

Harmonisation of the Tax Systems in Europe
Judgements of the European Court of Justice

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I. Introduction

The founding treaty of the European Economic Community (EC Treaty) has as its objective the creation of an economic unit within which the free movement of goods, persons, services and capital is facilitated¹. The establishment of this economic unit requires agreement on certain principles governing the inter-action of the tax systems of the member states and thereby a certain degree of harmonisation².

Such harmonisation of European tax law as has been successfully achieved so far by the legislature by means of directives, which require to be incorporated into domestic law by each member state, relates only to indirect taxation³. Harmonisation of direct taxation by means of directives incorporated into national law is in its initial stages only. This may be due to the preconditions required for harmonisation, in particular, the European Council requirement of unanimity⁴, and the principle of subsidiarity which is particularly relevant to matters of direct taxation⁵. In addition, taxation is understood by each member state to be a characteristic of its sovereignty and protected as such. Taxation has an over-riding significance as the means of financing national budgets, and of determining economic policy. Taxation policy can also be an instrument of competition⁶. Recent studies show an increasing trend towards the use of taxation in competition between member states in Europe⁷. This will become problematical when member states attract investors solely by lower rates of business and corporation taxation. Examples of the employment of such tax inducements are the „Coordination Centres“ in Belgium, the „Group Financing Companies“ in the Netherlands, the „Dublin International Financial Service Centre“ in Ireland, the „Centre for Financial and Insurance Services“ in Trieste, Italy, and the „Offshore Business Centre“ in Madeira, Portugal⁸. The member states rely on an agreed code of conduct which is politically - not legally - binding, to prevent „harmful“ competition through taxation regimes⁹. Harmonisation of direct taxation by means of directives is not to be anticipated in the foreseeable future.

The efforts of the European Court of Justice stand out in contrast to the lack of political will on the part of the member states to provide a European tax code and thereby a wide-ranging harmonisation of taxation by legislation. The judgements of the Court relevant to direct taxation in recent years make clear that it will provide the decisive

1 cf. Schmitt, IWB, Fach 11a, 363 ff.; Huschens, RIW 1999, 326 ff.

2 cf. Förster, in: Bleckmann, Europarecht, 6. Aufl., 717, 719; Voß, in: Dausen, Handbook of EU-WirtschaftsR, J Rn. 4.

3 This applies especially to Value Added Tax (VAT). Achievement of a common system of VAT (principle of transition from state of destination to state of origin) has, however, faded into the distant future (cf.: Dziadkowski, FS-Rädler, 1999, 137 ff.)

4 Cf. Art. 93, 94 EC

5 Cf. in detail: Lang, FS-Flick, 1997, 873, 876; Klein, DSTJG 19, 7, 23.

6 Voß, in: Dausen, Handbook of EU-WirtschaftsR, J Rn. 3; Förster, in: Bleckmann, Europarecht, 6. Ed. 717, 719.

7 Voß, ZEuS 1999, 335 ff.; Runge, FS-Rädler, 1999, 559 ff.; Blumenberg/Lausterer, FS-Rädler, 1 ff.

8 Cf. in detail: Voß, ZEuS 1999, 335, 346 ff.; Blumenberg/Lausterer, FS-Rädler, 1, 4 ff.

9 Decision of the Council and the representatives of the member states of 1. Dezember 1997 on a Code of Conduct for Corporation Taxation (OJ 1998 Nr. C 2/2). Cf: Saß, FR 1999, 77 ff.; Runge, FS-Rädler, 1999, 559,

impetus towards tax harmonisation. On the basis of the basic principle of non-discrimination contained in the EC Treaty, namely in Art. 39 ff. (free movement of workers), Art. 43 ff. (freedom of establishment), in Art. 49 ff. (free movement of services) and in Art. 56 ff. (free movement of capital and payments)¹⁰, the Court has elaborated clear principles to which national taxation must adhere. In addition, the Court has, in its relevant judgements, advanced the existing degree of harmonisation in indirect taxation. The Court, therefore, drives forward the process of European tax harmonisation and has become a powerful force, perhaps the most important force, for its achievement.

This article will review the judgements of the European Court of Justice on taxation and the relevant principles developed therein. The judgements of the Court must, because of the differing degrees of harmonisation, be distinguished between those pertaining to direct and indirect taxation.

II. Indirect Taxation (Value Added Tax)

The EC Treaty, in Art. 93 EC, provides an independent legal basis for the harmonisation of indirect taxation¹¹. Value Added Tax (VAT) is the most significant of such taxes as it generates most income¹². It is also the tax which is most harmonised among the member states. The most important legal provision in this respect is the 6th Value Added Tax (VAT) Directive¹³ which obliged the member states to harmonise their legal and administrative structures relating to this tax. The Court judgements are then of particular significance due to the importance of the 6th Directive in the national law of each member state¹⁴. The judgements extend to such areas as the essentials of „economic activity“, taxable turnover, place where the services are provided, basis of assessment, tax exemptions, input tax, issuing of invoices and travel services¹⁵. Out of the many judgements of the Court on the interpretation of the 6th Directive, only some of the most recent affecting „economic activity“ and basis of assessment will be presented here exemplifying the position of the Court.

564 ff.

¹⁰ Other taxation provisions in the EC Treaty are: Art. 2 (The Object of the Community), Art. 3 (Activity of the Community), Art. 4 (Activity of the Community in the Economic and Monetary Union), Art. 5 (Principle of Subsidiarity), Art. 12 (Prohibition of Discrimination), Art. 23 ff. (Free Movement of Goods), Art. 25 ff. (Customs Union), Art. 28 ff. (Prohibition of Mass Limitation on the Movement of Goods between Member States), Art. 87 (Restriction on Aids; Exceptions), Art. 90 ff. (Taxation Provisions), Art. 293 (Negotiations on Equalisation of Citizenship), Art. 295 (Property), Art. 308 (Provisions for Unforeseen Cases).

¹¹ Bleckmann, in: *ibid.*, *Europarecht*, 6. Ed., 87, 260; Klein/Wolffgang, in: *Lenz, EGV-Kommentar*, 2. Ed., Art. 93 Rn. 4; Voß, in: *Grabitz/Hilf, KommEU*, Art. 99 Rn. 9.

¹² Cf. Financial Report 2000 of the Federal Ministry of Finance, Table 12: Of 904.357 Mio. DM taxation income in 2000, 277.000 Mio. DM comes from Value Added Tax (VAT) including VAT on imports.

¹³ Sixth Directive 77/388/EEC of 17.05.1977 on the Harmonisation of the Laws of the Member States relating to Turnover Taxes (Value Added Taxes) - Common system of Value Added Tax: uniform basis of assessment (OJ 1977 Nr. L 145/1). In Germany this Directive was adopted into domestic law by the Amendment of the Value Added Tax and other Laws of 26.11.1979 (Federal Law Gazette I 1979, 1953).

¹⁴ Huschens, *EuZW* 1996, 261; Nowack, in: *von der Groeben/Thiesing/Ehlermann, Kommentar zum EU-/EG-Vertrag*, 5. Ed., Art. 99 Rn. 105.

1. ECJ 29.2.1997 (INZO)

In this case, *Intercommunale voor Zeewaterontzilting* - abbreviated to INZO - ¹⁶ the Court gave its view on the deduction of input tax made by the failing company. According to Art. 4 of the 6th Directive, any person carrying on an economic activity is subject to tax. Such a person is then also entitled to deduct tax paid on inputs. The point at which income is generated is not necessarily the point at which the economic activity commences. The commencement may go back to preparatory work and tax pre-paid during that phase may be deductible. The question was whether preparatory work can be regarded as having the characteristics of an economic activity when the business turns out to be unsuccessful and does not later produce taxable turnover.

