

ECJ - Recent Developments in Direct Taxation 2013

Bearbeitet von

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Edoardo Traversa/Kim Van de Velden

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I. Commission vs. Belgium (IP/13/136)

On 21 February 2013, the EU Commission issued a press release informing the public of its decision to refer Belgium to the ECJ with respect to the compatibility with the free movement of workers provisions, of a personal income tax reduction for investment adopted by the Walloon Region. According to the EU Commission, the breach lies in the fact that the tax reduction only applies to Walloon tax residents and not to residents of other EU Member States.

A. Facts and circumstances of the infringement proceedings

1. Formal request by the EU Commission

Within the framework of an infringement procedure based on Articles 258 to 260 of the TFEU, the EU Commission had already formally requested Belgium in 2012 to “*amend its regional and federal¹ laws that discriminate against non-resident taxpayers whose income is entirely or almost entirely earned in Belgium*”.² Since the federal discriminatory rules granting a tax credit have been amended in the meantime, the case now brought before the ECJ only concerns the regional scheme.

2. Applicable legislation

With the Walloon Decree establishing a Walloon Investment Fund (“WIF”)³, the Walloon Region introduced a personal income tax reduction for citizens buying shares or bonds in that Fund. By virtue of Article 3 of the Decree (which is a mere application of the constitutional division of taxing powers between Regions in Belgium), the personal income tax reduction can be claimed by taxpayers who are (tax) resident in the Walloon Region. The tax credit consists of a percentage of the amounts invested in WIF shares or bonds (8.75 % for shares and 3.10% for bonds capped at EUR 2,500 per taxpayer and per taxable period). This tax reduction can be applied for four consecutive taxable periods, provided certain holding conditions are met, and it is set-off against the final personal income tax that is due and payable.

B. Alleged incompatibility

According to the EU Commission, the exclusion of non-residents who earn (almost) all of their income in Wallonia restricts the free movement of workers as provided for by the TFEU. Since the cause of this exclusion is mainly the result of

1 The discriminatory federal rules granting a tax credit were amended and are no longer part of the claim brought before the ECJ.

2 See Commission Press release of 22 March 2012 (IP/12/281).

3 Walloon Decree of 3 April 2009, *BOG (Belgian official Gazette)*, 4 May 2009, articles 3 to 9.

the constitutional division of taxing powers in Belgium and not of a deliberate choice by the Walloon Region, it is necessary to discuss the case in the light of the recent evolution of the constitutional framework in Belgium and its compliance with EU Law requirements.⁴

C. Analysis

1. Taxing powers of Regions in Belgium

By virtue of Article 170, § 2 of the Belgian Constitution, Regions (and Communities) have an autonomous and general power to levy their own taxes. This constitutional fiscal autonomy is however not unlimited and is subject to various restrictions. In particular, it is also limited by the powers of the federal State, to exceptionally intervene by imposing or forbidding a tax measure whenever it appears to be necessary. As a result, the federal State adopted a provision (Article 1 of the Law of 23 January 1989), which precludes Regions from levying taxes or surcharges on “areas” which are already subject to federal taxation. This is in fact an application of the *non bis in idem* principle, by virtue of which the Regions may no longer fiscally interfere in areas which belong to the Federal State.⁵

Moreover, Regions have been transferred powers – and revenues – with respect to some former federal taxes. The extent of regional powers as regards transferred taxes and the methods of calculation of financial transfer mechanisms are determined according to criteria defined in the Special Act of 23 January 1989 on the Financing of Communities and Regions (amended in 1993 and 2001) (“Special Financing Act”).⁶ Since the important 2001 reform, the Regions have had the power to modify the tax rate, the tax base and the exemptions of 12 former federal taxes in accordance with Article 4(1) of the Special Financing Act. These taxes are the gambling and betting tax, the tax on automatic entertainment equipment, the tax on the sale of alcoholic beverages, inheritance duties, several types of registration duties relating to real estate transactions and to lifetime gifts of personal property or real estate, radio and television fees, the traffic tax on motor vehicles,

