The "*D*" Case against the Netherlands and the ECJ's Decision – Is There Still a Future for MFN Treatment?

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1. INTRODUCTION

Most-favoured-nation (MFN) treatment has attracted much attention in the last few years. Some authors have favoured the idea that MFN treatment can be derived from EC law. In their opinion, MFN treatment suits the notion that, within a single European market, residents of all the EU Member States should be treated equally. If not, this would free the road to new discrimination, which would violate EC principles.[1]

Other authors have disagreed. Their opinion is that a tax treaty is a "package deal".[2] It is therefore not possible to demand the application of only one part or provision of another treaty. They also think that the European Court of Justice (ECJ) will take into account that the Member States with innovative tax treaties will have to pay the bills for those Member States that are passive because residents of the latter can still apply the most beneficial treaty provisions.[3]

In the past few years, the discussion of MFN treatment within the European Union appears to have evolved from a discussion based on the arguments to a debate between the "believers" and "non-believers" on the incompatibility of MFN treatment with EC law, at least the non-believers would make us think so.[4] After the ECJ accepted the arguments of the Netherlands in the "*D*" case, the non-believers won the battle, and they implicitly suggest that the books can be closed. The question, however, is whether they are right because the ECJ's decision does not seem to cover all situations of MFN treatment. Consequently, this is not about believing or not believing. It is about the status of EC law, how it should work in order to optimize the single European market and, of course, what the role of the Member States should be. Even if the ECJ had decided that MFN treatment does not fit within the European Union at all, the question still remains whether the "*D*" decision is correct in light of the single European market.

This article discusses the question whether, even though the ECJ decided in the "*D*" case that the MFN principle was not at issue in D's situation, this means that MFN treatment cannot be applied at all. The article examines this from the view of the single European market. Without jumping to conclusions, however, one thing is clear. It is all about interpreting the law, not about believing.

2. MFN TREATMENT – SOME TECHNICAL REMARKS

The influence of EC law on treaties between two or more countries has been discussed in several articles and been the subject of various court cases.[5] Two court decisions have had an enormous impact on the development of EC law. The first is the decision in *Saint-Gobain*[6] which made it clear that, in certain circumstances, a permanent establishment (PE) can be

1. See e.g. Wolvers, S., "Tax Treaties and Most-Favoured-Nation Treatment in the European Community – Report of the Third ACIL Seminar on International and European Taxation held on 10 March 2005", 45 *European Taxation* 6 (2005), at 255.
2. See id. at 256 (comments of Prof. Eric Kemmeren); Dürrschmidt, D., "Tax Treaties and Most-Favoured-Nation Treatment, particularly within the European Union", 60 *Bulletin for International Taxation* 5 (2006), at 202; and de Graaf, A.C.G.A.C. and G. Janssen, "Nationale behandeling, horizontale non-discriminatie en meestbegunstigingsbehandeling. Wat betekent de uitkomst in de zaak D?", *MBB* 2005/377.
3. See e.g. de Graaf and Janssen, supra note 2.
4. Id.
5. See e.g. Craig, A., "Open Your Eyes: What the 'Open Skies' Cases Could Mean for the US Tax Treaties with the EU Member States", 57 *Bulletin for International Fiscal Documentation* 2 (2003), at 63; Martín Jiménez, A.J., et al., "Triangular Cases, Tax Treaties and EC Law: The *Saint-Gobain* Decision of the ECJ", 55 *Bulletin for International Fiscal Documentation* 6 (2001), at 241; and Lehner, M.M., "The Influence of EU Law on Tax Treaties from a German Perspective", 54 *Bulletin for International Fiscal Documentation* 9/10 (2000), at 461.
For the ECJ cases, see Case C-307/97, *Saint-Gobain*, [1999] ECR I 6161; the "open skies" cases: Cases C-466/98, C-467/98, C-468/98, C 469/98, C-471/98, C-472/98, C-475/98 and C-476/98 (involving Austria, Belgium, Denmark, Finland, Germany, Luxembourg, Sweden and the United Kingdom); and Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation* (currently pending; the Advocate-General has issued his opinion, but it has not yet been published).
6. Cited in note 5, supra. For an extensive discussion, see van den Hurk, Hans, "Did the ECJ's Decision in *Saint-Gobain* Change International Tax Law?", 55 *Bulletin for International Fiscal Documentation* 4 (2001), at 152.

considered to be a resident under a bilateral tax treaty.[7] The second is the decision in the "open skies" cases in which the ECJ ruled that, by concluding bilateral "open skies" agreements with the US government, the Member States violated the main principles of EC law.[8] In addition to these decisions, it is clear that the ECJ's judgement in the "*D*" case, issued on 5 July 2005,[9] is also a landmark decision. Even before the ECJ's decision, the case received a great deal of attention in the literature[10] because it could be of great importance for international tax practice. Depending on the outcome of the case, the MFN approach in tax treaties could be incompatible with EC law. The question remains whether MFN treatment, as a principle, can be derived from EC law.

The EC Treaty does not contain an MFN clause, as does e.g. the General Agreement on Tariffs and Trade (GATT).[11] Whether the MFN principle applies to tax treaties has been in discussion in many countries and at a many levels.[12] In most situations, MFN treatment has been rejected. This supports the idea that MFN treatment does not suit the specific principles of tax treaties, such as reciprocity and "package deal". The European Union, however, has concluded a new legal order in which different principles apply. This is why the question whether MFN treatment can be derived from EC law cannot be answered simply by referring to all the rejections under different legal systems.