A good example for the point of view on the deduction of input tax in these cases is the jurisprudence of the Federal Fiscal Court of Germany (BFH). The BFH had, for the most part, disallowed the deduction of pre-paid input tax by the unsuccessful business. According to its decision, a business in the course of its foundation may, provisionally, claim refund of its input tax payments. If, however, no taxable turnover is later produced, the characteristics of an economic activity were absent from inception and the provisional tax assessment can be revised or corrected. The same applied if an existing business founded another business with objects not materially related to the existing business. Deduction of pre-paid tax on inputs by the unsuccessful business would only be allowable, according to the decision of the BFH, if the business had taxable turnover from a similar business. In all other cases, the unsuccessful business was, because of the absence of taxable turnover, to be treated as an end user who must bear the tax¹⁷.

The ECJ in its decision in the INZO case in 1996 reached a different conclusion. INZO was a Belgian company having, according to its Articles of Association, the object of developing and exploiting processes for the treatment of sea water and brackish water and turning them into drinking water. For this purpose, INZO commissioned a profitability study, among other things. As, according to this study, the process would not be profitable, the company was dissolved. The ECJ accepted that INZO was engaged in an economic activity and, therefore, entitled to the refund of its pre-paid input tax. The decision of the Court was based, firstly, on the fact that Value Added Tax is neutral from the point of view of the tax burden on a business. Otherwise, unjustifiable tax discrimination could arise as between businesses which already have taxable turnover and those which incur expenditure (investment) in an endeavour to commence a business which will later produce taxable turnover. Secondly, the Court based its decision on the need for legal certainty, so that a provisional acknowledgement of pre-paid input tax as deductible would not later be reversed. The

¹⁵ Cf. Huschens, *EuZW* 1999, 357, 361 ff.; *ibid.*, *EuZW* 1998, 357, 363 ff.; *ibid.*, *EuZW* 1997, 261, 263 ff.; Dziadkowski, *FS-Rädler*, 1999, 137, 149.

¹⁶ ECJ, Judgement of 29.2.1996, C-110/94, *EuZW* 1996, 241 ff.

¹⁷ Cf. BFH, Judgement of 6.5.1993, *BStBl. II* 1993, 564; BFH, Judgement of 16.12.1993, *BStBl. II* 1994, 278; BFH, Judgement of 15.9.1994, *BStBl. II* 1995, 88.

Court allowed for such a correction only if the taxpayer acted with intent to defraud¹⁸. The ECJ, therefore, in the INZO case, placed the principles of the neutrality of Value Added Tax and legal certainty above the principle on which the decision of the BFH was based, namely, that Value Added Tax is paid ultimately by the end user¹⁹.

2. ECJ 5.5.1994 (Glawe)

A further good example of the influence of the decisions of the ECJ on national Value Added Tax law is the case of Glawe²⁰ in which the judgement of the ECJ is significant as to the base for tax assessment.

H. J. Glawe Spiel- und Unterhaltungsgeräte Aufstellungsgesellschaft mbH & Co. KG. installs and operates gaming machines in bars. The operation of these machines is legally regulated. They must be adjusted so that at least 60% of the stakes are returned to the players as winnings. For this purpose the machines are equipped with reserve compartments and cash boxes. The reserve compartments are for the purpose of pay-outs. When a player puts in a coin it falls firstly into the reserve compartment if the latter is, due to a recent pay-out, not completely full. Only when the reserve compartment is completely full does the coin fall into the cash box from where it can be taken by the operator of the machine²¹.

The tax authorities took all stakes inserted in the gaming machines during the year, net of Value Added Tax, as the basis for assessment of Value Added Tax, within the meaning of the German statute implementing Art. 11 of the 6th Directive²². The ECJ in its judgement in 1994 reached a different conclusion. It distinguished between the amounts which remained in the reserve compartments and the amounts which passed into the cash boxes, and thereby as profit into the hands of the operator. According to this decision of the ECJ, only the amounts passing into the cash boxes, net of Value Added Tax, make up the base on which Value Added Tax is due. The net profit from the gaming machines is, therefore, according to the ECJ, the basis for assessment of Value Added Tax²³.

3. ECJ 14.7.1998 (First National Bank of Chicago)

The Court, in the First National Bank of Chicago case, confirmed its judgement in the Glawe case²⁴. The question in the First National Bank of Chicago case concerned,

¹⁸ ECJ, Judgement of 29.2.1996, C-110/94, EuZW 1996, 241, 242 f.

¹⁹ Cf.: Pflüger, UR 1996, 180 ff.; Huschens, EuZW 1997, 261, 263 f.

²⁰ ECJ, Judgement of 5.5.1994, C-38/93, EuGHE 1994, I-1692

²¹ ECJ Judgement of 5.5.1996, C-38/93, EuGHE 1994, I-1692, 1694

²² ECJ Judgement of 5.5.1996, C-38/93, EuGHE 1994, I-1692, 1695

²³ ECJ Judgement of 5.5.1996, C-38/93, EuGHE 1994, I-1692, 1695 ff. Cf. also Felix, EWS 1994, 204; *ibid.*, BB 1994, 1198 f.; Dziadkowski, UVR, 1994, 226 ff.; *ibid.*, IStR 1994, 324 ff.; Lausterer, UR 1994, 183 f.; Huschens, EuZW 1999, 357, 361.

²⁴ ECJ, Judgement of 14.7.1998, C-172/96, IStR 1998, 471 ff.

inter alia, the assessment basis for foreign exchange transactions in respect of which the bank charged no fees or commission. The profit for the bank depended rather on the difference between the rate at which it bought and that at which it sold foreign currency. Each trader conducted his own dealings book, and was expected, over a certain time span, to show a profit. This profit represented the overall result of his dealings in the given period²⁵.

The ECJ in 1998 decided that the basis of assessment would be, not the entire amount of the bank's foreign currency dealings, net of Value Added Tax, but the disposable profit made out of foreign exchange dealings, over a specific period, consisting of the spread between buying and selling rates, net of Value Added Tax. The sum of this spread forms the profit. The assessment basis is, therefore, as in the Glawe case, the net profit achieved²⁶.

4. Conclusion

The above selected cases illustrate the extent to which the ECJ has penetrated, even into minute detail, the national Value Added Tax provisions. This is also confirmed by current decisions and procedures of the ECJ²⁷. As far as German Value Added Tax law is concerned, some questions which arise are, for example, whether EU law requires - in contrast to the terms of § 14 ss. 3 of the German Value Added Tax Code (UStG) - that an amended invoice be taken into account already in the tax assessment procedure rather than in a separate tax remission procedure, or whether amendment of an invoice is conditional on evidence of good faith²⁸. The ECJ has decided, regarding Austrian Value Added Tax law, that the 6th Directive does not prohibit various contributions to tourism organisations and to a tourism development fund²⁹. Other questions concerning Value Added Tax dealt with by the Court in recent cases include the import of a ship from the Dutch Antilles to a member state³⁰, the exclusion, by national legislation which predates the 6th Directive, of the entitlement to claim refund of pre-paid input tax on the acquisition of a motor vehicle³¹, tax exemption on the acquisition of building land³², tax exemption of certain socially beneficial activities³³ or tax exemption in respect of the import and the acquisition within the community of certain weapons³⁴.

²⁵ ECJ, Judgement of 14.7.1998, C-172/96, IStR 1998, 471, 472.

²⁶ Cf. ECJ, Judgement of 14.7.1998, C-172/96, IStR 1998, 471, 472 ff.; Geurts, IStR 1998, 474 f.; Huschens, EuZW 1999, 357, 361 f.

²⁷ Cf. Schmitt, IWB, Fach 11a, 363 ff.; Huschens, RIW 1999, 326 ff.

²⁸ BFH Decision of 15.10.1998, V R 38/97, V R 61/97, UVR 1999, 67, 70 f.

²⁹ ECJ, Judgement of 8.6.1999, C-338/97, C-344/97 und C-390/97, UR 1999, 328.

³⁰ ECJ, Judgement of 28.1.1999, C-181/97, UR 1999, 452.