4 On the impact of EU Law on regional taxing powers, see E. Traversa and M. Bourgeois, « L’influence du droit de l’Union européenne sur l’autonomie fiscale régionale » in E. Vandenbossche et S. Van Drooghenbroeck (eds.), *Europese voorschriften en staatshervorming / Contraintes européennes et réforme de l’Etat*, La Chartre, 2013, p. 271–293; E. Traversa, L’autonomie fiscale des Régions et des collectivités locales des Etats membres face au droit communautaire. Analyse et réflexion à la lumière des expériences belge et italienne, Larcier, 2010, 572pp.; E. Traversa, “Is there still room left in EU law for tax autonomy of Member States’ regional and local authorities?”, (2011) 20 *EC Tax Review* 1, pp. 4–15.

5 On fiscal federalism in Belgium, see E. Traversa and B. Vintras, “Tax coordination in Belgium – The Role of the Courts” in M. Lang, P. Pistone, J. Schuch and C. Staringer (eds.), *Horizontal Tax Coordination*, IBFD, 2012, p. 95–120.

6 Special Act of 16 January 1989 on the financing of the Communities and Regions, amended several times, M.B. 17 January 1989.

the road tax on motor vehicles and the eurovignette (road user charge imposed on heavy goods vehicles).

In addition, according to article 6(2) of the Special Financing Act, part of the revenue of the personal income tax is allocated to the Regions, who are allowed, according to the location of these taxes, to collect additional taxes and to grant tax reductions to individuals subject to personal income tax, residing in the territory of the Region (up to 6.75% of the tax collected).

The latest State reform (6th), which substantially extends the regional tax autonomy in the area of personal income tax, has been negotiated in 2011 and has yet to enter into force.

2. Implementation of Regional taxing powers and (non-) compliance with EU Principles⁷

In the exercise of their taxing powers, the Regions must abide by the principles of EU Law, more specifically, the fundamental freedoms of movement, the EU Directives on fiscal harmonization, the VAT Directive, and prohibited State aid (art. 107-108 TFEU).⁸

Concerning compliance with the fundamental freedoms, any regional authority that uses its fiscal powers to grant a tax advantage to its residents exclusively runs the potential risk of an EU Law infringement procedure, independent of the constitutional arrangements existing in the Member State. In Belgium, as in other states granting relatively broad fiscal powers to regional authorities, those taxing powers extend to the (internal) borders of the relevant Region. The granting of extra-regional territorial competence to Regions in the area of taxation would inevitably lead to significant difficulties, such as overlaps, mismatches and double taxation. For personal income tax purposes, this justifies – under an internal constitutional perspective – that a Belgian Region has no power to grant, among other things, tax advantages such as credits or reductions to persons other than its tax residents. However, although the various State reforms led to the more extensive transfer of certain federal tax powers to the Regions, the powers with respect to non-resident income taxation remain at federal level.

As a consequence, by granting a tax advantage within its powers, and provided the situation in which a (tax) non-resident finds himself would be similar to the situation of a (tax) resident of that Region (see *infra*), the Region would *de facto* always face the potential risk of violating the EU fundamental freedoms of move-

7 For an analysis of whether EU Law explicitly recognizes the tax autonomy of the sub-national entities of a Member State, see E. Traversa, “Is there still room left in EU law for tax autonomy of Member States’ regional and local authorities?”, (2011) 20 *EC Tax Review* 1, pp. 4–15.

8 See also E. Traversa, “The Selectivity Test: The Concept of ‘Regional Aid’”, in A. RUST and C. MICHEAU (eds.), *State Aid and Tax Law*, Kluwer Law International, 2013.

ment, as it would neither have the jurisdiction to legislate in matters involving non-resident taxation nor therefore to apply the same regime to non-resident taxpayers (whether residing in another state or in another part of the country).

