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Tax Treaty "Neutralization" of Source State Discrimination under the EU Fundamental Freedoms?

This article considers an issue discussed at the 2011 IFA Congress as to whether or not a source state may retain an apparently discriminatory dividend withholding tax and not eliminate domestic economic double taxation if its second layer of taxation is "neutralized" by the shareholder's residence state via a treaty credit.

1. Source State Discrimination of Dividend Distributions[1]

The case law of the European Court of Justice (ECJ) clearly demonstrates that non-extension of the source state's relief system to cross-border outbound distributions tends to restrict inbound investments in domestic capital-seeking companies and is, therefore, subject to scrutiny under the fundamental freedoms.[2] Accordingly, a source state that chooses to relieve the domestic economic double taxation of distributed profits for its residents must extend this relief to non-residents to the extent that similar domestic double economic taxation arises from the exercise of its tax jurisdiction over these non-residents, for example, where the source state subjects company profits first to corporation tax and then to a withholding tax on distribution and, therefore, places non-residents in an objectively comparable situation. This obligation to provide relief, for example, to exempt from or refund withholding tax, exists with regard to individual as well as corporate shareholders[3] and is neither dependent on taxation in the shareholder's residence state[4] nor called into question by the fact that the source state may not tax subsequent distributions by the foreign parent company in its residence state.[5] However, the source state is not required to do more than provide relief from domestic economic double taxation. It does not have to forego part of the corporate tax levied on the profits of the distributing company, as this "would mean in point of fact that that State would be obliged to abandon its right to tax a profit generated through an economic activity undertaken on its territory".[6]

In evaluating whether or not a discriminatory restriction exists, the ECJ, in principle, does not take into account the tax treatment in another country.[7] This approach is logical, as discrimination is the different treatment of similar situations by one Member State consistent with the prohibition of compensatory taxation.[8] Such a single-country-oriented perspective of comparability disregards collateral effects or the alternative (hypothetical) policy options of Member States.[9] Accordingly, each Member State must apply non-discriminatory treatment in its legal system, irrespective of the legal circumstances of the same taxable activity in other Member States.[10] This perspective is often described as aiming for the "equality in a box" ("*Kästchengleichheit*"), thereby indicating the right of a

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1. The subject of Seminar D (the "Seminar") at the 2011 International Fiscal Association (IFA) annual congress held in Paris, France on 13 September 2011 was "IFA/EU double taxation and EU law". The panel members consisted of Malcolm Gammie (United Kingdom), Philip Kermode (European Union), Georg Kofler (Austria) and Martha O'Brien (Canada). The Seminar was chaired by Peter J. Wattel (the Netherlands) with the help of Tomás Balco (Kazakhstan) as panel secretary.
2. UK: ECJ, 12 Dec. 2006, Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue*, ECJ Case Law IBFD; FR: ECJ, 14 Dec. 2006, Case C-170/05, *Denkavit Internationaal BV, Denkavit France SARL v. Ministre de l'Économie, des Finances et de l'Industrie*, ECJ Case Law IBFD; NL: ECJ, 8 Nov. 2007, Case C-379/05, *Amurta SGPS v. Inspecteur van de Belastingdienst/Amsterdam*, ECJ Case Law IBFD; NL: ECJ, 11 June 2009, Case C-521/07, *Commission of the European Communities v. Kingdom of the Netherlands*, ECJ Case Law IBFD; FI: ECJ, 18 June 2009, Case C-303/07, *Aberdeen Property Fininvest Alpha Oy*, ECJ Case Law IBFD; IT: ECJ, 19 Nov. 2009, Case C-540/07, *Commission of the European Communities v. Italian Republic*, ECJ Case Law IBFD; ES: ECJ, 3 June 2010, Case C-487/08, *European Commission v. Kingdom of Spain*, ECJ Case Law IBFD; and PT: ECJ, Order, 22 Nov. 2010, Case C-199/10, *Secilpar – Sociedade Unipessoal SL v. Fazenda Pública*.
3. With regard to the latter, this is specifically relevant if the conditions for exemption from withholding taxation under the EU Parent-Subsidiary-Directive (1990): Council Directive 90/435/EEC of 23 July 1990 on the Common System of Taxation Applicable in the case of Parent Companies and Subsidiaries of Different Member States, art. 5, OJ L 225 (1990), EU Law IBFD are not met, for example, because of the 10% minimum holding requirement.
4. *Aberdeen Property* (Case C-303/07), at para. 52. See also M. Tenore, *Taxation of Cross-Border Dividends in the European Union from Past to Future*, 19 EC Tax Rev. 2, p. 77 (2010).
5. *Aberdeen Property* (Case C-303/07), at para. 71 et seq. and *Commission v. Italy* (Case C-540/07), at paras. 42 et seq. and 56.
6. *ACT Group Litigation* (Case C-374/04), at para. 59.
7. See, inter alia, B. Knobbe-Keuk, *Restrictions on the Fundamental Freedoms Enshrined in the EC Treaty by Discriminatory Tax Provisions – Ban and Justification*, 3 EC Tax Rev. 3, p. 77 et seq. (1994). For a broader perspective, see G. Teixera, *Tax Systems and Non-Discrimination in the European Union*, 34 Intertax 2, p. 52 (2006).
8. DE: ECJ, 26 Oct. 1999, Case C-294/97, *Eurowings Luftverkehrs AG v. Finanzamt Dortmund-Unna*, paras. 43 et seq., ECJ Case Law IBFD; FI: ECJ, 3 Oct. 2002, Case C-136/00, *Rolf Dieter Danner*, para. 56, ECJ Case Law IBFD; and NL: ECJ, 12 Dec. 2002, Case C-385/00, *F. W. L. de Groot v. Staatssecretaris van Financiën*, para. 97, ECJ Case Law IBFD.
9. FR: ECJ, 28 Jan. 1986, Case 270/83, *Commission of the European Communities v. French Republic* (*Avoid fiscal*), para. 21, ECJ Case Law IBFD.
10. See extensively A. Cordewener, *Europäische Grundfreiheiten und nationales Steuerrecht* p. 828 et seq. (O. Schmidt 2002) and J. Englisch, *Dividendenbesteuerung* p. 240 (O. Schmidt 2005).