The MFN principle, as such, is not part of EC law. EC law does, however, have a non-discrimination provision in Art. 12 of the EC Treaty which forbids discrimination based on nationality. This means, for example, that the Netherlands may not treat a Danish national who resides in the Netherlands less favourably than it treats its own nationals – called "vertical discrimination". A related question is whether the Netherlands must give the same treatment to a Danish national residing in the Netherlands as it gives to a Portuguese national residing in the Netherlands – referred to as "horizontal discrimination".[13]

Translated to tax treaties, this means that if State A grants a certain advantage to a resident of State B, State A must also give the same advantage to a resident of State C. If State A does not grant the resident of State C the same benefits it grants to the resident of State B, the resident of State C could use the argument of "less favourable" treatment in relation to the resident of State B. This situation was discussed for the first time in the "*D*" case.

The situation considered in *Saint-Gobain* did not involve MFN treatment, at least not if interpreted from an EC law point of view. In *Saint-Gobain*, the French resident company successfully applied the treaty between the United States and Germany. The reason why this did not relate to MFN treatment is that the French resident company already had substantial activities in Germany which qualified as a PE under the France–Germany tax treaty. It must be understood that, under EC principles, a PE is not equal to a subsidiary, but to the extent a PE is comparable to a subsidiary, the PE must receive the same treatment.[14] And although Saint-Gobain was not a resident under the United States–Germany treaty, from an EU point of view, its PE was fully comparable to a subsidiary under that treaty. Moreover, although the ECJ could not, under the EC Treaty, force the United States to treat the German PE as a resident of Germany, the ECJ could require Germany to give the PE the same benefits it grants to a subsidiary.[15] This is a classic case of granting non-residents the same rights as residents, provided the non-residents are in a situation that is fully comparable to that of residents. In an MFN situation, however, there is no link at all – like a PE – between a company in State A and the treaty between States B and C.

Whether such MFN "treatment" is prohibited within the EU must be derived from an analysis of the non-discrimination provision and the principles of freedom of establishment (as a derivative of non-discrimination) and Community loyalty.[16] An argument why a different treatment should be prohibited is that, within the single European market, a Member State is not allowed to treat residents of the other Member States differently. An argument why a different treatment is acceptable is found only in the reasoning that a tax treaty is a "package deal". Comparison of two treaties with respect to only one aspect is therefore not possible.[17] The decision in the "*D*" case is food for thought since the ECJ, in ruling that the interests of the Netherlands government must be protected, decided in favour of the latter reasoning.

3. THE "*D*" CASE

3.1. Facts

D was a German resident with a holiday home in the Netherlands, which was approximately 10% of his total wealth. According to Dutch tax law, D was subject to the Dutch wealth tax as a non-resident taxpayer. Under Dutch domestic tax law, a non-resident taxpayer is entitled to a tax-free allowance if at least 90% of his

7. This case can be seen as the "tax successor" to Case 235/87, *Matteucci*, [1988] ECR 5589.
8. The "open skies" cases are cited in note 5, supra.
9. Case C-376/03, *D*, [2005] ECR (not yet published).
10. See e.g. Weber, D. and E. Spierts, "The '*D* Case': Most-Favoured-Nation Treatment and Compensation of Legal Costs before the European Court of Justice", 44 *European Taxation* 2/3 (2004), at 65; and Meussen, G.T.K., "The Advocate General's Opinion in the '*D*' Case: Most-Favoured-Nation Treatment and the Free Movement of Capital", 45 *European Taxation* 2 (2005), at 52.
11. See Schön, Wolfgang, "World Trade Organization Law and Tax Law", 58 *Bulletin for International Fiscal Documentation* 7 (2004), at 283; and De Ceulaer, Stefaan, "Community Most-Favoured-Nation Treatment: One Step Closer to the Multilateralization of Income Tax Treaties in the European Union", 57 *Bulletin for International Fiscal Documentation* 10 (2003), at 493.
12. See e.g. Dürrschmidt and de Graaf/Janssen, both supra note 2.
13. For an explanation of vertical and horizontal discrimination, see Kofler, G.W. and C.P. Schindler, "'Dancing with Mr D': The ECJ's Denial of Most-Favoured-Nation Treatment in the '*D*' Case", 45 *European Taxation* 12 (2005), at 530.
14. See Case C-253/03, *CLT UFA*, [2006] ECR (not yet published); and van den Hurk, Hans, *Europees Gemeenschapsrecht en directe belastingen* (Deventer, the Netherlands, 2001), Para. 4.3.3.12.
15. Whether Germany is liable for damages because it concluded a treaty with a third state which violates EC law principles is a question that still has to be answered; see id. at 132.
16. See Art. 10 of the EC Treaty. This provision can be compared with the *pacta sunt servanda* principle, although the rationale of Art. 10 goes far beyond this principle.
17. For an overview of the arguments for and against, see Wolvers, supra note 1.

wealth is situated in the Netherlands. Although D did not satisfy this criterion, he applied for the allowance. His application was denied by the Dutch tax inspector.

D subsequently brought an action against the denial in the tax court. He argued that denying the tax-free allowance for wealth tax purposes in the case of a non-resident taxpayer who did not have at least 90% of his wealth in the Netherlands was incompatible with the free movement of capital principle in the EC Treaty. D's position was based on the argument that, because Germany does not levy a wealth tax, 100% of his taxable wealth was located in the Netherlands. Therefore, in D's opinion, he fulfilled the 90% criterion, even though the 100% of his taxable wealth in the Netherlands was only 10% of his *total* wealth.