3. The comparability of situations involving (tax) residents and (tax) non-residents for personal income tax purposes

With respect to the situation of residents and non-residents in direct tax matters, the ECJ⁹ has repeatedly ruled that their situations are in principle not comparable. Pursuant to the foregoing principle, the source state can – subject to exceptions – refuse to grant the same tax advantages to non-residents.

Said tax advantages must however pertain to the personal and family situation of the taxpayer, as opposed to tax advantages linked to the taxable income. The latter can in principle not be denied by the source state to non-residents, when they find themselves in a situation that is similar to residents.¹⁰ Furthermore, the *Schumacker* case also confirms that a non-resident taxpayer who derives the majority of his professional income in the source state, and who does not derive any – or a very limited amount of – income in his state of residency and can therefore not claim any personal tax advantages which it offers to residents, must be granted the same tax advantages linked to personal and family situation to tax residents of the source state.

This case law was confirmed with respect to the compliance with almost all of the four fundamental freedoms of movement and applied to all the characteristics of (professional, movable, immovable) income taxes (tax rates, calculation, reduction and procedural aspects thereof).¹¹ In general, the ECJ rulings can be summarized by stating that the Treaty freedoms encompass “*a double prohibition for the Member States and their subdivisions. On the one hand, they prohibit discriminations, i.e. unjustified treatment of comparable situations, based on nationality or another criterion indirectly linkable with nationality, caused by a Member State. On the other hand, the freedoms guarantee citizens of a Member State to move and to deploy their economic activity in another Member State without unjustified restrictions.*”¹²

This long-standing case law must also be applied by regional authorities within Member States, whatever the constitutional framework allocating taxing powers

9 ECJ 14 February 1995, C-279/93, *Schumacker* [1995] ECR I-00225.

10 ECJ 12 June 2003, C-234/01, *Gerritse* [2003] ECR I-05933.

11 See J. Malherbe, Ph. Malherbe, I. Richelle and E. Traversa, *The impact of the Rulings of the European Court of Justice in the area of direct taxation*, requested by the European Parliament's Committee on Economic and Monetary Affairs, 1st edition: April 2008, 2nd edition : November 2011, available on www.europarl.eu.

12 E. Traversa, “Is there still room left in EU law for tax autonomy of Member States’ regional and local authorities?”, (2011) 20 *EC Tax Review* 1, pp. 4–15

prescribes. As the Court has stated on various occasions, “When provisions of the Treaty or of regulations confer power or impose obligations upon the States for the purposes of the implementation of Community law, the question of how the exercise of such powers and the fulfilment of such obligations may be entrusted by Member States to specific national bodies is solely a matter for the constitutional system of each State”.¹³ However, “the Court has consistently held that a Member State cannot plead provisions, practices or situations prevailing in its domestic legal order, including those resulting from the constitutional organisation of that State, to justify the failure to observe obligations arising under Community law”.¹⁴

Belgian Regional tax provisions have already come under ECJ scrutiny on several occasions.¹⁵ For example, the *Geurts & Vogten*¹⁶ case concerned the Flemish inheritance duties. For the 5 years preceding his death, M. Vogten had been a tax resident in the Flemish Region. His estate included a 100% participation in two companies incorporated under the laws of the Netherlands, with their real seat also located in the Netherlands. For more than three years prior to his death, each of his two companies had employed more than five workers on a continuous basis in the Netherlands.

Because of his tax residency in Flanders, the Flemish inheritance tax code was applicable and provided for a tax exemption on the inheritance of family companies subject to certain conditions.¹⁷ The heirs of Mr. Vogten claimed the exemption, but the tax authorities refused to grant it, contending that the workers of the two companies were not employed in the Flemish region (but in the Netherlands). The heirs disagreed with this viewpoint and initiated court proceedings in Belgium. The national court decided to request a preliminary ruling, on the following question: “[do] articles 43 EC and 56 EC preclude inheritance tax legislation of a Member State which excludes from the exemption from that tax available for family undertakings those undertakings which employ in the three years preceding the date of death of the deceased at least five workers in another Member State, whereas it grants such an exemption where that employment is located in a region of the first Member State?”¹⁸

13 Joined Cases ECJ 15 December 1971, C-51/71 to C-54/71, *International Fruit Company and Others* [1971] ECR 01107, para 4.