³¹ ECJ, Judgement of 5.10.1999, C-305/97, IStR 1999, 630.

³² ECJ, Judgement of 29.4.1999, C-136/97, UR 1999, 326.

³³ ECJ, Judgement of 7.9.1999, C-216/97, IStR 1999, 599.

³⁴ ECJ, Judgement of 16.9.1999, C-414/97.

In general, interpretation of national Value Added Tax law has, since the coming into force of the 6th Directive, in practice passed to the ECJ³⁵. The advanced state of harmonisation in Value Added Tax, brought about by the 6th Directive, has positioned the ECJ more and more as the court of final appeal in European taxation matters³⁶.

III. Direct Taxation

In contrast to its provisions on indirect taxation, the EC Treaty provides no special legal basis for the harmonisation of direct taxes. Harmonisation of direct taxes, in particular, income and corporation tax, is, under the EC Treaty, as amended, based on the general legal harmonisation provisions of Arts. 94 and 95 ss. 2 EC, and has not progressed significantly³⁷. So far, this process is limited to the adoption into national laws of a number of directives and multi-lateral treaties having the aim of facilitating cross border trade. Examples are the Cross-border Parent and Subsidiary Directive³⁸, the Directive on Transactions associated with Cross-border Mergers³⁹, and the Transfer Pricing Arbitration Convention⁴⁰ of 1990. Many attempts have been made to advance this process further, but without concrete results. The most recent example of the absence of political will in this regard is the failure of the attempted common taxation of interest⁴¹.

The importance of the efforts of the ECJ towards harmonisation of direct taxation grows as the likelihood of achieving such harmonisation through directives adopted into national law diminishes. The Court, in a number of cases, has taken positions on the conformity or non-conformity of national income and corporation tax laws with the basic freedoms contained in the EC Treaty.

1. ECJ 28.1.1986 (Avoir Fiscal)

In its first judgement on direct taxation, in the so-called Avoir Fiscal case of 28.1.1986⁴², the ECJ set down basic principles on freedom of establishment and free

³⁵ Nowack, in: von der Groeben/Thiesing/Ehlermann, Kommentar zum EU-/EG-Vertrag, 5. Ed., Art. 99 Rn. 105.

³⁶ Nowack, in: von der Groeben/Thiesing/Ehlermann, Kommentar zum EU-/EG-Vertrag, 5. Ed., Art. 99 Rn. 105. Cf. Birkenfeld, StW 1998, 55, 73.

³⁷ Voß, in: Dausen, Handbook of EU-WirtschaftsR, J Rn. 48; Tipke/Lang, Steuerrecht, 16. Ed., 38 f.

³⁸ Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries in different Member States (OJ 1990 Nr. L 225/6).

³⁹ Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different member states (OJ 1990 Nr. L 225/1).

⁴⁰ Convention 90/436/EWG on the elimination of double taxation in connection with the adjustment of transfer of profits between associated undertakings (OJ 1990 Nr. L 225/10).

⁴¹ Cf.: unattributed, EU-Zinsbesteuerung kommt nicht voran, Handelsblatt 12.09.1999; unattributed, Neuer Rettungsversuch für europäische Zinssteuer, Frankfurter Allgemeine Zeitung (FAZ) 9.12.1999, 17; unattributed, EU-Zinsbesteuerung vorerst gescheitert, FAZ 11.12.1999, 13 f. For background cf.: Saß, StW 1999, 164 f.

⁴² ECJ, Judgement of 28.1.1986, 270/83, EuGHE 1986, 273

movement. Insurance companies, having their registered offices in France, received a tax credit on dividends paid to them from French shares - the so-called „avoir fiscal“. French subsidiaries of foreign companies were also treated as resident in France, and likewise benefited from this tax credit. In contrast, permanent establishments (branches, or agencies) of companies whose registered offices were not in France, were not treated in this way. Due to the fact that such establishments did not qualify as „resident in France“ they received no tax credits of the kind mentioned. In all other respects the permanent establishments in France were taxed in the same manner as companies resident there⁴³.

The ECJ found a breach of the right of freedom of establishment. Firstly, freedom of establishment includes the freedom to choose the commercial form of the establishment in another member state whether as a branch or subsidiary company. The Court further found that freedom of establishment prohibits not only overt discrimination on the basis of the nationality of a natural person or the location of the registered office of a legal person, but also such discrimination which would typically affect foreign natural or legal persons. Distinctions made in tax law on the basis of „residence“ or „non-residence“ were found by the Court to possibly conceal a form of covert discrimination⁴⁴. Such a distinction constitutes discrimination if the non-resident taxpayer is subject to more tax than a resident taxpayer when their circumstances are otherwise comparable. In the present case, the Court found that such discrimination existed, and developed the principle of acknowledgement in response. The fact that branches and agencies in France of companies whose registered offices were abroad were treated for tax purposes in the same manner as resident companies in all respects - other than in relation to the tax credit - implied that France had acknowledged that no objective distinction existed between them and that their circumstances were comparable⁴⁵.

Discrimination in this manner was not regarded by the Court as justified. The Court rejected the arguments of the French government that, inter alia, the non-resident had possible advantages over the resident, the absence of harmonisation of tax laws, the absence of corresponding provision for foreign companies in other member states, the absence of Tax Treaty provisions and double liability⁴⁶.

⁴³ ECJ, Judgement of 28.1.1986, 270/83, EuGHE 1986, 273, 299 f.

⁴⁴ ECJ, Judgement of 28.1.1986, 270/83, EuGHE 1986, 273, 302 ff.; cf. also Advocate General Mancini in: EuGHE 1986, 275, 276 and Thömmes, DStJG 19 (1996), 79, 83.

⁴⁵ ECJ, Judgement of 28.1.1986, 270/83, EuGHE 1986, 273, 303 ff. cf. also Jacobs, Internationale Unternehmensbesteuerung, 4. Ed., 180.

⁴⁶ ECJ, Judgement of 28.1.1986, 270/83, EuGHE 1986, 273, 303 ff.

2. ECJ 27.9.1988 (Daily Mail)

The Daily Mail case produced a further important decision of the Court on 27.9.1988⁴⁷. The facts in the case were: A British company - Daily Mail and General Trust plc. - proposed to transfer its central management and control to the Netherlands, solely for tax reasons. Immediately after this transfer the company wished to sell some of its holding of share investments without incurring British tax on these hidden reserves. The transfer of its central management required the consent of the British Treasury, which was refused⁴⁸.

The ECJ stated that while freedom of establishment presupposes, in the first place, the absence of discrimination by the new host state, it may also be invoked against restrictions by the home state. Nevertheless, the ECJ did not find the refusal of consent by the British Treasury to be in breach of the right to freedom of establishment. Because of the, so far, incomplete harmonisation of national corporation tax laws within the EC, the Court regarded the problem of the transfer of registered office as one which is unresolved. So long as this is the case, national restrictions on the right of transfer do not breach the right to freedom of establishment⁴⁹.

3. ECJ 8.5.1990 (Biehl)

The Court in its judgement of 8.5.1990⁵⁰ in the Biehl case discussed free movement of workers. The German national Biehl had lived and worked for some years in Luxembourg. In the year involved in the dispute, he moved to Germany to reside and work. His claim for a refund of income tax overdeducted in Luxembourg was refused in accordance with Luxembourg's tax laws, according to which residence in Luxembourg for the entire year in respect of which a refund is claimed is required, and not merely for part of the year⁵¹.

The Court found that this was in breach of the right to free movement of workers, and stated that, according to its previous decisions, free movement of workers implied not merely the absence of overt discrimination on the basis of nationality, but also of all covert forms of discrimination which would have similar consequences. The Court found that the requirement of residence in Luxembourg as a pre-condition for the refund of tax excessively deducted there, may constitute such covert discrimination. Often nationals of another member state do not fulfil this residence requirement and, therefore, do not receive refunds of overdeducted tax. The Court found that short-term residents are at a disadvantage compared to long-term residents in otherwise

⁴⁷ ECJ, Judgement of 27.9.1988, 81/87, EuGHE 1988, 5483.