D also argued that if he was not entitled to the allowance under Dutch domestic law, he should at least be entitled to the same allowance as a Belgian resident taxpayer. Under the Netherlands–Belgium tax treaty, a Belgian resident with a holiday home in the Netherlands was entitled to the tax-free allowance for Dutch wealth tax purposes even if he did not have at least 90% of his worldwide wealth in the Netherlands; D was of the opinion that he should benefit from the same advantage.

Since the tax court had doubts regarding the arguments made by D, it referred the case to the ECJ for a preliminary ruling.[18] The tax court asked the following questions:

(1) Is it compatible with the principle of free movement of capital to grant the tax-free allowance for wealth tax purposes to resident taxpayers in all cases, while a non-resident taxpayer is entitled to the allowance only if at least 90% of his wealth is situated in the Netherlands?

(2) If the answer is in the affirmative, does it make a difference that, under the Netherlands–Belgium treaty, the Netherlands grants the tax-free allowance to a Belgian resident with a holiday home in the Netherlands in all cases while, under the Netherlands–Germany treaty, a German resident is entitled to the allowance only if at least 90% of his wealth is situated in the Netherlands?

3.2. The Advocate-General's opinion

Advocate-General (A-G) Poiares Maduro published an extensive opinion in the "*D*" case on 26 October 2004.[19] In order to answer the first question, he considered it necessary to start with a comprehensive description of the current state of EC law regarding the direct taxation of individuals. He took into account almost all the previous cases referred to the ECJ which involved individual income taxation. The A-G distinguished between differences in treatment based on the taxpayer's place of residence and differences in treatment based on the source of income.

The most important case mentioned, which was referred to as the A-G's starting point, was *Schumacker*.[20] This case was put into the first category – a case where the different treatment was based on the taxpayer's place of residence. In that case, the ECJ ruled that the state of employment must grant a non-resident taxpayer the same tax treatment that it grants to a resident taxpayer, provided the non-resident taxpayer earned more than 90% of his income in that state.

After an extensive analysis of the ECJ's previous decisions, the A-G focused on their application to the current situation. He was of the opinion that, in D's situation, three elements were relevant, of which two were legal and one was factual (Para. 60 of the A-G's opinion). The first legal element was that non-resident taxpayers are entitled to the tax-free allowance for wealth tax purposes only if they hold at least 90% of their wealth in the Netherlands, while resident taxpayers are always entitled to the allowance. The second legal element was that Germany does not levy a wealth tax. The factual element was that D held only 10% of his total wealth in the Netherlands.

According to the A-G, D's situation can be compared to that of a Dutch resident, and the A-G was of the opinion that the beneficial treatment of resident taxpayers should also be granted to D. The basis of the A-G's reasoning was that, since Germany does not levy a wealth tax, all of D's taxable property was situated in the Netherlands. Consequently, the A-G specifically considered it to be relevant what tax treatment D received in his residence state[21] and concluded that D was entitled to the same tax-free allowance as a Dutch resident taxpayer.

The A-G then decided that it was no longer necessary to consider the second preliminary question. The A-G nevertheless commented on the second question because the ECJ might reach a different outcome regarding the first question. He referred to the second question as being a rhetorical one (Part IV-C of the A-G's opinion).

The answer to the second question was the most awaited one in the literature on the "*D*" case.[22] This question, after all, concerned the compatibility of tax treaty provisions with EC law. D thought that he was entitled to the tax-free allowance under the same conditions as a Belgian resident based on the Netherlands–Belgium tax treaty.

The Netherlands grants the tax-free allowance for wealth tax purposes to a Belgian resident under the same conditions as it grants the allowance to a Dutch resident. In the provision in the Netherlands–Germany treaty, however, the Netherlands included the condition that more than 90% of the German resident's property had to be situated in the Netherlands in order to qualify for the allowance. D argued that the more favourable treatment of Belgian residents compared with German residents under the Netherlands–Germany treaty is incompatible with EC law.

According to the A-G, the difference in treatment of comparable German and Belgian residents for Dutch wealth tax purposes based on a bilateral treaty indeed

18. Court of 's-Hertogenbosch, 24 July 2003, No. 00/00296.
19. A-G's opinion in Case C-376/03, *D*, [2005] ECR (not yet published).
20. Case C-279/93, [1995] ECR I-225.
21. Although in some cases the ECJ has taken a different view; see Case C-494/03, *Senior Engineering Investments*, [2006] ECR (not yet published).
22. See e.g. Weber and Spierts, supra note 10.

constituted an infringement of EC law. He agreed that, due to the lack of harmonization in the field of direct taxation of individuals, including with regard to the avoidance of double taxation, the Member States in principle are allowed to enact their own tax legislation. Although the Member States possess sovereignty in the field of taxation, it is nevertheless settled ECJ case law that they must exercise this competence in compliance with Community law. For this reason, the A-G concluded that a Belgian resident and a German resident, both with a holiday home in the Netherlands, were in a comparable situation for Dutch tax purposes. The fact that the two non-residents of the Netherlands were treated differently was based only on the Netherlands–Belgium and Netherlands–Germany tax treaties. The comparison became even clearer since neither Belgium nor Germany levies a wealth tax. Consequently, the avoidance of double taxation was not an issue in either case.

Ultimately, the A-G stated that he was well aware that, if the ECJ agreed with his position that the more favourable treatment in the Netherlands–Belgium treaty must also be granted to a German resident, the complex system of bilateral tax treaties between the Member States would be severely fettered (Para. 105 of the A-G's opinion). This conclusion, however, should not prevent the ECJ from deciding the "*D*" case this way.