14 See, inter alia: ECJ 10 June 2004, C-87/02 *Commission v Italy* [2004] ECR I-05975, para 38; ECJ 26 October 2006, C-102/06 *Commission v Austria* [2006], [2006] ECR I-00111, para 9.

15 Concerning the Belgian Regions, see the cases ECJ 11 September 2008, C-11/07, *Eckelkamp* [2008] ECR I-06845; ECJ 11 February 2011, C-25/10, *Missionswerk Werner Heukelbach Halley* [2011] ECR I-00497; ECJ 15 September 2011, C-132/10, *Halley* [2011] ECR I-08353; ECJ 1 December 2011, C-250/08, *Commission v. Belgium*.

16 ECJ 25 October 2007, C-464/05, *Geurts and Vogten* [2007] ECR I-09325.

17 In the meantime the Flemish Region adapted its legislation but the Flemish Region still provides that the inheritance of family companies can be tax neutral subject to certain conditions. These conditions however differ from the conditions applicable at the time of the case.

18 ECJ 25 October 2007, C-464/05, *Geurts and Vogten* [2007] ECR I-09325, para 12.

In a nutshell, and after confirming having jurisdiction over such a regional yet cross-border matter, the ECJ ruled that the Flemish tax provision (indirectly) violated the freedom of establishment by making the tax advantage conditional on the place of work of the relevant employees,¹⁹ for which no overriding reason in the general interest could be invoked to justify a difference in treatment in comparison with undertakings having their seat in another Member State than the Flemish region.

The ECJ therefore rejected the arguments of the Belgian government which contended (i) that the litigious tax provision was introduced in order to ensure the survival of small and medium-sized undertakings and the upholding of employment in the event of inheritance, and (ii) because of the requirement for the effectiveness of tax audits. The particular relevancy of this case lies in the fact that the ECJ ruled that the confinement of a tax advantage to the territory of a region could be deemed as non-compliant.

On the basis of this case law and also non-tax cases such as the *Zorgverzekering* case (see above), there is little doubt that the Court will follow the Commission's position and consider the Walloon measure as violating the freedoms of movement of the TFEU.

4. The application of EU Law to a difference in treatment between residents of different regions of the same MS: lessons from the *Zorgverzekering* case on the definition of a purely internal situation

However, this case also raises the delicate issue of the application of EU Law to purely internal situations. Although the Commission's infringement procedure does not mention the potential violation of the fundamental freedoms due to the fact that this measure does not apply to residents of other Belgian Regions (reverse discrimination), this question should be raised.

Due to the specificity of regional tax powers in the case at hand, as opposed to cases involving Member States, one must first analyse whether a situation involving a regional tax resident and a regional non-resident (within Belgium) can fall under the scope of EU Law. This would imply that the situation cannot be qualified as a "purely internal situation". The latter is defined by the ECJ case law as a

19 *"The legislation in question in the main proceedings lays down as a condition for the grant of the benefit for which it provides the employment for a certain period of a certain number of workers in the territory of a region of the Member State concerned, a condition which unquestionably can be fulfilled more easily by a company already established in that Member State. Consequently that legislation introduces, for the purpose of granting a tax benefit, indirect discrimination between taxpayers on the basis of the place of employment of a certain number of workers in a certain period, discrimination which is liable to hinder the exercise of freedom of establishment by those taxpayers."* ECJ, 25 October 2007, C-464/05, *Geurts and Vogten* [2007] ECR I-09325, paras 21–22.

situation where there is no link with EU Law and where all the relevant elements are confined within the territory of one Member State²⁰. The ECJ further states that the EU fundamental freedoms²¹ do not govern such purely internal situations. This would *prima facie* entail that the Belgian legislator, within the framework of an institutional reform on non-harmonized taxes such as personal income taxes, should have discretionary powers to determine the localization criterion for taxable income between the different regions.