⁴⁸ ECJ, Judgement of 27.9.1988, 81/87, EuGHE 1988, 5483, 5484 ff., 5506 ff.

⁴⁹ ECJ, Judgement of 27.9.1988, 81/87, EuGHE 1988, 5483, 5510 ff.; cf. also Eilers, in: von der Groeben/Thiesing/Ehlermann, Kommentar zum EU-/EC-Vertrag, 5. Ed., Vorbem. Art. 95 - 99 Rn. 132; Jacobs, Internationale Unternehmensbesteuerung, 4. Ed., 180 f.

⁵⁰ ECJ, Judgement of 8.5.1990, C-175/88, EuGHE 1990, I-1779.

⁵¹ ECJ, Judgement of 8.5.1990, C-175/88, EuGHE 1990, I-1779, 1790 f.

comparable circumstances - at least in some situations - and that this constituted covert discrimination⁵².

4. ECJ 28.1.1992 (Bachmann)

The Bachmann judgement of 28.1.1992 is also important⁵³. This case concerned the right to deduct insurance premiums from taxable income. Bachmann was a German national working in Belgium who, during his period in Belgium, paid insurance premiums to a German insurer. The Belgian tax authorities refused to accept these payments as legitimate deductions from his taxable income. Under Belgian law only such payments made in Belgium were deductible⁵⁴.

The ECJ examined this matter under the aspect of freedom of movement. It firstly confirmed its previous decisions on covert discrimination, and concluded that covert discrimination also existed in this case. The provisions of Belgian tax law according to which only insurance premiums paid in Belgium were tax deductible placed mainly nationals of other member states at a disadvantage. Nationals of other member states would usually have arranged their insurances in their home state with the consequence that their premiums would not be tax deductible under Belgian tax law⁵⁵.

The Court, however, considered this discrimination to be justified. Although it rejected the argument that the absence of harmonisation of tax law justified this discrimination, it accepted its justification under the so-called coherence of the relevant Belgian provision. The deduction of insurance premiums from taxable income is permitted in the context of the later taxation of the insurance benefits in Belgium. If the insurance premiums are tax deductible, the future benefits of the insurance are taxable. If the premiums are not tax deductible, the future benefits are tax free. According to the Court, in the present state of tax laws within the EC, Belgium, if it granted the deduction of insurance premiums paid to a foreign insurer from taxable income is not guaranteed tax on the future benefits of the insurance. It is in the very case of foreign insurers and nationals of another member state that the future insurance benefits could not be taxed because such nationals normally return to their home state when their working life ends⁵⁶. In its later judgements the Court did not return to this coherence principle as a justification for discrimination.

⁵² ECJ, Judgement of 8.5.1990, C-175/88, EuGHE 1990, I-1779, 1792 ff.

⁵³ ECJ, Judgement of 28.1.1992, C-204/90, EuGHE 1992, I-249.

⁵⁴ ECJ, Judgement of 28.1.1992, C-204/90, EuGHE 1992, I-249, 277 f.

⁵⁵ ECJ, Judgement of 28.1.1992, C-204/90, EuGHE 1992, I-249, 279.

⁵⁶ ECJ, Judgement of 28.1.1992, C-204/90, EuGHE 1992, I-249, 279 ff.

5. ECJ 26.1.1993 (Werner)

The Bachmann judgement was followed in approximately one year by the judgement in the Werner case⁵⁷. The essential question in this case was whether a member state can discriminate against its own nationals. As a German national resident in the Netherlands but working as a self-employed dentist in Germany, Werner was subject to limited domestic taxation on his German income. A person who has neither his residence or usual place of abode in Germany, i.e. is non-resident, is subject to this limited taxation regime. Under German tax law, Werner, as a non-resident subject to limited taxation, was denied the benefit of the „splitting tariff “ (applicable to spouses) and thereby incurred a considerably higher tax liability⁵⁸.

The ECJ rejected the complaint. The right to freedom of establishment facilitates the establishment and exercise of self-employed professional activity in another member state. The unequal tax treatment in this case was not, however, due to the establishment or exercise of such an activity in another member state. Werner continued to work in Germany. It was only his residence in another state which resulted in the unequal tax treatment. The right to freedom of establishment was not thereby infringed⁵⁹. This decision of the ECJ was widely regarded as a retrograde step in its jurisprudence and has been criticised as such⁶⁰. Today the decision would probably be otherwise as in the meantime change of residence for purely private reasons is protected by Art. 18 EC⁶¹.

6. ECJ 13.7.1993 (Commerzbank)

In this judgement of 13.7.1993⁶² the Court once again confirmed its previous decisions. The facts of the case were: The Commerzbank had established a branch office in London which received a tax refund. The tax authorities refused, however, to pay the usual „repayment supplement“ applicable to this refund and invoked Section 825 of the Income and Corporation Taxes Act 1988 according to which only companies resident in the United Kingdom could receive such “repayment supplement”⁶³.

The ECJ found that this provision was in breach of the right to freedom of establishment. Consistent with its prior judgements, the Court stated, firstly, that freedom of establishment included the freedom to choose the form of establishment,

⁵⁷ ECJ, Judgement of 26.1.1993, C-112/91, EuGHE 1993, I 429.

⁵⁸ ECJ, Judgement of 26.1.1993, C-112/91, EuGHE 1993, I 429, 465 ff.; cf. also Advocate General Darmon in: EuGHE 1993, I-454 ff.

⁵⁹ ECJ, Judgement of 26.1.1993, C-112/91, EuGHE 1993, I 429, 469 f.

⁶⁰ For evidence, cf: Eilers, in: von der Groeben/Thiesing/Ehlermann, Kommentar zum EU-/EC-Vertrag, 5. Ed., Vorbem. Art. 95 - 99 Rn. 140.

⁶¹ Cf. Herzig/Dautzenberger, DB 1997, 8, 10 f. The relatively higher taxation of German nationals under e.g. the German trade tax and/or the discussed reintroduction of asset tax is not, therefore, contestable before the ECJ because the EC Treaty contains no prohibition on such national taxes.

⁶² ECJ, Judgement of 13.7.1993, C-330/91, EuGHE 1993, I-4017.

⁶³ ECJ, Judgement of 13.7.1993, C-330/91, EuGHE 1993, I-4017, 4018 ff., 4040 f.

including as a branch. The Court, secondly, invoked its principle of covert discrimination, and found that such discrimination was present. The provision in the United Kingdom's tax legislation under which a „repayment supplement“ on tax refunds would be due only to companies which were resident for tax purposes prejudiced, in particular, companies resident in other member states⁶⁴.

The ECJ saw no justification for this discrimination. Following its line in previous judgements, the Court rejected the argument of the United Kingdom government that other tax advantages were available only to non-resident companies. In particular, the Court did not accept as significant the fact that the Commerzbank received the tax refund only because of the very fact that it was non-resident⁶⁵.

7. **EuGH 14.2.1995 (Schumacker)**

The Schumacker judgement of the Court on 14.2.1995 is also an important one⁶⁶. The Belgian national Schumacker was employed in Germany. He had, however, no permanent residence or usual place of abode in Germany i.e. he was a non-resident. His place of residence and usual abode was in his home state, Belgium. According to German income tax law, Schumacker was subject to limited taxation, and as such was denied the opportunity of availing of the „splitting tariff“ (applicable to spouses). On the other hand, neither Schumacker or his wife had income in Belgium in the period concerned in the case, and so, while subject to unlimited taxation in Belgium they were also denied the benefit of the „splitting tariff“ and other personal tax allowances⁶⁷ there.

