarks on real discrimination exegesis (see ground 32 of the judgment) which leads it to conclude (at ground 42) that the effect of the German provision under consideration was “*to treat foundations in objectively comparable situations differently by reason of their place of residence*”, and that the various reasons for the unequal treatment put forward by the German Government could not be accepted.

It can of course be argued that, in all these cases, the discrimination discussion at the justification stage of the judgments would not have taken place had there not been a difference in treatment to begin with, in other words that the difference in treatment was fundamental to the Court’s finding of a restriction. However, the extracts quoted above show that the Court is not content to make a finding of different treatment and pass straight on to the examination of its justification; it feels the need to link any reference to unequal treatment to a notion of deterrence of, or obstacle to, capital movements between Member States⁹³. The result is, at best, ambiguity as to whether the Court treats a national tax measure as a restriction and therefore, in principle, unlawful simply on the basis that it is unattractive to investors and not because it treats national and transnational operations differently.

Doubt as to Criterion for Finding of No Restriction

This ambiguity of approach is discernible even in cases where the Court finds that the national legislation at issue does not constitute a restriction on the free movement of capital. In van Hilten-van der Heijden⁹⁴, the national measure giving rise to a reference to the Court of Justice was a Dutch rule deeming a Dutch national to be resident in the Netherlands at the time of his/her death where s/he had left the Netherlands within the previous ten years. Mrs van Hilten-van der Heijden was a Dutch national who had left the Netherlands less than ten years before her death. Her estate included property

92 Case C-386/04 Centro di Musicologia Walter Stauffer v Finanzamt München für Körperschaften [2006] ECR I-8203

93 See also, in this respect, Case C-364/01 Barbier at ground 62

94 Case C-513/03 Heirs of M.E.A. van Hilten-van der Heijden [2006] ECR I-1957

(moveable and immovable) in five different countries. Her heirs were disgruntled to find themselves assessed to tax in the Netherlands because of the “deeming” rule. In considering whether this rule gave rise to a restriction on free movement of capital, the Court first quoted previous judgments to the effect that the measures prohibited, as being such restrictions,

include those which are likely to discourage non-residents from making investments in a Member State or to discourage that Member State’s residents to do so in other States or, in the case of inheritances, those whose effect is to reduce the value of the inheritance of a resident of a State other than the Member State in which the assets concerned are situated and which taxes the inheritance of those assets (ground 44, emphasis added).

It then went on to say that a provision such as the Dutch measure under consideration was not a restriction because

[b]y enacting identical taxation provisions for the estates of nationals who have transferred their residence abroad and of those who have remained in the Member State concerned, such legislation cannot discourage the former from making investments in that Member State from another State nor the latter from doing so in another Member State from the Member State concerned, and, regardless of the place where the assets in question are situated, nor can it diminish the value of the estate of a national who has transferred his residence abroad (ground 46, emphasis added).

The meaning of this is not quite clear. The reference to identical tax provisions applying whatever the place of residence seems irrelevant: in determining whether a measure might or might not create a problem for cross-frontier investments or inheritances, the issue is surely whether the same rule applies wherever the property is situated. In any event, the Court’s somewhat complex reasoning seems to imply that, had the legislation in question somehow been “discouraging” in relation to cross-border investments, it would have been a restriction on capital movements irrespective of the situation on the purely internal level.

Synthesis and Conclusion

A very mixed picture emerges from the foregoing study of the caselaw. There are cases of clear and less clear discrimination analysis, judgments relying substantially on ideas of unjustified different treatment but nevertheless including “obstacle” language, and at least five cases (Sandoz, Sea-Land, Commission v Denmark, Commission v Finland and Commission v Belgium) in which the Court deliberately ignored any idea of discrimination in arriving at the conclusion that there was a restriction. Had the Court not found the national measures justified in Sandoz and Sea-Land, it would have been obliged to declare them unlawful. In the other three cases, it did declare national measures unlawful without verifying whether they produced extra effects for a transnational economic operation. There is clearly a danger that, if the Court continues to embrace, simultaneously or alternatively, discrimination and obstacle analysis, one day it will condemn an entirely neutral tax measure which it finds foolish or disproportionate.

Particularly noticeable is the sense of any lack of definite direction in the Court’s chosen approach. This is exemplified by the declaration in Mobistar (8 September 2005) that tax measures affecting in exactly the same way national and transnational transactions do not fall within the scope of Article 49, followed by the judgment in Commission v Belgium a little more than one year later (9 November 2006) which ignored any idea of discrimination in finding a Belgian tax measure contrary to that provision. Similarly, only two days separate the judgments in Ritter-Coulais (21 February 2006), in which the Court based its reasoning explicitly on unjustified different treatment and Commission v Finland (23 February 2006) in which it adopted the “obstacle” approach. On a less dramatic level, one can compare two judgments handed down on the same day in the field of freedom of establishment: on 23 February 2006, the Court handed down judgment in Keller, in which it carried out a perfect discrimination analysis, and CLT-UFA which, as we have seen above, requires a certain mental effort to see that it is in fact about discrimination.

These twists and turns in the caselaw undermine any idea that the Court is now firmly on a discrimination track as far as Member State tax measures are concerned⁹⁵. It is true that two Advocates General have firmly advocated a discrimination approach to such measures⁹⁶, and that there have been a number of judgments recently which could be read as bearing witness to a resurgence of that method of reasoning, notably the ACT and FII Test Claimants cases, Denkavit and Meilicke. However, there have been false dawns before now and it seems too soon to conclude that the Court has decided irrevocably to acknowledge that Member State tax measures should be scrutinized at Community level only when they affect differently national and transnational economic operations. It is suggested that the time has come for the Court to do this: the study of the cases set out above shows that the result the Court seeks to arrive at can always be reached by an approach based on the idea of discrimination, and the failure to adopt, consciously and explicitly, such a method of reasoning gives rise to a danger of the wrong result being arrived at. It also leads to a lack of clarity and transparency as to the real test being applied by the Court. The authority of the Court's judgments is moreover undermined by the use of unconvincing arguments based on "obstacle" analysis.