The *Zorgverzekerings* case, although it deals with social security, could be a relevant precedent in order to establish whether the viewpoint of the European Commission in the infringement procedure at hand is too narrow or not, because it does not encompass the violation of EU Law caused by the exclusion of (some) residents of another region in Belgium from the contested measure. Indeed the jurisdiction of the ECJ will depend on the answer to the question whether this pending case pertains to a purely internal situation or not.

The *Zorgverzekerings* case dealt with the EU compliance of a provision granting a social security advantage to persons with physical disabilities. By virtue of the Constitution, the Flemish Community had the power to grant such advantages. The criteria used by the Flemish Community were both the residency of disabled persons in the Flemish speaking Region, and the exercise of employment in the Flemish speaking Region, by disabled persons residing in another Member State. This entailed that persons residing in another territorial component of the Belgian federal State, irrespective of their nationality or place of employment, were excluded from this social security advantage. Another question referred to the ECJ was whether the free movement of persons precluded a limitation on the benefit of such a system to “*persons who are resident in the territorial components of a federal Member State of the EU?*”²².

The Flemish government contended that these questions pertained to a purely internal situation, unconnected to EU Law, because the activities “*are confined in all relevant respects within a single Member State*”²³. As a rebuttal to that argument, the ECJ referred to its case law pursuant to which “any national of a Member state, irrespective of his place of residence and his nationality, who has exercised

20 Regarding the free movement of capital see ECJ 15 May 2003, C-300/01, *Salzmann* [2003] ECR I-04899; With respect to the freedom of establishment see, ECJ 26 January 1993, C-112/91, *Werner* [1993] ECR I-00429; With respect to the free movement of workers see ECJ 2 July 1998, joint cases C-225/95, C-226/95 and C-227/95, *Anestis Kapasakalis, Dimitris Skiathitis and Antonis Kougiagkas* [1998] ECR I-04239; With respect to the free movement of services see ECJ 19 March 1992, C-97/98, *Jägerskiöld c. Gustafsson* [1999] ECR I-07319. See also Traversa/Bourgeois, “L’influence du droit de l’Union européenne sur l’autonomie fiscale régionale”, p. 210 for more references.

21 With respect to the application of the free movement of goods – which is not covered by the present contribution – that does apply to purely internal situations, see Traversa/Bourgeois, “L’influence du droit de l’Union européenne sur l’autonomie fiscale régionale”, p. 210–214.

22 ECJ 1 April 2008, C-212/06, *Zorgverzekerings* [2008] ECR I-01683.

23 ECJ 1 April 2008, C-212/06, *Zorgverzekerings* [2008] ECR I-01683 para 33.

the right to freedom of movement for workers and who has been employed in another Member State, falls within the scope of those provisions”²⁴.

The Court finally held that “*on a proper construction of Articles 39 EC and 43 EC, legislation of a federated entity of a Member State limiting affiliation to a social security scheme and entitlement to the benefits provided by that scheme **only to persons residing in that entity’s territory** is contrary to those provisions, in so far as such limitation affects nationals of other Member States working in that entity’s territory or nationals of the Member State concerned who have made use of their right to freedom of movement within the European Community.*”

The ECJ applied in its judgement, a very narrow definition of a purely internal situation, by only excluding Belgian nationals working in the qualifying territories, but living in the other non-qualifying regions of Belgium, and who have never exercised that freedom to move within the European Union. In other words, only the latter are deemed purely internal situations which clearly do not fall within the scope of Community law according to the ECJ.²⁵ All other Belgian or EU citizens who do not fulfil these conditions may therefore enjoy the protection of the EU freedoms. This broad category covers nationals of Member States other than Belgium, working in the qualifying Belgian regions but living in a non-qualifying Belgian region or in another Member State, as well as Belgian nationals living in another Member State or even in other Belgian Regions, provided that they have already made use of their right to freedom of movement within the European Union.