The ECJ found this situation to be in breach of the right of freedom of movement. Following the line of its previous judgements, the Court held that a distinction in tax law on the basis of residence and non-residence could constitute covert discrimination. National legal provisions which differentiated between residents and non-residents by denying non-residents some tax concession which was available to residents could affect, in particular, nationals of another member state. The ECJ found that covert discrimination was present in that it viewed, exceptionally in this case, the circumstances of a resident and a non-resident in this case as comparable. The Court, however, stated that, in principle, residents and non-residents are not in comparable circumstances, and that, therefore, distinction made in tax law between them resulting in some tax advantage being denied to a non-resident, is not generally discriminatory. In principle, it is for the state in which a taxpayer resides to take the taxpayer's personal circumstances into account. An exception to this principle is to be made, according to the Court, when a non-resident taxpayer derives most of his income within

⁶⁴ ECJ, Judgement of 13.7.1993, C-330/91, EuGHE 1993, I-4017, 4043 .

⁶⁵ ECJ, Judgement of 13.7.1993, C-330/91, EuGHE 1993, I-4017, 4044.

⁶⁶ ECJ, Judgement of 14.2.1995, C-279/93, EuGHE 1995, I-225.⁶⁷ ECJ, Judgement of 14.2.1995, C-279/93, EuGHE 1995, I-225, 252 ff.

the state of employment and is responsible for practically all of the family income. In such a case, the state in which the taxpayer works is the only one which can confer tax advantages and, therefore, similarity exists between the situation of resident and non-resident. In addition to the material discrimination of the denial of the „splitting tariff“ and of other personal and family tax allowances, the ECJ found that the denial of the facility of the annual income tax balancing adjustment to be a formal discrimination⁶⁸.

The latter was adjudged by the Court not to be justified. The Court rejected, by reference to the Mutual Assistance Directive⁶⁹, the argument of the German tax authorities that it was hindered by administrative considerations from assessing the income of a non-resident in his state of residence and thereby from ascertaining whether the non-resident derived most of his income in Germany⁷⁰.

8. ECJ 11.8.1995 (Wielockx)

The Wielockx case produced a landmark judgement of the Court on 11.8.1995⁷¹. The Belgian national Wielockx worked in the Netherlands in a self-employed capacity and derived all his income there. According to the law in the Netherlands, self-employed persons may build up pension reserves for their retirement, and the contributions to this pension reserve fund may be deducted from their taxable income. The law, however, provides this facility only to residents. Wielockx resided in Belgium and was, therefore, unable to avail of this facility⁷².

The ECJ found a breach of the right to freedom of establishment. The Court repeated that a distinction in tax law on the basis of residence and non-residence could conceal discrimination and found that such covert discrimination existed in this case. Consistent with its previous judgements, the Court stated that while the circumstances of resident and non-resident are not, in principle, comparable, an exception occurred when the non-resident derived all or almost all of his income in the state in which he works, as in the present case⁷³.

In contrast to previous judgements, the Court in this case did not accept that this discrimination was justified by the principle of coherence. To that extent it rejected the argument of the government of the Netherlands that the tax exemption of contributions to the pension reserve fund should be seen in the context of their future liability to tax. The tax law assumed that the pension reserve would be liquidated when the taxpayer reached the age of 65 and then subject to tax. Under the Tax Treaty between Belgium

⁶⁸ ECJ, Judgement of 14.2.1995, C-279/93, EuGHE 1995, I-225, 257 ff.

⁶⁹ Directive of the Council 77/799/EEC Concerning Mutual Assistance by the Competent Authorities of the member states in the field of direct taxation (OJ 1977 Nr. L 336/15).

⁷⁰ ECJ, Judgement of 14.2.1995, C-279/93, EuGHE 1995, I-225, 262 f.; cf. also Futura-Singer, ECJ, Judgement of 15.5.1997, C-250/95, EUGHE 1997, I-2471.

⁷¹ ECJ, Judgement of 11.8.1995, C-80/94, EuGHE 1995, I-2491.

⁷² ECJ, Judgement of 11.8.1995, C-80/94, EuGHE 1995, I-2491, 2510 ff.; cf. also Advocate General Léger in: EuGHE 1995, I-2495

⁷³ ECJ, Judgement of 11.8.1995, C-80/94, EuGHE 1995, I-2491, 2514 ff.

and the Netherlands, no tax would accrue to the Netherlands on periodic pension payments drawn out of the pension reserves in this case. According to the Tax Treaty, tax on retirement pensions accrued to the state of residence, in this case, Belgium, and not to the Netherlands. The ECJ stated that a state could base the coherence of its tax system on the principle of the correlation between the tax exemption of the contributions and the taxation of the future benefits. The state could also ignore this principle. This is what the Netherlands had done by agreeing in the Tax Treaty that pensions would be liable to tax in the state of residence. The Netherlands thereby had waived tax on the contributions made in the Netherlands to pension reserves by non-residents. In return, the Netherlands collected tax on pensions received by residents within its jurisdiction irrespective of the state in which the contributions to such pensions were paid. The coherence of the tax system is thereby, in the opinion of the Court, maintained at the level of the Tax Treaty. While the Court did not, in this judgement, expressly reject the principle of coherence as a justification, it is likely that the significance of this principle will thereby be greatly reduced for the future⁷⁴.

9. ECJ 27.6.1996 (Asscher)

The Asscher judgement of 1996⁷⁵ shows continuous development of the Court's position. Asscher was a director of both a Belgian and a Netherlands company. He was a Netherlands national, resident in Belgium, non-resident in the Netherlands. According to Netherlands law, a taxpayer who was non-resident and who derived less than 90% of his world-wide income from within the Netherlands was subject to a higher initial rate of tax⁷⁶.

The ECJ found a breach of the right to freedom of establishment. Once again, the Court stated that distinctions made between residents and non-residents can be a form of covert discrimination if, though their circumstances are comparable, one incurs increased tax liability. The Court also repeated that, in principle, residents and non-residents are not in a comparable situation with regard to direct taxation. The Court stated that an exception to this principle arose, however, in the case of tax benefits which followed from a taxpayer's personal circumstances and when the taxpayer derived almost his entire world-wide income from the state of employment. The Court decided that in the case of different tax rates and other differences in taxation treatment, the circumstances of resident and non-resident were, however, comparable, and, therefore, covert discrimination was involved, even though Asscher, as a non-resident, did not derive his entire or almost his entire income in the Netherlands⁷⁷.

⁷⁴ ECJ, Judgement of 11.8.1995, C-80/94, EuGHE 1995, I-2491, 2516 f., cf. also Advocate General Léger in: EuGHE 1995, I-2495, 2504 f.

⁷⁵ ECJ, Judgement of 27.6.1996, C-107/94, EuGHE 1996, I-3089.

⁷⁶ ECJ, Judgement of 27.6.1996, C-107/94, EuGHE 1996, I-3089, 3115 ff.

⁷⁷ ECJ, Judgement of 27.6.1996, C-107/94, EuGHE 1996, I-3089, 3122 ff.; cf. also Jacobs, *Internationale Unternehmensbesteuerung*, 4. Ed., 186 ff.

This discrimination was deemed by the Court not to be justified. The Court did not accept as justification the argument that non-residents were not subject to Netherland social insurance contributions⁷⁸.

10. ECJ 15.5.1997 (Futura-Singer)

Direct taxation was also the subject of the judgement of the ECJ in the Futura-Singer case⁷⁹. The French company Futura SA was operating in Luxembourg through its branch Singer, i.e. it had a permanent establishment there. The income derived by this permanent establishment in Luxembourg was taxable there. Losses from previous years could be set off against total income subject to two conditions. Firstly, that the losses related economically to income derived in Luxembourg, and secondly, that books of account be maintained according to Luxembourg legal requirements and that such account books be retained in Luxembourg⁸⁰.

The ECJ found that the first condition was not a breach of the right to freedom of establishment. No overt or covert discrimination could be implied in the requirement that losses which could be set-off should be economically related to income derived in Luxembourg. The Court, however, found that the second condition was such a breach. The requirement to maintain books of account according to Luxembourg law was, according to the Court, a restriction of the freedom of establishment because, in the case of cross border businesses, separate books of account would have to be maintained and the books of account retained in Luxembourg⁸¹.