3.3. The ECJ's judgement

Since in most cases the ECJ follows the A-G's opinion, the Member States anxiously awaited the definitive judgement of the ECJ. A negative judgement for the Member States could result in treaty shopping by taxpayers. The uncertainty for the Member States came to an end on 5 July 2005 when the ECJ decide the "*D*" case, but not in line with the A-G's opinion on the two preliminary questions.

With regard to the first question, the ECJ decided that a Member State may provide a different tax treatment for resident and non-resident taxpayers. Subsequently, referring to the *Schumacker* judgement, the ECJ also ruled that, in granting a tax advantage, the Member States are allowed to use the requirement that at least 90% of a non-resident taxpayer's wealth be located in that Member State. Consequently, the previous ECJ case law on individual income taxation has been extended to wealth taxation (Para. 37 of the ECJ's decision).

After this consideration, the ECJ had to determine whether resident and non-resident taxpayers were in a comparable situation for Dutch wealth tax purposes. The ECJ decided that their situation was not comparable. The main reason in support of this was that the major part of a non-resident taxpayer's income and wealth is concentrated in his residence state. Therefore, that state is most capable of taking into account the taxpayer's overall ability to pay, for instance, by granting an allowance. Consequently, the state in which only a small part of a taxpayer's wealth is located is not obliged to grant the same allowance to non-resident taxpayers as it grants to resident taxpayers.

Since the ECJ ruled that the Dutch tax provision in this case was not incompatible with EC law, the ECJ had to examine the second preliminary question, which related to the applicability of the Netherlands–Belgium tax treaty to German residents. Even though the A-G's opinion was that it is incompatible with EC law for a Member State to treat comparable non-resident taxpayers from different Member States differently based on the applicable tax treaty, the ECJ in this case ultimately ruled that the existing treaty law was in line with EC law.

The ECJ's reasoning on this point started with the determination that the Member States can enter into negotiations with each other in order to secure for the benefit of their nationals the abolition of double taxation within the internal market. If no Community harmonization has taken place in this field, the Member States are allowed to establish the connecting factors for purposes of allocating taxing rights.

The case at hand, however, did not concern a resident of a contracting party who appealed to the Netherlands–Belgium tax treaty, but a resident of another Member State. The ECJ concluded that the scope of a bilateral tax treaty is in principle limited to persons specifically mentioned in that treaty. Only in exceptional situations is the scope extended to third-country residents.[23] The ECJ then examined whether a German resident is comparable to a Belgian resident for Dutch wealth tax purposes. The ECJ determined that both Belgian and German taxpayers are deemed to be in a comparable situation for equal treatment for wealth tax purposes (Para. 59 of the ECJ's decision). In the bilateral tax treaty between the Netherlands and Belgium, however, the taxing rights are allocated in such a way that residents of one contracting state with property in the other contracting state are entitled to the same advantages and allowances as residents of that other contracting state. The absence of a similar provision in the Netherlands–Germany tax treaty made the situations of D and of a Belgian resident incomparable.

It is of no importance that, in practice, Belgium does not levy a wealth tax and the reciprocal advantage in the Netherlands–Belgium treaty therefore only has effect one way. The provision is to be seen as an integral part of the treaty contributing to its overall balance, and the provision cannot be regarded as a benefit separable from the rest of the treaty.

3.4. Comment and analysis

The ECJ's judgement in the "*D*" case was heavily criticized. Some tax lawyers described the outcome of the case as a political judgement.[24] From an EC perspective, the outcome of the case can, to some extent, be considered understandable.

23. For example, in the case of a treaty between States A and B, State A should grant the same tax treatment to a PE in its territory of a company in State C as State A grants to a domestic company; see Case C-307/97, *Saint-Gobain*, [1999] ECR I-6161.
24. See e.g. "Arrest Europees Hof voorkomt aanpassing belastingverdragen" (ECJ judgement prevents the adaptation of tax treaties), in *Het Financieele Dagblad* of 6 July 2005.

Since no harmonization has taken place in the field of direct taxation of individuals, the Member States are entitled, within the limits set by primary EC law, to enact their own tax legislation. Based on settled ECJ case law, a difference can be made between resident and non-resident taxpayers. The Member State of residence is, in the first instance, the most appropriate state to take into account the personal circumstances of taxpayers; thus, regarding income taxes, the Member State of residence can include in its domestic tax legislation the condition that certain tax advantages are to be granted to non-resident taxpayers only if they earn at least 90% of their income in that Member State.[25] This line of reasoning now also seems applicable to other taxes such as, in this case, the wealth tax. For Dutch wealth tax purposes, therefore, the different situation of residents (taxed on their global wealth) and non-residents (taxed only on their wealth situated in the Netherlands) can justify denying the tax-free allowance to a non-resident taxpayer with only 10% of his total wealth in the Netherlands.[26]

Furthermore, since EC law focuses on the compatibility of a domestic provision with EC law, the question arises whether it is important what actually happens in the other country. The authors think that this can be considered relevant, although within limits. This can be derived from several cases that are not related to the MFN question, one example being *Océ van der Grinten*.[27] In this case, the ECJ decided, among other things, that a withholding tax on a tax credit is acceptable *only if* the taxed company can offset the tax against its own corporate income tax liability. Other examples with respect to individuals are *De Groot*[28] and *Schempp*.[29] The individual's factual position seems to be decisive. The same principles apply in tax treaty cases such as *Océ van der Grinten*. Also in situations regarding withholding taxes, neutrality is key.