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taxpayer to non-discriminatory treatment in each partial market of the Internal Market.[11]

The ECJ, therefore, generally does not proceed on the basis of an "overall approach", the "pan-European approach"[12] or "Internal Market approach",[13] which would take an integrated view of the taxpayer's overall situation, thereby combining the treatment in the source and the residence states.[14] Indeed, it is true that the ECJ's case law sometimes "takes a look" across the border to determine a factual situation, for example, when it comes to the overall income of a taxpayer to determine comparability in the source state,[15] so as to avoid "double dips"[16] or when the amount of taxes levied is relevant.[17] Nevertheless, the ECJ has implicitly[18] and explicitly[19] rejected an approach that would, for example, take into account the factual removal of a disadvantage created by the source state as a result of unilateral action by the residence state.

However, a well discussed (and highly relevant) issue is whether or not, and to what extent, treaty relief from international juridical double taxation in the shareholder's residence state might relief the source state from the obligation to extend its domestic relief system to non-residents because such discrimination, i.e. the non-mitigation of domestic economic double taxation, is effectively neutralized.[20] Whilst the ECJ strongly favours a focus on only one Member State, it has, beginning with *Denkavit Internationaal BV v. Ministre de l'Économie* (Case C-170/05) and *Amurta v. Inspecteur van de Belastingdienst* (Case C-379/05),[21] introduced a "treaty-based overall approach" to allow for the neutralization of a discriminatory withholding tax in the source state through a treaty-based tax credit in the taxpayer's residence state. This means that an apparently discriminatory second level of taxation, for example, a withholding tax, which gives rise to economic double taxation in the source state and, at the same time, results in juridical double taxation if the taxpayer's residence state also taxes the distribution, may be in line with the freedoms if the disadvantage is "neutralized" by a treaty credit in the taxpayer's residence state. Accordingly, the removal of international juridical double taxation by the residence state may permit the source state to retain its domestic economic double taxation.

2. Treaty-Based Overall Approach: Treaty "Neutralization" of Source State Discrimination

2.1. Overview

The ECJ's case law on treaty "neutralization" or "compensation" is basically concerned with the question whether or not treaty relief in the shareholder's residence state under a tax treaty might relieve the source state from discrimination. In other words, and in the context of dividend taxation, can treaty relief from the source state taxation of the shareholder, i.e. relieve from juridical double taxation from the residence state's perspective, "neutralize" the discriminatory effects of a non-extension of source state relief, i.e. relief from domestic economic double taxation from the source state's perspective? If the answer to this question is "yes", there would be no discrimination in the first place and possible arguments for justifications would, therefore, not have be considered to uphold the source state's taxation.[22]

It should first be noted that, outside treaty situations, in *Amurta*, ECJ has forcefully rejected a general "overall approach" regarding the issue of cross-border dividends case, in stating that:[23]

> a Member State may not rely on the existence of a full tax credit granted unilaterally by another Member State to a recipient company established in the latter Member State in order to escape the