The Court dealt extensively with the question of whether this discrimination could be justified on compelling grounds of the public interest, and decided that in the present state of the harmonisation of community law, in particular, the lack of harmonisation of the law relating to the ascertainment of profits, the investigation and levying of tax due, including the investigation of the losses to be set off, could only take place under Luxembourg tax law and in the context of the proper maintenance of account books. The Court, however, did not accept that it was necessary that the books of account be retained in Luxembourg. In this regard the Court referred to the Mutual Assistance Directive⁸² and did not accept that the requirements were justified⁸³.

⁷⁸ ECJ, Judgement of 27.6.1996, C-107/94, EuGHE 1996, I-3089, 3127 ff.

⁷⁹ ECJ, Judgement of 15.5.1997, C-250/95, EuGHE 1997, I-2471.

⁸⁰ ECJ, Judgement of 15.5.1997, C-250/95, EuGHE 1997, I-2471, 2494 ff.

⁸¹ ECJ, Judgement of 15.5.1997, C-250/95, EuGHE 1997, I-2471, 2498 ff.

⁸² Directive of the Council 77/799/EWG concerning Mutual Assistance by the competent authorities of the member states in the field of direct taxation (OJ 1977 Nr. L 336/15).

⁸³ ECJ, Judgement of 15.5.1997, C-250/95, EuGHE 1997, I-2471, 2500 ff.

11. ECJ 12.5.1998 (Gilly)

The jurisprudence of the ECJ achieved a new dimension in the judgement of 12.5.1998 in the Gilly case⁸⁴. In this case, for the first time Tax Treaties between states were contested before the ECJ. The facts of the case were: Mr. and Mrs. Gilly resided in France near the German border. Mr. Gilly was a French national and a teacher in the public school system in France. Mrs. Gilly was a German national and had also acquired French citizenship by marriage. She was a teacher in a state school in Germany. Under the provisions of the Tax Treaty between France and Germany, Mrs. Gilly's income from public service employment was subject to German income tax. Likewise, under the Tax Treaty, the same income was subject to French income tax. This liability to double taxation was intended to be rectified by a set-off system. The amount, however, which could be set-off against French tax under this system was not the full amount of the tax actually paid in Germany, but the amount which would have been due on the same income under French law. The result was that Mr. and Mrs. Gilly together bore a higher tax liability than would have been the case if both were exclusively employed and taxed in France⁸⁵.

The ECJ stated, firstly, that Art. 220 EC Treaty (now Art 293 EC), second indent, according to which the member states, as far as necessary, should conduct negotiations with a view to the removal of double taxation within the community, did not have direct effect and could not be invoked by individuals⁸⁶. The Court then stated that cases such as the instant case fell under the freedom of movement provisions of the EC Treaty and expressed its readiness to adjudicate on the validity of Tax Treaties from that point of view. However, in the present case the Court found that the Tax Treaty did not offend against freedom of movement. Under the Tax Treaty, the tax situation of Mrs. Gilly was the result of a complicated distinction: the Tax Treaty distinguishes firstly, between employees in the private sector and those in the public service, like Mrs. Gilly. Public service employees were then further distinguished between those who had either German or French citizenship, and those who, like Mrs. Gilly, had both nationalities. A further distinction was made on the basis of the length of the employment. The view of the Court was that such distinctions are not to be considered as inadmissible discrimination. Such distinctions arose because due to the inadequate harmonisation of laws within the community, the contracting states are entitled to settle between them the criteria for the exercise of their tax sovereignty⁸⁷. This result is surprising because tax inequality is based on the distinction made in the Tax Treaty on the basis of nationality.

⁸⁴ ECJ, Judgement of 12.5.1998, C-336/96, EuGHE 1998, I-2793. also: Rainer, IStR 1998, 340 f.; Lehner, IStR 1998, 341 f.; Lang, Festschrift-Rädler, 1999, 429, 435 f.

⁸⁵ ECJ, Judgement of 12.5.1998, C-336/96, EuGHE 1998, I-2793, 2825 ff.

⁸⁶ ECJ, Judgement of 12.5.1998, C-336/96, EuGHE 1998, I-2793, 2831.

⁸⁷ ECJ, Judgement of 12.5.1998, C-336/96, EuGHE 1998, I-2793, 2826 ff., 2832 ff.

12. ECJ 16.7.1998 (ICI)

A further important decision of the ECJ is given in the judgement of 16.7.1998 in the ICI case⁸⁸. Imperial Chemical Industries - abbreviated to ICI - had its registered office in the United Kingdom. Together with another company, ICI formed a consortium which owned 23 subsidiaries. ICI wished to set off losses in a United Kingdom company which was one of these subsidiaries against its taxable profits. The United Kingdom Inland Revenue disallowed this because the majority of the subsidiaries were resident not in the United Kingdom but some in other community member states and most in third countries⁸⁹.

The ECJ found a breach of the right to freedom of establishment. Referring to its previous decision in the Daily Mail case, the Court stated that freedom of establishment implied not only equal treatment by the host member state but prohibits also the member state of origin from hindering the use of the right to establish subsidiaries in another member state, as in the present case. The fact that set off of losses is permitted only to companies which have their subsidiaries or the majority of them in the United Kingdom was found by the Court to be inadmissible discrimination⁹⁰.

The Court also found that this discrimination was not justified. It rejected the argument of the British government that as well as the likelihood of tax avoidance, the coherence of its tax system was endangered. The British government claimed that the tax reductions achieved by the set off of the losses in the resident subsidiaries was in a context which included the tax revenues from profitable resident subsidiaries. If the set off of losses in non-resident subsidiaries were allowed, the tax loss could not be made up from the taxation of profitable non-resident subsidiaries. The ECJ stated that the principle of coherence could be applied only when a direct connection existed between tax reduction and tax revenue⁹¹ and, in this case, found that no such direct connection existed. This decision of the Court is consistent with its previous judgements in which the application of the principle of coherence has been progressively restricted.

13. ECJ 9.3.1999 (Centros)

The facts of the Centros case, the judgement in which was given on 9.3.1999⁹², are : two Danish nationals and residents of Denmark formed the company Centros Ltd. in the United Kingdom. In fact, this was a „post-box“, „name plate“, company, which did not trade in the United Kingdom, and it was never intended that it should do so. The purpose of the forming of Centros Ltd. was to circumvent onerous Danish laws on

⁸⁸ ECJ, Judgement of 16.7.1998, C-264/96, EuZW 1999, 20. Cf. also Saß, BB 1999, 447; *ibid.*, StuW 1999, 164, 168; *ibid.*, EWS 1998, 347; Montag, NJW 2000, 32, 35 f.; Hahn, IStR 1999, 609 ff.; Hahn, Die Vereinbarkeit von Normen des deutschen internationalen Steuerrechts mit EC-Recht, 1999, 147 ff.; Weiß, EuZW 1999, 493, 495 f.

⁸⁹ ECJ, Judgement of 16.7.1998, C-264/96, EuZW 1999, 20, 21 f.

⁹⁰ ECJ, Judgement of 16.7.1998, C-264/96, EuZW 1999, 20, 22.

⁹¹ ECJ, Judgement of 16.7.1998, C-264/96, EuZW 1999, 20, 23.

⁹² ECJ, Judgement of 9.3.1999, C-212/97, IStR 1999, 253

company formation, in particular, the requirement of having a minimum paid-up capital. Centros Ltd. was intended to conduct its entire trading as a branch in Denmark, where registration of the branch was refused on the basis of the alleged abuse of the right to freedom of establishment⁹³.