5. The application of the *Zorgverzekerings* case’s strict definition of “purely internal situations” to direct taxation matters

If applied to regional matters involving personal income taxes, such as the WIF tax provisions, the Walloon region could potentially be facing four categories of taxpayers, (i) its own (tax) residents who qualify for the WIF tax advantage, (ii) foreign EU nationals who would be in a similar situation as the first category, and could therefore not be treated differently without infringing the free movement of workers, (iii) Belgian nationals residing in the Flemish or Brussels regions who previously made use of their right to freedom of movement, and pursuant to *Zorgverzekerings*, should be entitled to TFEU protection, even though they are moving solely within the Belgian territory, and finally (iv) the Belgian nationals residing in the Flemish or Brussels regions who have not made previous use of their right to freedom of movement. This fourth category would be excluded from EU Treaty protection pursuant to the definition given by the ECJ to purely internal situations.

24 ECJ 1 April 2008, C-212/06, *Zorgverzekerings* [2008] ECR I-01683 case-law quoted under para 34.

25 ECJ 1 April 2008, C-212/06, *Zorgverzekerings*, [2008] ECR I-01683 paras 37 and 38.

Based on the foregoing, it appears that the exercise of internal tax powers applying a residency criterion to its 'non-mobile' residents would be compliant with EU Law, and would only constitute an EU Law infringement if this criterion were applied to 'mobile' regional residents (aside from non-residents at large). Hence in *Zorgverzekerings*, the ECJ confirmed its jurisdiction in situations involving movements within the territory of a single Member State, provided there is an indirect link with other Member States, namely the previous exercise of the right to move freely within the European Union. However, the conditions enabling it to determine whether Belgian nationals from a region other than Wallonia are entitled to EU Treaty protection, are not well defined and raise a series of practical questions. Moreover, and although the Advocate-General opined on the paradox that would arise whereby nationals could be treated less favourably than other qualifying nationals or non-residents by virtue of EU Law limitations (reverse discrimination), the ECJ addressed this concern by merely 'inviting' the national jurisdictions to make use of EU Law for excluding purely internal distortions.²⁶

In the case at hand, an application by analogy of this strict definition of purely internal situations means that besides the violation of EU Law concerning the non-application of this tax incentive to residents of other Member States, the contested measure also contradicts EU Law by excluding residents of other Belgian Regions who have made use of their right to freedom of movement. The ECJ should seize the opportunity to at least provide confirmation of this in its judgment, to avoid too narrow an implementation of this decision by the Walloon Region/the Belgian State.

D. Conclusion

In our opinion, it seems more likely than not that the court will decide in favour of the Commission and against Belgium, more precisely the Walloon region. There is some uncertainty about whether the Court will also address the issue of reverse discrimination. The application of EU Law to certain internal situations which are not deemed purely internal pursuant to the *Zorgverzekerings* case could have consequences in the case at hand whereby a category of Belgian nationals and residents, could nevertheless be deemed non-residents for regional direct tax purposes. However, the uncertainties regarding the definition of what remains a

²⁶ The Advocate-General, in her conclusions preceding the *Zorgverzekerings* decision (para 116), confessed to finding it "deeply paradoxical", that "after 50 years of abolishing barriers to freedom of movement between the Member States, decentralized authorities of the latter may nevertheless reintroduce barriers through the back door by establishing them within Member States. One might ask rhetorically, what sort of a European Union it is if freedom of movement is guaranteed between Dunkirk (France) and De Panne (Belgium), but not between Jodoigne and Hoegaarden?" ECJ 1 April 2008, C-212/06, *Zorgverzekerings* [2008] ECR I-01683, para 40. For an analysis on the Belgian constitutional principle of economic and monetary union see Traversa/Vintrass, *Horizontal tax coordination...*, para. 4.3 (see fn 5).