11. Cordewener, *supra* n. 10, at p. 829 and J. Hey, *Perspektiven der Unternehmensbesteuerung in Europa*, 81 *Steuer und Wirtschaft*, p. 194 (2004).
12. F.A. García Prats, *Is It Possible to Set a Coherent System of Rules on Direct Taxation under EC Law Requirements?*, in *A Vision of Taxes within and outside European Borders – Festschrift in honor of Frans Vanistendael* pp. 432-433 (L. Hinnekens & P. Hinnekens eds., Kluwer 2008).
13. E. Kemmeren, *The Internal Market Approach Should Prevail over the Single Country Approach*, in Hinnekens & Hinnekens, *supra* n. 12, at pp. 561-564.
14. This issue was first raised after DE: ECJ, 14 Feb. 1995, Case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker*, ECJ Case Law IBFD, as it remained unclear if this decision has an effect on countries that do not exempt foreign-source wages, but, rather, provide a foreign tax credit. On this discussion, see, for example, G. Toifl, *Can a discrimination in the state of residence be justified by the taxable situation in the state of source?*, 5 EC Tax Rev. 4, p. 165 (1996); P. Farmer, *EC law and national rules on direct taxation: a phoney war?*, 7 EC Tax Rev. 1, p. 15 et seq. (1998); S. Eden, *Some awfully big questions on tax sovereignty v level playing field*, 4 EC Tax J. , p. 36 (1999); and J.F. Avery Jones, *A Comment on "Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances"*, 40 Eur. Taxn. 8 (2000), Journals IBFD, in response to P. Wattel, *Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why* Schumacker, Asscher, Gilly *and* Gschwind *Do Not Suffice*, 40 Eur. Taxn. 6 (2000), Journals IBFD. See also Kemmeren, *supra* n. 13, at p. 555 et seq.
15. *Schumacker* (C-279/93).
16. *De Groot* (C-385/00), at para. 100 and FI: ECJ, 18 July 2007, Case C-231/05, *Oy AA*, para. 37, ECJ Case Law IBFD. See also J. Englisch, *Taxation of cross-border dividends and EC fundamental freedoms*, 38 Intertax 4, p. 218 (2010).
17. FI: ECJ, 7 Sept. 2004, Case C-319/02, *Petri Manninen*, para. 54, ECJ Case Law IBFD and DE: ECJ, 6 Mar. 2007, Case C-292/04, *Wienand Meilicke, Heidi Christa Weyde, Marina Stöffler v. Finanzamt Bonn-Innenstadt*, para. 15, ECJ Case Law IBFD.
18. GR: ECJ, 29 Apr. 1999, Case C-311/97, *Royal Bank of Scotland plc v. Elliniko Dimosio (Greek State)*, ECJ Case Law IBFD (no consideration of potential credit in the home state in case of discriminatory taxation of a branch in the source state) and DE: ECJ, 15 Feb. 2007, Case C-345/04, *Centro Equestre da Lezíria Grande Lda v. Bundesamt für Finanzen*, ECJ Case Law IBFD (no consideration of potential credit in the home state in case of discriminatory denial of cost deductions in the source state).
19. *Amurta* (C-379/05), at para. 78 and NL: ECJ, 11 Sept. 2008, Case C-43/07, *D.M.M.A. Arens-Sikken v. Staatssecretaris van Financiën*, para. 66, ECJ Case Law IBFD.
20. For an extensive analysis of this discussion up to 2007 see G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* pp. 564-604 (Linde 2007).
21. *Denkavit Internationaal* (C-170/05), at para. 45 et seq.; *Amurta* (C-379/05), at para. 79 et seq.; *Commission v. Italy* (C-540/07), at para. 36 et seq.; *Commission v. Spain* (C-487/08), at para. 58 et seq.; and, *Secilpar* (C-199/10), at para. 40.
22. *Commission v. Italy* (C-540/07), at para. 55 and *Secilpar* (C-199/10), at paras. 41-42.
23. *Amurta* (C-379/05), at paras. 84 and 78; *Arens-Sikken* (C-43/07), at para. 66; and *Commission v. Spain* (C-487/08), at para. 66. A possibly different view was expressed in FR: Opinion of Advocate General *Geelhoed*, 27 Apr. 2006, Case C-170/05, *Denkavit International BV, Denkavit France SARL v. Ministre de l'Économie, des Finances et de l'Industrie*, para. 52, ECJ Case Law IBFD ("whether pursuant to the applicable DTC or otherwise"). For a broader approach, arguing additionally for consideration of unilateral relief, see E. Kemmeren, *ECJ should not unbundle integrated tax systems!*, 17 EC Tax Rev. 1, p. 9 (2008) and *supra* n. 13; B. Terra & P. Wattel, *European Tax Law* 5th ed., pp. 741-745 (Kluwer 2008); and M. Schwenke, *Kapitalertragsteuer bei Streubesitzdividenden gemeinschaftswidrig?*, 17 *Internationales Steuerrecht* 13, p. 477 (2008).