In certain situations, however, the tax treatment in the other Member State seems to be irrelevant. An example is the *Senior Engineering Investments* case in which a UK parent company made a direct informal capital contribution to its German sub-subsidiary.[30] The Netherlands, the Member State of the intermediary company, wanted to levy a capital tax because Germany did not do so. The ECJ held that a direct informal capital contribution by a parent company to its sub-subsidiary could lead to only one taxable event. The fact that the Member State of the sub-subsidiary (in this case Germany) did not levy a capital tax on this taxable event did not justify the levy of a capital tax at the level of the intermediary company. Consequently, the Member State of the intermediary company could not levy a (capital) tax based on the tax treatment (including no taxation) by the Member State of the sub-subsidiary.[31]

Why would the ECJ not follow one line of reasoning? In the authors' opinion, the reason for this different approach is that a Member State can take into account the tax treatment in another Member State in order to treat the taxpayer as if the internal market were a single Member State,[32] but a Member State cannot let its tax treatment depend on what the other Member States do.[33] In the authors' view, a Member State is allowed to tax its resident companies, but not depending on the tax treatment in the other Member State because that would violate the principle of mutual acceptance of each other's tax system.[34]

It seems that the reason why the ECJ did not consider the question whether D paid a wealth tax in Germany had everything to do with Dutch tax law, which required D to pay tax only on his Netherlands-situs wealth. From this judgement, it is clear that the fact that Germany does not levy a wealth tax had no effect for purposes of determining the percentage of D's taxable wealth in the Netherlands. Consequently, D's argument that, since Germany does not levy a wealth tax, 100% of D's *taxable* wealth was located in the Netherlands (instead of the approach that 10% of his *total* wealth was located in the Netherlands) could not be accepted. Thus, the tax treatment of wealth in Germany had no influence on the tax treatment in the Netherlands.

Theoretically more important was the answer to the second preliminary question. This answer can be regarded as "remarkable" since the ECJ ruled that Belgian and German non-residents are not in a comparable situation because of the tax treaties that Belgium and Germany concluded with the Netherlands. In principle, it is correct that Belgian and German residents are not in a comparable situation *due to* the differences between the Netherlands–Belgium treaty and the Netherlands–Germany treaty. In cases of MFN treat-

25. Case C-279/93, *Schumacker*, [1995] ECR I-225. But see Case C-385/00, *De Groot*, [2002] ECR I-11819 and the annotation to it by Hans van den Hurk, *SEW* 2003/106. If an individual earns less than 90% in another Member State and he cannot set off his personal costs in that state, his residence state should grant him this benefit.

26. In the authors' opinion, this has more to do with the difference between resident and non-resident taxpayers than with 90% as the principal criterion.

27. Case C-58/01, [2003] ECR I-9809.

28. Case C-385/00, [2002] ECR I-11819.

29. Case C-403/03, [2005] ECR (not yet published). In this case, however, the ECJ's decision had negative consequences for the individual taxpayer because he was not entitled to deduct in Germany the alimony payments to his former wife who resided in Austria (where the alimony received was not taxed).

30. Case C-494/03, [2006] ECR (not yet published).

31. A consistent approach by the ECJ in taking into account the tax treatment in the other Member State, however, cannot be found. Case C-169/03, *Wallentin*, [2004] ECR I-6443, concerned a German resident who received remuneration from his internship in Sweden. According to the ECJ, Sweden had to grant Wallentin the same exemption that it grants to a Swedish resident because Wallentin did not receive enough German-source income to use the advantage in Germany. In this case, therefore, the ECJ found it important whether Wallentin could use the advantage in Germany.

32. For instance, as in Case C-403/03, *Schempp*, [2005] ECR (not yet published), a Member State can deny a deduction for costs if the costs are not taxable in the other Member State. Other examples can be found in Cases C-446/03, *Marks & Spencer*, [2005] ECR (not yet published); C-385/00, *De Groot*, [2002] ECR I-11819; and C-279/93, *Schumacker*, [1995] ECR I-225.

33. Case C-494/03, *Senior Engineering Investments*, [2006] ECR (not yet published).

34. From Art. 10 of the EC Treaty (on Community loyalty), it can be deduced that a Member State may not take into account the tax treatment in another Member State to determine its own taxable base, but the Member State must consider the other Member State's interests. Based on Art. 10, the Member States must in principle accept each other's legislation; otherwise, the objectives of the EC Treaty could be jeopardized, specifically regarding cross-border activities and, following Art. 10, the Member States must make sure that this does not occur. Recently, in his opinion in Case C-196/04, *Cadbury Schweppes* (on the UK CFC legislation), A-G Philippe Léger stated that a Member State can in principle take into account the tax treatment in another Member State in order to determine the taxable base in the parent company's Member State if the CFC legislation applies only to wholly artificial arrangements intended to circumvent the national law.

ment, however, the question is whether a Belgian resident and a German resident must be treated equally *despite* the differences in the Netherlands–Belgium and Netherlands–Germany treaties.[35] Consequently, the question that should be answered is whether two non-resident taxpayers from different Member States may be treated differently because of the differences in the applicable tax treaties.