The ECJ found the refusal of the Danish authorities to be a breach of the right to freedom of establishment. Referring to its previous judgements, the Court stated that freedom of establishment included the choice of form of business entity and, therefore, included the establishment of a branch. A national of a member state who forms a company in another member state where company law is less onerous, and then establishes a branch in another member state, is not guilty of abuse of the right to freedom of establishment. The Court rejected the argument of the Danish authorities that the refusal to register the branch was a precaution against the danger of fraudulent insolvency. The Court expressed the opinion that the refusal of registration exceeded the measures which would be justified to prevent this danger⁹⁴.

The Centros judgement caused much discussion in the legal literature⁹⁵, in particular, in Germany. Hitherto, according to German legal theory, the place of central management determined the legal form of a company. German legal theory of establishment did not accept that companies formed under a foreign law and which then transferred their place of central management to Germany became capable of legal acts - acquired legal capacity - in Germany. Such companies could not, therefore, be registered in a Commercial Register as holders of a branch in Germany⁹⁶. According to some opinions, this situation is not affected. This opinion holds that the Centros decision is not applicable to Germany because in Denmark and the United Kingdom, unlike in Germany, the place of incorporation determines the legal form of a company, Therefore, the transfer of such a place of central management is possible⁹⁷. Others, however, express the opinion that the judgement is applicable to Germany and that considerable implications follow. According to this view, it is now expressly made possible to circumvent the onerous German formation requirements by the formation of a „post-box“ company in the United Kingdom and then a branch of that company in Germany and transfer the place of central management there. Foreign „post-box“ companies would then have not only the right to be recognised as legally competent - having legal capacity - in Germany and therefore registrable in the Commercial

⁹³ ECJ, Judgement of 9.3.1999, C-212/97, IStR 1999, 253 f.

⁹⁴ ECJ, Judgement of 9.3.1999, C-212/97, IStR 1999, 253, 254 ff.

⁹⁵ Cf. e.g. Steindorff, JZ 1999, 1140 ff.; Leible, NZG 1999, 300 ff.; Roth, ZIP 1999, 861 ff.; Dautzenberg, StUB 1999, 541 ff.; Meilicke, DB 1999, 627 f.; Sedemund/Hausmann, BB 1999, 810 f.; Werlauff, ZIP 1999, 867, 874 ff. Neye, EWiR 1999, 259 f.; Breuninger/Krüger, Festschrift-Rädler, 1999, 79, 93 ff.; Schmidt/Sedemund, DStR 1999, 2057 ff.; Bungert, DB 1999, 1841 ff.; Risse, MDR 1999, 752 ff.; Görk, GmbHR 1999, 793 ff.; Behrens, IPRax 1999, 323 ff.; Freitag, EuZW 1999, 267 ff.

⁹⁶ Meilicke, DB 1999, 625, 627.

⁹⁷ So e.g. Görk, GmbHR 1999, 793, 796.

Register, but would, more importantly, be protected against discrimination in the tax system⁹⁸.

This could have implications for taxation of groups within which the income of one company can be attributed for tax purposes to another group company. A pre-condition for the use of such tax regime is, according to § 14, 3 of the German Corporation Tax Act (KStG), that the place of central management as well as the registered office according to the Articles of Association, be situated in Germany. This requirement, which applies also to trade tax under § 2 ss.2 sentence 2 of the German Trade Tax Act (GewStG), could, by the Centros judgement, be rendered ineffective. The result may be that taxation of a group could take place through a company formed under the law of another member state and having its registered office there. Furthermore, § 1 ss. 1 no. 1 KStG could now be the applicable basis for the tax liability of foreign companies having administrative centres and their managements in Germany. From this would follow that such companies could claim the tax exemption provided under § 8 b KStG. On the other hand, the onerous provisions of § 8 a KStG could be applied to a company from another member state⁹⁹.

14. ECJ 29.4.1999 (Royal Bank of Scotland)

The jurisprudence of the ECJ on direct taxation was further developed in the Royal Bank of Scotland judgement of 29.4.1999¹⁰⁰. The Royal Bank of Scotland had its registered office in the United Kingdom, and was represented in Greece by a branch. Greek tax legislation imposed a tax rate of 40% on profits of a foreign company trading in Greece, irrespective of its legal form, while a rate of 35% was applicable to domestic companies¹⁰¹.

The ECJ found this to be in breach of the right to freedom of establishment. Consistently with its previous judgements, the Court stated that freedom of establishment implies that no form of establishment is excluded, whether an agency, branch or subsidiary. Further, the Court repeated its earlier findings that residents and non-residents are not, in principle, in comparable positions from the point of view of tax law. In the present case, however, the Court found the circumstances of resident and non-resident companies to be comparable, because their profits were ascertained in the same manner. The application of different tax rates was seen, therefore, by the Court as discriminatory¹⁰².

⁹⁸ So e.g. B. Meilicke, DB 1999, 627, 628.

⁹⁹ Breuninger/Krüger, FS-Rädler, 1999, 79, 97 f.; Meilicke, DB 1999, 627, 628; Götsche, DStR 1999, 1403, 1407.

¹⁰⁰ ECJ, Judgement of 29.4.1999, C-311/97, IStR 1999, 341.

¹⁰¹ ECJ, Judgement of 29.4.1999, C-311/97, IStR 1999, 341 f.

¹⁰² ECJ, Judgement of 29.4.1999, C-311/97, IStR 1999, 341, 342 f.

15. ECJ 14.9.1999 (Gschwind)

The judgement of 14.9.1999 in the Gschwind case is an important one for German tax law¹⁰³. Gschwind was a Netherlands national, working in Germany. His wife worked in the Netherlands where they both lived. Gschwind had, therefore, neither permanent residence or usual place of abode in Germany. Under German tax law he was, therefore, subject to limited taxation. The result was that he was denied the advantage of the „splitting tariff“ (applicable to spouses). An unusual feature of Mr. Gschwind's situation was that, under German tax law, as a national of another member state of the EC he could not take advantage of the “splitting tariff” as subject to unlimited taxation, because under §§1 ss. 3 and 1a ss. 1 no. 2. of the German Income Tax Act, this required that at least 90% of the spouses joint income was subject to German income tax, or that the portion thereof not subject to German income tax was not more than 24,000 DM in a calendar year. These requirements were not fulfilled in this case. Mr. Gschwind had taxable income of approx. 74,000 DM in the calendar year and this meant that only 58% of the spouses joint income was subject to German taxation¹⁰⁴.

The ECJ found no breach of the right to freedom of movement. Following its previous judgements, the Court stated that residents and non-residents are not, in principle, in comparable situations and consequently denial of certain tax advantages, for example, the „splitting tariff“, to non-residents, is not discriminatory. In principle, according to the ECJ, it is for the state of residence to take account of the personal circumstances of the taxpayer. An exception to this rule arising from previous judgements, exists when the non-resident derived most of his income and practically all of the family income in the state of non-residence. The present case did not qualify under this exception, because Mr. Gschwind derived only 58% of the family income in Germany¹⁰⁵. This judgement implies that the 90% limit imposed by § 1 ss. 3 of the German Income Tax Act (KStG) is recognised by EC law as admissible.

16. ECJ 21.9.1999 (Compagnie de Saint-Gobain)

The judgement of the ECJ on 21.9.1999 in the Saint-Gobain case is a further relevant decision¹⁰⁶ affecting German tax law. The French company Saint-Gobain SA was represented in Germany by a permanent establishment, the branch Saint-Gobain ZN, and, therefore, subject to limited taxation in Germany. Through the German branch, the company held participations in subsidiaries in Germany and abroad. The German subsidiaries were bound to the branch by a group contract, and in turn, held participations in foreign companies - sub-subsidiaries. Under the German income tax laws applicable in 1994, the branch was denied various tax allowances, which would have been available to a company resident in Germany. In particular, the following

¹⁰³ ECJ, Judgement of 14.9.1999, C-391/97, IStR 1999, 597.

¹⁰⁴ ECJ, Judgement of 14.9.1999, C-391/97, IStR 1999, 597, f.