> obligation to prevent economic double taxation of dividends resulting from the exercise of its power to tax in a situation where the first Member State prevents economic double taxation of dividends distributed to companies established in its territory.

Implicitly rejecting the EFTA Court's ruling in *Fokus Bank v. The Norwegian State* (Case E-1/04),[24] the ECJ has, however, adopted an approach that can be described as a "treaty-based overall approach" by acknowledging that Member States may transfer their obligations under EU law by way of bilateral treaties (typically tax treaties).[25] In line with its decisions in *Gilly v. Directeur des Services Fiscaux du Bas-Rhin Case* (Case C-336/96),[26] and *De Groot v. Staatssecretaris van Financiën* (Case C-385/00),[27] and based on the insight that bilateral tax treaties are part of both the legal systems of the concluding states and may, therefore, influence a taxpayer's position, the ECJ has constantly held that the effect of tax treaties must be considered in determining discrimination.[28] Although the ECJ has not yet made a positive application of the "neutralization" argument, the Court, nevertheless, made it clear in *Amurta* and subsequent case law that:[29]

> it cannot be excluded that a Member State may succeed in ensuring compliance with its obligations under the Treaty through the conclusion of a convention for the avoidance of double taxation with another Member State.[30] [It is hence] for the national court to establish whether account should be taken, in the main proceedings, of the DTC, and, if so, to determine whether that convention enables the effects of the restriction on the free movement of capital... to be neutralised.

Such "neutralization" depends on whether the:[31]

> application of the double taxation convention allow the effects of the difference in treatment under national legislation to be compensated for. The difference in treatment between dividends distributed to companies established in other Member States and those distributed to resident companies does not totally disappear unless the tax withheld at source under national legislation can be set off against the tax due in the other Member State in the full amount of the difference in treatment arising under the national legislation.

In so holding, the ECJ is obviously not concerned with the (potential) liquidity disadvantages resulting from the time delay between the application of the (discriminatory) withholding taxation and the availability of the credit.[32]

2.2. Theoretical foundation

The ECJ's "treaty-based overall approach" can be underpinned by various dogmatic considerations.[33] First, "the Member States are free to apportion between themselves not only tax jurisdiction but also priority to taxation".[34] It already follows from this that it is open to the source state, which imposes double economic taxation on dividends, to ensure that, by way of a tax treaty, such taxation is relieved by the home state. Second, "if the effect of the DTC in an individual case were not taken into account, this would ignore the economic reality of that taxable subject's activity and incentives in a cross-border context. Put otherwise, it could distort the real effect on that taxpayer of the combination of home and source State obligations".[35] Conversely, however, it "would be no defense, for example, to argue that the home State had been in breach of its DTC obligations by failing to relieve the relevant economic double taxation".[36] This is exactly the ECJ's approach, which focuses on the effects of a tax treaty and finds that, through such a treaty, the effects of the restriction on the free movement of capital may be neutralized.[37] The ECJ has, therefore, also rejected the contrary view of the EFTA Court in *Fokus Bank*, which had adhered to a "single-country approach".[38] As already implied in *De Groot*,[39] a treaty obligation to grant relief, for example, via a credit, is an obligation under international public law. It is, therefore, part of the legal systems of both the contracting states and, as such, provides a relevant link between the two systems.

The ECJ does not clearly reveal why its recent jurisprudence on neutralization requires a compensatory mechanism, i.e. a tax credit, to be agreed bilaterally.[40] However, Advocate General Mengozzi had reasoned that, under a general overall approach, the discrimination verdict for the source state would effectively depend on another state's tax system. This, in turn, would give rise to friction