The ECJ's approach in this case can be compared to the approach taken in the *Schumacker* case. In that situation, the ECJ found that resident and non-resident taxpayers were in principle not comparable and thus could be treated differently, unless it was objectively determined that the circumstances of the case were the same. In the "*D*" case, the ECJ took the first step in the approach (Belgian and German residents are in principle not comparable; thus, no discrimination), but without taking the second step (determining whether they are objectively in the same situation).[36]

The reasoning also qualifies as remarkable because the circumstances of the case with either a Belgian resident or a German resident are comparable. The only difference between the two non-resident taxpayers is that different tax treaties apply. Consequently, a Belgian resident with 10% of his wealth in the Netherlands is factually in the same situation as D – only the applicable legal position differs. This difference arises because there has been no harmonization in the field of direct taxation of individuals. Objectively, it can be stated that comparable situations are treated differently based on differing legal standards. In principle, this constitutes discrimination (equal situations are treated differently), but the ECJ is of the opinion that there is no equal situation because of the differing legal standards. The ECJ does not seem to realize that discrimination is mostly the consequence of applying different legal standards to comparable situations.[37] The ECJ's line of reasoning appears to be artificial.

This line of reasoning was recently used by A-G L. Geelhoed as well.[38] In a corporate income tax case before the ECJ, a comparison was first made between dividends received by domestic and foreign companies. A comparison was then made between two non-resident companies receiving dividends, only one of which was granted a tax advantage by a bilateral tax treaty. A-G Geelhoed ultimately concluded in line with the "*D*" decision and, for both arguments, rejected national treatment in a cross-border situation. Consequently, a company in Member State A receiving dividends from a company in Member State B could not seek the tax advantages in the domestic legislation of Member State B or the advantages that would be granted to a receiving company in Member State C under a bilateral tax treaty between Member State B and (third) Member State C. In the authors' opinion, the A-G applied the principles established by the ECJ in the "*D*" case. The circumstances in which this line of reasoning seems, in the authors' view, to be invalid are discussed later (see 4.).

The "*D*" case was the first tax case before the ECJ which dealt with MFN treatment. MFN treatment was rejected due to the lack of harmonization. One consequence of this lack of Community harmonization in the field of direct taxation of individuals is that double taxation should be avoided by tax treaties. This reasoning is understandable. Tax treaties create a reciprocal system of rights and obligations which applies only with respect to the residents of the contracting parties. For this reason, the ECJ is of the opinion that a treaty provision is to be interpreted taking into account the entire system of the treaty concerned. The ECJ, therefore, seems to approach a tax treaty as a "package deal". In the authors' opinion, this approach, although understandable, does not fit within the system of the internal market because, under this approach, the Member States are actually rewarded for not acting.[39] More specifically, the lack of harmonization seems to be the reason why the ECJ protects the Member States from EU citizens. But the lack of harmonization is not caused by the individuals or companies within the EU, but by the Member States. And understandably, the ECJ cannot by a ruling harmonize double taxation relief within the EU. In this situation, however, the authors see no disparity since it is obvious that there is discrimination. The ECJ could, after all, easily have concluded that D, a German resident, was treated less favourably than a Belgian resident who, except for his place of residence, was in the same situation. Thus, because the ECJ seems to see a disparity, the remaining question is what can actually be considered to be a disparity. For example, a resident of Member State A who has income from Member State B might suffer a higher tax burden than a resident of Member State A with only domestic income because Member State B levies tax on the same taxable base, but at a higher rate.[40] Ultimately, this will make investing in Member State B more expensive, and therefore less attractive. This is not the consequence of discrimination, but of the lack of harmonization. This is what is referred to as a disparity. The only way to resolve these disparities is simple, namely, to harmonize the rules. After all, in such situations, it is very difficult to blame a country because the problem is not caused by (indirect) discrimination. The lack of harmonization in itself is not enough to constitute a disparity. Sometimes a disadvantage is caused by the lack of harmonization, but it can still be qualified as a discriminatory measure by applying the four freedom because a company is effectively restricted. For example, a cross-border legal merger within the EU was not possible due to the lack of harmonization of civil law. The negative consequences of this should therefore be resolved by harmo-

35. See the annotation by Hans van den Hurk to Case C-376/03, *D*, *SEW* 2006/163.

36. It is clear that, in the "*D*" case, both the German and Belgian residents were non-resident taxpayers in the Netherlands. This difference with the *Schumacker* case is, in the authors' opinion, essentially irrelevant.

37. In most cases, however, the differences arise from domestic legislation which treats residents more favourable than non-residents without distinguishing between the origin of the non-residents.

38. Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation* (the A-G's opinion has not yet been published).

39. The Member States have not concluded a multilateral tax treaty in conformity with Art. 293 of the EC Treaty, and harmonization has also not been achieved in any other way. Moreover, no initiative has yet been taken to actually work on creating a pan-European system for double taxation relief. See Thoemmes, O., "A Tax Treaty for Europe: An Independent View under EU Law", and Weber, D.M., "Differences between Tax Treaties: Prohibited discrimination?", 45 *European Taxation* 8 (2005), at 343 and 339, respectively; see also Kofler and Schindler, supra note 13.

40. For a different situation, see Case C-336/96, *Gilly*, [1998] ECR I-2793.

nization.[41] In any event, the German company Sevic Systems felt restricted when it wanted to merge with a Luxembourg company. In *Sevic Systems*,[42] the ECJ ruled that the lack of harmonization was not a reason that justified the restriction on the German company by German law. Thus, even if discrimination and restrictions, on the one hand, and disparities, on the other hand, occur, a different treatment can be accepted by the argument that no harmonization has taken place only if the situation itself does not constitute discrimination or a restriction. If, however, the situation involves discrimination or a restriction, EC law applies. In the "*D*" case, the ECJ did not follow this reasoning, which it later expressed in *Sevic Systems*. Double taxation relief is, according to the decision, one of the situations which urges harmonization. Art. 293 of the EC Treaty stipulates that a multilateral tax treaty would promote the furtherance of the single European market. Because no step has yet been taken to harmonize tax treaties, the existing treaties form a "band-aid" which helps to limit the number of problems that can arise. In the "*D*" case, the ECJ accepted the tax treaty even if one consequence of this was that the Netherlands treated a Belgian resident more favourably than a German resident. The ECJ expressed this with the words that the allocation of taxing rights helps to prevent double taxation and is therefore acceptable to decrease the effects of the disparity. In the authors' opinion, this is correct, but this does not eliminate the consequence that D was discriminated against compared to a Belgian resident.