The most obvious example of this is the frequent reference to free movement being "hindered" or "discouraged" by State measures which are, in reality, unlikely to have any such effect. The problem here is that, while the "deterrence" argument is perfectly valid in a case of discrimination against an "outward" transaction, where the more favourable treatment reserved to the purely national equivalent clearly does have a dissuasive effect on the transnational operation, the same is not true in the "inward" situation: where the discrimination consists in favouring nationals over incomers, the decision of the latter to carry on with the inward transaction will generally be determined by a comparison, not of the two systems offered by the host State, but of the different possibilities available to the incomer. In such cases, it would be much more convincing – and quite sufficient – to say that the measure in question is unlawful because (without justification) it puts the incoming operation at a disadvantage in comparison with an equivalent national transaction. Such discrimination – on grounds of nationality or place of establishment – is contrary to the Treaty provisions on the fundamental freedoms considered without need of supplementary argument.

Similarly, a clear "discrimination" approach would allow the Court to avoid the aberrations of Sandoz or Sea-Land, where it undertook an examination of the justification of perfectly neutral tax measures. In the first case, this led it to distort the nature of the provision examined in order to find it justified, and in the other to enter into a discussion of the merits of a system of raising revenue which it is hard to see as other than a matter for national legislatures. Under a discrimination approach, on the other hand, all the Court has to examine as to its justification is the difference in treatment as between the national and transnational situation, and not the wisdom of the basic choices of the national legislator.

In the area of free movement of capital, the Court seems to have been led towards the "obstacle" approach by its reading of Article 58 as derogating from Article 56⁹⁷: it seems to reason that, since Article 58 permits certain kinds of different treatment in the context of tax law, in derogation from the rule of Article 56, therefore the notion of restriction in Article 56 must be wider than the idea of different treatment. In Bouanich, it said:

95 In an article published in the October 2007 edition of the Common Market Law Review ("A light in the darkness: Recent developments in the ECJ's Direct Tax Jurisprudence"), Suzanne Kingston suggests that the Court has now definitely moved to discrimination analysis in direct tax cases. It is submitted, however, that the analysis carried out above rather undermines that idea. In any event, an examination of the judgments in both direct and indirect tax cases gives a better indication as to whether the Court's caselaw in this area has now become a consistent whole.

96 A.G. Geelhoed in the ACT and FII Test Claimants cases, cited above in footnotes 47 and 49, and A. G. Poirares Maduro in Marks and Spencer, cited above in footnote 49.

97 This reading has been spelt out repeatedly by the Court. See, eg, Manninen at ground 28 or Centro di Musicologia at ground 31.

Article 56 EC prohibits all restrictions on the movement of capital between Member States, subject to the grounds of justification set out in Article 58 EC (ground 30, emphasis added).

This, however, is neither the only nor – it is submitted – the best way of reading the relationship between the two provisions. Article 58 can better be understood as a guide to understanding the meaning of Article 56 than as a derogation from it. It provides that Article 56 “shall be without prejudice to” certain kinds of national measure, ie that it leaves them untouched, so long as they are not in reality discriminatory. By reading Article 56 in the light of Article 58, one can bring discrimination concerns to the fore from the beginning of the examination of a national measure, rather than merely hinting at them in the first part of the reasoning and examining thoroughly the possibility of discrimination only in the part of the judgment dealing with justification. A measure would thus have to be examined as to its justification only if it affected differently national and transnational capital movements. If it did not do so, there would be no need to proceed to an enquiry into its justification. Only this reading is compatible with the view that the Treaty provisions on the fundamental freedoms, like those specifically dealing with Member State tax measures, interfere with such measures only to the extent that they are protectionist.

One may wonder why the Court seems to hesitate to adopt the approach proposed. The answer probably lies, at least in large measure, in the implications this would have for the general interpretation of the Treaty provisions on the four freedoms; while it is conceivable in theory to follow a discrimination approach for tax measures while sticking to “obstacle” analysis for others, there would inevitably be a weakening of the latter approach if the Court were openly to opt for discrimination orientation in tax cases. The systemic acknowledgment this would imply of the respective spheres of Member State legislation and the Community provisions on the fundamental freedoms would raise important questions about the other areas of economic and social legislation in which the Member States have also retained their competence under the Treaty system, subject only to the possibility of harmonisation at Community level and the prohibitions of discrimination and “restrictions” enshrined in the different Treaty provisions. The Court might find it hard to explain why the concept of “restriction” had one meaning for tax provisions and another for other kinds of State regulation. It is true that not all the arguments which can be deployed in favour of a “discrimination” interpretation in the tax area apply in other sectors. However, the basic argument is equally valid: to interpret the provisions on the fundamental freedoms as going beyond a ban on protectionist State measures is to risk entering into an unwarranted examination of the policy choices made by national legislators, thus causing Community law to encroach on areas of competence which the Treaty has left, in principle, to the Member States. It is proposed, therefore, that the Court should grasp the nettle and do for the other freedoms what it has almost done for the free movement of goods: make discrimination the criterion of the existence of a restriction on a fundamental freedom and thus enhance the clarity and authority of its rulings.

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