24. NO: EFTA Court, 23 Nov. 2004, Case E-1/04, *Fokus Bank ASA v. The Norwegian State*, ECJ Case Law IBFD (imputation system and withholding taxation).
25. Kofler, *supra* n. 20.
26. FR: ECJ, 12 May 1998, Case C-336/96, *Mr and Mrs Robert Gilly v. Directeur des Services Fiscaux du Bas-Rhin*, paras. 23-34, ECJ Case Law IBFD.
27. *De Groot* (C-385/00), at para. 99.
28. SE: ECJ, 19 Jan. 2006, Case C-265/04, *Margaretha Bouanich v. Skatteverket*, para. 51, ECJ Case Law IBFD; *ACT Group Litigation*, (C-374/04), at para. 71; and *Denkavit Internationaal* (C-170/05), at para. 44 et seq.
29. *Amurta* (C-379/05), at para. 83.
30. *Amurta* (C-379/05), at para. 79 and *ACT Group Litigation* (C-374/04), at para. 71.
31. *Commission v. Italy*, (C-540/07), at para. 37 and *Commission v. Spain* (C-487/08), at para. 59.
32. For critical analysis, see G.T.K. Meussen, Denkavit Internationaal: *The Practical Issues*, 47 Eur. Taxn. 5, sec. 3. to 6. (2007), Journals IBFD and M. Lang, *ECJ case law on cross-border dividend taxation – recent developments*, 17 EC Tax Rev. 2, p. 71 (2008), both of who draw a comparison with DE: ECJ, 3 Oct. 2006, Case C-290/04, *FKP Scorpio Konzertproduktionen GmbH v. Finanzamt Hamburg-Eimsbüttel*, ECJ Case Law IBFD.
33. For an extensive analysis, see Kofler, *supra* n. 20. See also the discussion in IT: ECJ, Opinion of Advocate General Kokott, 16 July 2009, Case C-540/07, *Commission of the European Communities v. Italian Republic*, paras. 53-60, ECJ Case Law IBFD.
34. UK: ECJ, Opinion of Advocate General Geelhoed, 23 Feb. 2006, Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation (Pirelli, Essilor and Sony) Test Claimants in Class IV of the ACT Group Litigation (BMW) v. Commissioners of Inland Revenue*, para. 71, ECJ Case Law IBFD.
35. Id., at para. 71.
36. Id.
37. *Amurta* (C-379/05), at para. 83. See also *Denkavit Internationaal* (C-170/05), at paras. 46-47.
38. See also European Union Press Release IP/07/1152, Taxation of outbound dividends: Commission takes steps against Austria, Germany, Italy and Finland (23 July 2007), where the Commission noted that, according to *Denkavit Internationaal* (C-170/05) "it may be relevant to take into account whether the State of residence of the shareholder gives a tax credit to the shareholder for the withholding tax levied by the source State. Up to now, the Commission followed the same approach as the EFTA Court in the *Fokus Bank* case (Case E-1/04), where it explicitly ruled that it was not relevant whether a tax credit was given in the State of residence."
39. *De Groot* (C-385/00), at para. 99.
40. *Amurta* (C-379/05), at paras. 84 and 78; *Arens-Sikken* (C-43/07), at para. 66; and *Commission v. Spain* (C-487/08), at para. 66. For a possibly different (earlier) position in the ECJ's case law, see NL: ECJ, 7 Sept. 2006, Case C-470/04, *N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo*, para. 54, ECJ Case Law IBFD. See also Englisch, *supra* n. 16.

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with the existing tax sovereignty of the Member States.[41] Indeed, an "overall approach" that would also take into account unilateral relief in deciding on the discriminatory effects of the source state's taxation would make the compatibility of one Member State's tax system with EU law dependent on which tax system another Member State has adopted. This, in turn, would clearly restrict the fiscal sovereignty of Member States, as each Member State would be required to adjust its system to the systems of its fellow Member States.[42] The limitation of considering the compensatory effects to those negotiated in binding agreements, such as tax treaties, has found support in the literature,[43] as it avoids an overt contradiction with the general prohibition of counterbalancing tax disadvantages with unrelated tax advantages in other jurisdictions.[44]

However, some scholars argue that unilateral compensation should also be sufficient as long as the discrimination is undone,[45] as, in both scenarios, there is eventually only a budgetary transfer between the two states involved, thereby leaving the absolute tax position of the taxpayer unchanged, i.e. not disadvantaged. Whilst this is true from the taxpayer's perspective, the ECJ's focus is obviously more on the legal framework in the source state, thereby noting that a tax treaty forms part of the applicable legal framework and binds both of the states involved.[46] Only if the tax systems of the two states are linked through a binding international agreement does this have an effect on the analysis of whether or not the source state's restriction can be "neutralized". Put differently, only where two states are linked through a tax treaty, under which the residence state has accepted an obligation to credit source state taxes, can the source state succeed in "transferring" its obligations under EU law to the other state. If the case law is accepted as it stands, the ECJ's approach in *Amurta* and subsequent case law may be distinguished from *De Groot*, where the Court had conceded that Member States may take into account allowances granted unilaterally in another Member State and limit the deductions for personal and family benefits in their own systems accordingly.[47] As Englisch (2010) correctly notes, *De Groot* "dealt with a constellation where an equal treatment in both jurisdictions might lead to 'double dips'",[48] whereas "the dividend cases are concerned with the compensation for seemingly discriminatory treatment in one Member State by specific tax privileges or a lower-than-normal level of taxation in another Member State".[49]