The judgement in the "*D*" case therefore makes it possible for the Member States to introduce a justified discrimination of individual taxpayers through the conclusion of tax treaties.[43] It seems, after all, not to be an infringement of EC law for Member State A to treat a non-resident taxpayer from Member State B differently from a non-resident taxpayer from Member State C, even if the situations of the two non-residents are identical. Thus, it seems that the Member States can, by means of bilateral tax treaties, provide a different tax treatment for residents from different Member States.[44] The reciprocal nature of tax treaties seems to be decisive for the ECJ. The ECJ therefore found the protection of the Member States' interests more important than the protection of the interests of their citizens. Consequently, it is not an understatement to say that the pressure on the Member States to conclude a multilateral treaty for avoiding double taxation based on Art. 293 of the EC Treaty was not increased by the ECJ's judgement in the "*D*" case.

4. DEVELOPMENTS

4.1. In general

The issue remains whether all the questions regarding MFN treatment have been answered. In the authors' opinion, the "*D*" decision does not cover all situations, and the ECJ's decision in that case should be interpreted narrowly. The ECJ emphasized the fact that there has been no harmonization in the field of direct taxation of individuals in order to justify the restriction by applying the provisions of bilateral treaties. Specifically, in situations where the law *has been* harmonized, this justification seems invalid since an infringement of EC law is not necessary to guarantee the avoidance of double taxation. An example of such a situation is an intra-group dividend distribution whose tax treatment was harmonized through the Parent-Subsidiary Directive. Thus, for dividend taxation, company A (resident in Member State A) should be treated the same whether it distributes dividends to its parent company B in Member State B or to parent company C in Member State C, irrespective of the applicable tax treaty.[45] The discussion below examines two situations in which the relevant reasoning in the "*D*" case seems not to be applicable.

4.2. French and Italian tax credits

The 1989 France–Italy tax treaty includes a tax credit with respect to dividend distributions. If certain conditions are met, a dividend distribution from a French subsidiary to its Italian parent company is accompanied by a tax credit paid by the French treasury (Art. 10(3) of the treaty). Due to the reciprocal nature of the provision, the tax credit is also granted in the reverse situation (Art. 10(4) of the treaty). Dividends distributed to companies established in the other Member States are not accompanied by a tax credit. Example 1 illustrates how the credit works in the French/Italian situation.

Example 1

Italian distributing company:	
pre-tax profit	100
corporate tax (37%)	(37)
net profit available for distribution	63
French receiving company:	
dividends received	63
tax credit (50% x 37%)	18.5
withholding tax on dividends and tax credit (81.5% x 5%)	(4.075)[46]
net dividend at the border	77.425

41. Which actually has taken place, although the ultimate implementation date is only 15 December 2007.
42. Case C-411/03, [2006] ECR (not yet published).
43. See the annotation by Hans van den Hurk to Case C-376/03, *D*, *SEW* 2006/163; and Wolvers, supra note 1.
44. Or, as A-G Geelhoed opined in *Test Claimants in Class IV of the ACT Group Litigation* (Case C-374/04), a Member State can provide a different treatment for a resident of another Member State by a bilateral tax treaty based on the residence state of the shareholder of the dividend-receiving company. In that case, the granting of an ACT credit on dividend distributions to a company of another Member State was limited by the limitation on benefits clause. Consequently, only if the shareholder was also entitled to the ACT credit could the credit be granted to the dividend-receiving company. According to A-G Geelhoed, this limitation is compatible with EC law and the Member States can thus make the tax treatment of a taxable event dependent on the tax treatment in another Member State.
45. See e.g. Case C-170/05, *Denkavit International*, and Case C-379/05, *Amurta*, both currently pending.
46. According to Case C-58/01, *Océ van der Grinten*, [2003] ECR I-9809, a withholding tax can be levied on the tax credit connected to dividends, but only to the extent the withholding tax can be credited at the recipient's level. The last part of this decision has been ignored in the relevant literature. It is therefore questionable whether this judgement can have effect with respect to the France–Italy treaty if the French parent is replaced by a Dutch parent because the tax credit received would normally be seen as a dividend, which is not part of the taxable base of the parent company.

A Dutch or German shareholder would receive a net dividend of only 63 at the border. Example 1 shows that the Italian government pays an extra amount to shareholders resident in France. The ECJ decided in the "*D*" case that the Member States may conclude bilateral tax treaties for the allocation of taxing rights. The dividend tax credits at issue, however, are not necessary for the allocation of taxing rights. In fact, the dividend tax credits are no longer even relevant for avoiding double taxation.

In the past, both France and Italy had a credit system in their domestic tax laws. Consequently, a dividend tax credit was necessary to avoid double taxation. The tax credit was also included in the bilateral tax treaty between the two countries. However, both France and Italy currently use an exemption system; thus, the dividend tax credit is no longer necessary to avoid double taxation. But the credit has still not removed from the treaty, nor has it been declared that the credit no longer applies. Consequently, dividends received qualify under the participation exemption, and a tax credit on this distribution is granted by the Member State of the distributing company. In fact, France gives Italian companies with a French subsidiary an additional advantage that has nothing to do with avoiding double taxation. Since the tax credit does not seem to be relevant for avoiding double taxation, the principles of the "*D*" case cannot be applied, and the tax credit should also be granted to other EU companies receiving dividends from qualifying companies resident in France or Italy.