¹⁰⁵ ECJ, Judgement of 14.9.1999, C-391/97, IStR 1999, 597, 598 f.; cf. also Kischel, IWB Fach 11a, S. 389 f.

allowances were disallowed: firstly, because of the international intercompany privilege in Tax Treaties, exemption from corporation tax on dividends distributed by a company resident in a third country; secondly, credit against German corporation tax of the corporation tax paid in another member state by a subsidiary resident in that other member state. By the Standortgesetz of 1993¹⁰⁷, §§ 8 b ss. 4 and 26 ss. 7 were introduced into the Corporation Tax Act with the result that from the tax year 1994 onwards the said allowances are granted to the German branches of foreign companies which are subject to limited taxation¹⁰⁸.

As the German legislature stated in the explanatory memorandum to this amendment that a breach of the right to freedom of establishment would be excluded by the amendment, the ECJ had no difficulty finding that up to 1994 the law breached the right to freedom of establishment. The ECJ stated that it was prepared to adjudicate not only on national tax laws, but also on whether interstate Tax Treaties complied with EC law. The Court found that to disallow tax reliefs on the basis of non-residence in Germany, disadvantaged foreign companies and constituted, therefore, covert discrimination. The Court found also that this discrimination was not justified. The German government's arguments that branches of non-resident companies enjoyed other advantages and, in particular, that the loss of tax revenue would not be made up by the tax on the dividends paid out by the parent company abroad, were rejected¹⁰⁹.

17. ECJ 26.10.1999 (Eurowings)

One of the most recent judgements of the ECJ on direct taxation is that in the Eurowings case¹¹⁰. Eurowings Luftverkehrs AG operates schedule and charter flights in Germany and Europe. In 1993 Eurowings leased an aircraft from an Irish resident company for 467,914.-- DM. The current capital value of the aircraft was 1,320,000.-- DM. The tax authorities in their assessment for 1993 added half of the actual leasing charge, i.e. 233,957.-- DM, to the profit determined in accordance with § 8 No. 7 of the Trade Tax Act (GewStG). At the same time, according to § 12 ss. 2 GewStG¹¹¹, the tax authorities added the capital value of the aircraft, i.e. 1,320,000.-- DM, to the capital account of the business¹¹².

The ECJ found a breach of the right to free movement of services. The Court stated, by reference to its previous decisions on covert discrimination, that the free movement of services required the removal of all obstacles which are based on the fact that the

¹⁰⁶ ECJ, Judgement of 21.9.1999, C-307/97, IStR 1999, 592.

¹⁰⁷ Federal Law Gazette I S. 1569.

¹⁰⁸ ECJ, Judgement of 21.9.1999, C-307/97, IStR 1999, 593 f. cf. also: Rainer, IStR 1999, 114.

¹⁰⁹ ECJ, Judgement of 21.9.1999, C-307/97, IStR 1999, 594 ff.

¹¹⁰ ECJ, Judgement of 26.10.1999, C-249/97, IStR 1999, 691. cf. also: Ehrke, ELR 1999, 510 ff.; Knebel/Born, NWB 2000, Fach 5, 1491.

¹¹¹ Repealed with effect from the 1998 financial year by the law on the continuation of the reform of company taxation (Gesetz zur Fortsetzung der Unternehmenssteuerreform) of 29.10.1997 (Federal Law Gazette I, 2590).

¹¹² ECJ, Judgement of 26.10.1999, C-249/97, IStR 1999, 692.

party providing a service is resident in a member state other than that in which the services are provided. The Court found covert discrimination to exist. According to § 8 No. 7 GewStG and formerly according to § 12 ss. 2 No. 2 sentence 2 GewStG, the addition of the above figures is excluded when the leased goods are already taxed as the lessor's assets. This excludes most cases in which the lessee and lessor are German residents, as the lessor is usually subject to German tax. On the other hand, this provision places German companies which lease goods from another member state at a disadvantage, as the lessor is not subject to German tax. German companies which lease goods from a resident of another member state, therefore, do so less economically, and the ECJ found that this could inhibit them from doing so¹¹³.

The ECJ did not find a justification for this discrimination. The argument based on the principle of coherence was rejected, as was that based on possible tax advantages available to residents of another member state who are not subject to a similar trade tax¹¹⁴.

18. Conclusion

The following principles can be deduced from the decisions of the ECJ in direct taxation cases.

The Court first examines whether a basic right applies. To such basic rights belong the right of free movement of workers, the right to freedom of establishment, and in more recent cases the right to the free movement of capital and services. The right to freedom of establishment includes the freedom to choose the business form, whether subsidiary or branch, to be established in another member state, and is directed in the first place against discrimination in the host member state but equally can be invoked against impediments placed by the state of origin. Not only national laws, but also interstate Tax Treaties are subject to the rights to freedom of establishment and freedom of movement.

In its second step the Court will examine whether the right to freedom of establishment or freedom of movement has been infringed. Discrimination which is openly based on the nationality of the natural person or the residence of the legal person is not the only form of discrimination which is prohibited, but also covert discrimination which typically is directed against foreign resident individuals or companies. Such covert discrimination is usually found in tax laws which differentiate on the basis of resident and non-resident, - in German tax law in the distinction between limited taxation and unlimited taxation. Discrimination is found to exist if the non-resident is more heavily taxed than the resident while their circumstances are otherwise comparable. With regard to direct taxation, the circumstances of resident and non-resident are not, in principle, comparable, although their circumstances can be found to be comparable

¹¹³ ECJ, Judgement of 26.10.1999, C-249/97, IStR 1999, 693.

when the criteria which have been set down by the Court are met, e.g. when a state treats residents and non-residents equally in other tax matters and thereby acknowledges that their circumstances as comparable. In the case of tax allowances which are connected to the personal and family circumstances of a taxpayer, the Court regards the circumstances of residents and non-residents as comparable if the non-resident derives all or almost all of his income in the state of non-residence. In case of possible disadvantage arising from other tax provisions, e.g. assessment principles or rates, or procedural disadvantages, such as the annual balancing refund of tax, the Court tends to find discrimination irrespective of the amount of income.

If discrimination is found, the Court examines whether it has any justification. In most cases, the Court rejects the arguments for justification. The most important arguments which have been rejected are:

- the lack of opportunity to compensate for the tax advantages available to non-residents e.g. by limited taxation,
- lack of reciprocity among the member states,
- the absence of harmonisation of tax laws among member states,
- the absence of Tax Treaty provisions,
- precautionary measures, over and above those necessary, against fraudulent insolvencies,
- additional financial burdens resulting from the removal of double taxation,
- the principle of coherence,
- administrative difficulties in checking information from abroad¹¹⁵.

The above principles from the jurisprudence of the Court make it clear how far the Court has advanced in its efforts towards the harmonisation of direct taxation. On the basis of the principles developed by the Court, many provisions of the German taxation system, particularly relating to limited and unlimited taxation, are, at least, questionable¹¹⁶. The most recent decisions of the Court, such as that of 28.10.1999 in the Vestergaard case¹¹⁷, show that further impetus from the Court can be expected. In the light of the lack of political will within the member states to advance the course of tax harmonisation, it is to be anticipated that the ECJ will continue to be the driving force towards harmonisation of direct taxation.

¹¹⁴ ECJ, Judgement of 26.10.1999, C-249/97, IStR 1999, 693.

¹¹⁵ Cf. Jacobs, Internationale Unternehmensbesteuerung, 4. Ed., 191.

¹¹⁶ Cf. e.g. Jacobs, Internationale Unternehmensbesteuerung, 4. Ed., 200 ff.; Saß, FR 1998, 1, 3 ff.; Ebke/Deutschmann, JZ 1999, 1131, 1138 ff.

¹¹⁷ ECJ, Judgement of 28.10.1999, C-55/98, IStR, 1999, 694; cf. also Schmitt, IWB, Fach 11a, 353 ff.