Despite this discussion, a "treaty-based" approach of neutralization is, in any event, perfectly aligned with the ECJ's decision in *Gilly*, according to which the Member States remain at liberty to determine the connecting factors for the inter-se allocation of fiscal jurisdiction by way of bilateral agreements. If, however, the source state were prohibited from levying a tax on outbound dividends despite the fact that it had required the residence state to credit such tax, this would result in a transfer of taxing jurisdiction, as the residence state would be relieved from granting a credit without improving the overall position of the taxpayer. Such an outcome would clearly conflict with *Gilly*, as it would undermine the bilateral allocation of taxing jurisdiction (and tax revenue).[50]

The inclusion of a tax treaty's effects in the discrimination analysis under the fundamental freedoms may effectively provide a "tie-breaker rule" by accepting the agreed taxing priorities between the states involved, thereby avoiding a circular argument to the detriment of the taxpayer. Assume that a residence state only regards a foreign tax as a creditable compulsory charge if the taxpayer has exhausted all of the legal means of reducing the source state tax, including challenges against discriminatory source state taxation under the fundamental freedoms.[51]

41. NL: ECJ, Opinion of Advocate General Mengozzi, 7 June 2007, Case C-379/05, *Amurta S.G.P.S v. Inspecteur van de Belastingdienst*, para. 78, ECJ Case Law IBFD. See also, for example, DE: ECJ, 28 Feb. 2008, Case C-293/06, *Deutsche Shell GmbH v. Finanzamt für Großunternehmen in Hamburg*, para. 43, ECJ Case Law. Compare further, Toifl, *supra* n. 14, at p. 167; D. Weber, *In Search of a (New) Equilibrium Between Tax Sovereignty and the Freedom of Movement Within the EC*, 34 Intertax 12, pp. 590-591 and 599-600 (2006) and Lang, *supra* n. 32.
42. For support of the ECJ's position see, for example, Weber, *supra* n. 41, at pp. 590-591. See also Lang, *supra* n. 32, at pp. 70-72; F. Vanistendael, *Does the ECJ have the power of interpretation to build a tax system compatible with the fundamental freedoms?*, 17 EC Tax Rev. 2, pp. 60-61 (2008); and Englisch, *supra* n. 16. Compare, AG Opinion in *Commission v. Italy* (C-540/07), at para. 50.
43. See, for example, Lang, *supra* n. 32, at p. 71 et seq.; J. Bellingwout, *Amurta: A Tribute to (the Late) Advocate General Geelhoed*, 48 Eur. Taxn. 3 sec. 4.5. (2008), Journals IBFD; D. E. van Sprundel, *An Analysis of the Netherlands Dividend Withholding Tax on Shares – No Need to Abolish This Tax Yet?*, 48 Eur. Taxn. 12, sec. 4.7. (2008), Journals IBFD; and Englisch, *supra* n. 16, with further references.
44. Englisch, *supra* n. 16, with further references.
45. Terra & Wattel, *supra* n. 23 and Kemmeren, *supra* nos. 13 and 23. See also AG Opinion in *Denkavit Internationaal* (C-170/05), at para. 52 ("whether pursuant to the applicable DTC or otherwise").
46. For instance, *Denkavit Internationaal* (C-170/05), at para. 45.
47. *De Groot* (C-385/00), at para. 100.
48. Indeed, according to *Schumacker* (C-279/93) and *De Groot* (C-385/00), it is either the source or the residence state that must grant all of its domestic personal and family benefits. If, however, the source state voluntarily and unilaterally was to provide (part of) its personal and family benefits to non-resident taxpayers and the residence state still had to provide all of its benefits, the result would be double benefits. So what *De Groot* (C-385/00) implies is that the residence state may reduce its benefits to take into account the benefits already received by the taxpayer in the source state. For detailed criticism of *De Groot* (C-385/00), see Terra & Wattel, *supra* n. 23, at pp. 733-737.
49. Englisch, *supra* n. 16. For a different position, see Terra & Wattel, *supra* n. 23.
50. See, in this direction, also H. Loukota, *Ist § 94a EStG wirklich europarechtswidrig?*, 16 *Steuer & Wirtschaft International* 1, p. 16 (2006); J. Bellingwout & S. Baranger, *The Advocate General's Opinion in* Denkavit II, 46 Eur. Taxn. 9 (2006), Journals IBFD. See also Opinion of AG in *Commission v. Italy* (C-540/07), at para. 55. However, Weber, *supra* n. 41, at pp. 598-600, tries to separate the budgetary effects and the allocation of taxing jurisdiction, but seems to neglect the bilateral effect of tax treaties and the reciprocal obligations. With regard to the latter, see SE: Opinion of Advocate General Kokott, 14 July 2005, Case C-265/04, *Margaretha Bouanich*, para. 68 with footnote 54, ECJ Case Law IBFD. In a tax treaty, the contracting states are ultimately only "demarcating their respective tax jurisdictions, thereby governing the division of the tax revenues between themselves".
51. For this discussion in light of DE: Income Tax Law (*Einkommensteuergesetz*), sec. 34c(1), National Legislation IBFD and DE: Corporate Income Tax Law (*Körperschaftsteuergesetz*), sec. 26(1), National Legislation IBFD, see A. Cordewener & A. Schnitger, *Europarechtliche Vorgaben für die Vermeidung der internationalen Doppelbesteuerung im Wege der Anrechnungsmethode*, 83 *Steuer und Wirtschaft*, p. 66 et seq. (2006) and A. Schnitger, *Germany*, in *Key practical issues to eliminate double taxation of business income, cahiers de droit fiscal international*, Vol. 96b, p. 362 (Sdu Uitgevers 2011), Online Books IBFD. See also F. Roser, in *KStG*, 2nd ed., § 26 m.no. 99a (D. Gosch ed., C.H. Beck 2009), who argues that, under the principle of *venire contra factum proprium*, as long as Germany violates its corresponding obligations under EU law, it cannot rely on taxation in violation of EU law in the source state in determining a tax credit.