An additional argument in this respect is that the tax credit cannot be considered standard with respect to the OECD Model Tax Convention. According to Art. 23 B of the OECD Model, tax credits are in principle provided by the Member State of the *receiving* company. In the France–Italy treaty, however, the Member State of the *distributing* company grants the dividend tax credit. In cases involving the avoidance of double taxation, the ECJ in recent decisions referred to the system included in OECD-type treaties. Since the dividend tax credit is not in conformity with the OECD Model, the tax credit seems not to be in conformity with international – and EU – standards either. Consequently, France and Italy cannot use the argument that granting the tax credit – as provided by the France–Italy treaty – is common practice.

4.3. Tax sparing credits

Another example of a treaty advantage can be found in tax sparing credits. By granting a tax sparing credit, a country grants a credit for a withholding tax based on a fictitious withholding tax percentage that usually exceeds the percentage of withholding tax actually levied.

Historically, the Netherlands has granted tax sparing credits to stimulate investment in developing countries. Tax sparing credits were, for instance, included in the bilateral tax treaties between the Netherlands and Brazil and the Netherlands and Greece. Neither Brazil nor Greece, however, is now on the list of developing countries in Dutch legislation. Nevertheless, until recently, tax sparing credits in both treaties were still applicable.[47]

Based on the tax sparing credits, a Dutch company with investments in Brazil can credit an amount of withholding tax on dividends, interest and royalties which exceeds the amount of withholding tax actually paid in Brazil.[48] A tax sparing credit, however, is no longer necessary and justifiable on the grounds that it made investments in developing countries more interesting – since neither Brazil nor Greece still qualifies as a developing country. Thus, the position can be taken that the Netherlands should accept tax sparing credits for investments in other countries as well.

If the non-reciprocal tax sparing credits in the Netherlands–Brazil treaty were also granted with respect to investments in the EU Member States, this would mean that companies would benefit from a fictitious withholding tax credit on the receipt of dividends, interest and royalties from any other EU Member State. Possibly, the benefit for investments in companies established in the other EU Member States is equal to the fictitious amount in the treaty reduced by the actual percentage levied in Brazil. Consequently, the same net advantage would be granted for investments in companies in the other Member States as for investments in companies in Brazil.

The tax sparing credits in the Netherlands–Brazil treaty are still in force. It is an accepted principle within the EU that non-EU countries may not receive a more favourable treatment than the Member States.[49] From this point of view, an appeal based on these tax sparing credits could be fruitful.[50]

5. CONCLUDING REMARKS

In the "*D*" case, the ECJ took the position that a German resident was not entitled to the same tax treatment in the Netherlands as a Belgian resident because Germany's and Belgium's bilateral tax treaties with the Netherlands differed. The fact that this resulted in a treatment of a Belgian resident that was more favourable than the treatment of a comparable German resident did not influence the outcome of the case. The ECJ based its judgement on the fact that there has been no harmonization in the field of avoiding double taxation within the internal market. The authors disagree with this decision because it sets the internal market back in time. The Member States can now, by concluding tax treaties, take any action without considering

47. The tax sparing credit in the Netherlands–Greece treaty was abolished on 1 July 2006 by the protocol of 18 January 2006; see press release of the Netherlands Ministry of Finance of 8 February 2006. The tax sparing credit in relation to Brazil is still applicable.

48. In relation to Greece, the tax sparing credit was granted only with respect to interest and royalty payments.

49. See e.g. Para. 19 of the preamble to Directive 2000/12 (Banking), which provides: "It is important at the present time to provide that such rules may not be more favourable than those for branches of institutions from another Member State." This principle, which is based on Art. 10 of the EC Treaty, was later confirmed by the ECJ in the "open skies" cases (cited in note 5, supra). See also Waters, M., "A Tax Treaty for Europe? Most-Favoured Nation and the Outcome of the '*D*' and *Bujara* Cases in the European Court of Justice", 45 *European Taxation* 8 (2005), at 347.

50. See e.g. Wolvers, supra note 1 (comments by Prof. Eric Kemmeren); Moons, P.V.S., "Meestbegunstiging kan binnen de Europese fiscale rechtsorde worden toegepast", *WFR* 2003/1145; and van Thiel, S., "Het direct werkende Europese Gemeenschapsrecht en het inkomstenbelastingrecht en de belastingverdragen van de lidstaten", *TFO* 2001/78.

what it means under a non-discrimination provision or one of the fundamental freedoms. For some authors, however, this case supports the position that the denial of MFN treatment and horizontal discrimination are accepted in almost all circumstances.

In the authors' view, the discussion is not over yet. Based on several pending cases regarding company taxation, the authors think that the "*D*" case should not be followed unconditionally. After all, there has been harmonization in several specific areas of taxation through different directives. Although the EU Member States have not yet concluded a multilateral tax treaty, this cannot justify an infringement of EC law on a subject with regard to which harmonization has taken place. Consequently, the ECJ's judgement in the "*D*" case cannot be transposed to a situation concerning company taxation. Since there are still many uncertainties after this decision, however, many cases regarding the compatibility of tax treaty provisions with EC law will probably follow. The discussion of MFN treatment is still ongoing. It is clear that applying MFN treatment is not possible in all circumstances, but it seems to be possible in certain circumstances.