The residence state, from this perspective, does not credit a discriminatory dividend withholding tax. Conversely, the source state might, nevertheless, rely on the obligation of the residence state to grant a credit under the tax treaty and, in arguing that the residence state must credit such tax under the tax treaty, would not refrain from taxation at source. The ECJ in *Denkavit Internationaal* and *Amurta* has implicitly resolved this potential conflict between the source and residence states and between treaty law and the fundamental freedoms to the benefit of the source state. If the residence state has accepted an obligation to grant a tax credit in a tax treaty, it must accept a source state withholding tax that complies with the tax treaty as a creditable compulsory charge, irrespective of whether or not, in isolation, the withholding tax may be regarded as discriminatory. Of course, the "neutralization" under EU law eventually depends on whether or not such a credit is given. This might again be an issue of the interpretation of the tax treaty or of domestic law, which is not within the ECJ's competence. As noted, however, the EU law perspective reflects on treaty interpretation insofar as the residence state must not interpret the tax treaty so as to not be obligated to grant a credit merely based on the argument that the source state's withholding tax is discriminatory.

2.3. Requirements for "neutralization"

Many details of such a "treaty-based overall approach" remain unclear. For one, a number of scholars[52] and the Commission[53] take the position that "neutralization" requires that the tax treaty envisages a "full credit", including a refund of uncreditable tax by shareholder's residence state,[54] which, of course, is neither required by the OECD Model (2010)[55] nor included in any tax treaty between the Member States.[56] The argument behind this position appears to be that only when a full credit is envisaged in the tax treaty, has the source state, in any event, succeeded in transferring its obligation to remove discrimination to the residence state. A more natural understanding of the ECJ's case law, however, leads to a result-oriented approach that takes into account the dogmatic underpinning of a "treaty-based overall approach" and asks if the credit "enables the effects of the restriction on the free movement of capital to be neutralized".[57] Whilst it appears to be understandable that the ECJ has rejected the "neutralization" argument in infringement cases, i.e. in Commission of the *European Communities v. Italian Republic* (Case C-540/07) and *European Commission v. Kingdom of Spain* (Case C-487/08), where no factual situation was on the table and the typical "ordinary credit" provisions had the potential for discrimination,[58] *Amurta*[59] and *Secilpar v. Fazenda Pública* (Case C-199/10)[60] clearly indicate that "neutralization" depends on the factual neutralization of a discriminatory withholding tax. Such neutralization can also result from an "ordinary credit" (with a credit limitation),[61] if the dividends are sufficiently taxed

52. See, for example, Lang, *supra* n. 32; Bellingwout, *supra* n. 43, at sec. 4.5.2.2.; M. Dasesse, *Belgian Withholding Taxes on Outbound Dividends and Interest: The Challenge of Community Law*, 62 Bull. Intl. Taxn. 8/9, sec. 3.3. (2008), Journals IBFD; A. Cordewener, *EG-rechtlicher Grundfreiheitsschutz in der Praxis – Auswirkungen auf die Quellenbesteuerung Nichtansässiger*, *Internationale Wirtschaftsbriefe* 8, Fach 11 Gr. 2, pp. 977-978 (2009); D. Weber, Commission v Italy. *Higher taxation on cross-border dividend not compensated by ordinary credit in tax treaty; under EEA Agreement general anti-abuse rule justified by the fight against tax evasion*, 3 Highlights & Insights Eur. Taxn. 2, p. 52 (2010); and A. Fortuin, Commission v Spain. *Failure to fulfil obligations. Dividends distributed to resident and non-resident companies. Court of Justice*, 3 Highlights & Insights Eur. Taxn. 9, pp. 61-62 (2010). See also M. Lang, *Verbietet das Gemeinschaftsrecht die Erhebung von Quellensteuern?*, 18 *Internationales Steuerrecht* 15, pp. 543-544 (2009).
53. See the Commission's arguments in pending ECJ, Pending Case C-284/09, *Commission of the European Communities v. Federal Republic of Germany*, OJ, C 256, 8 (2009), where it states that: "Where the relevant Member State has also, as in the present case, concluded a double taxation convention with the other Member States, that Member State may rely on that convention only if its rules concerning offsetting fully compensate the possible economic multiple taxation of shareholders from other Member States or EEA States, and in the same way as is guaranteed to domestic shareholders by its own tax system. That is not, however, the case with respect to the conventions concluded by Germany with the other Member States; in order to prevent double taxation, those conventions provide, indeed, for rules concerning offsetting the German withholding tax against the tax burden in the Member State of the parent company, however, the amount to be taken into account may not exceed the part of the tax assessed prior to the offset, which is imposed on income from Germany. The offset is consequently restricted, a refund of possible funds from the difference between the tax burden in the relevant Member State and the German withholding tax is not provided for in that convention and is therefore excluded."
54. The statements in the Opinion of AG in *Amurta* (C-379/05) on this issue are not entirely conclusive. Whilst Advocate General Mengozzi notes that a "full credit" is required for "neutralization" (para. 87) and that an "ordinary credit" would not be sufficient because "a Portuguese company such as Amurta would continue to bear part of the effects of Netherlands withholding tax" (para. 88), he also states that "[u]nder the partial tax credit mechanism, neutralisation of the effects of Netherlands withholding tax would be possible only if the same tax rate were applied in the Netherlands and Portugal, so that the amount of Netherlands withholding tax were the same as the amount of Portuguese corporation tax applicable to Netherlands dividends and could therefore be completely offset by the latter" (para. 88 together with footnote 42).
55. *OECD Model Tax Convention on Income and Capital* (22 July 2010), Models IBFD.
56. See Englisch, *supra* n. 16, at p. 219.
57. *Amurta* (C-379/05), at para. 84. See also J. Englisch, *Quellensteuerabzug bei Dividenden, die an eine ausländische Empfängergesellschaft ausgeschüttet werden*, 16 *Internationales Steuerrecht* 23, p. 859 (2007) and Vanistendael, *supra* n. 42, at p. 60 ("effective impact of a tax treaty").
58. See also Englisch, *supra* n. 16, at p. 219 and E. Raingeard de la Blétière, *EU Report*, in *Key practical issues to eliminate double taxation of business income*, *supra* n. 51, at p. 76. Indeed, the ECJ has rejected the "neutralization" argument in the infringement cases noting that, as the credit limitation depends on the level of taxation in other states, tax treaties do not "in all cases" allow for the difference in treatment arising from the application of national legislation to be neutralized (*Commission v. Italy* (C-540/07), at para. 39 and *Commission v. Spain* (C-487/08), at para. 64). This, of course, implies that, where factually all of the discriminatory withholding tax is credited "neutralization" indeed takes place.
59. *Amurta* (C-379/05), at para. 83.
60. *Secilpar* (C-199/10), at para. 40.
61. See also, for example, Van Sprundel, *supra* n. 43; A. P. Dourado, Secilpar v Fazenda Pública. *Parent-Subsidiary Directive. Double taxation convention Portugal–Spain. Supreme Tribunal Administrativo*, 3 Highlights & Insights on Eur. Taxn. 10, pp. 88-89 (2010) and Raingeard de la Blétière, *supra*n. 58. This approach has also been taken by domestic courts. For Austria, see the decisions of AT: VwGH, 23 Sept. 2010, 2008/15/0086, Tax Treaty Case Law IBFD and AT: UFS, 13 July 2011, RV/1271-L/10 (both taking into account the tax treaty credit actually given), and, for the Netherlands, the "*dividendmixer*" decision of NL: HR, 8 Aug. 2008, No. 40.586, BNB 2008/255 (holding that an ordinary credit can neutralize a restriction if it in fact leads to a set-off). As the ECJ is not competent to interpret tax treaties or domestic law, it remains unclear what weight should be attached to the fact that the ECJ in *Amurta* (C-379/05) was fully aware of the "ordinary credit" provision in the tax treaty in question, but, nevertheless, left it to the domestic court "to determine whether that convention enables the effects of the restriction on the free movement of capital … to be neutralised" (paras. 10 and 83).

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in the Member State of the shareholder[62] and that, therefore, effectively a full credit results. Conversely, however, the mere fact that the residence state has "allowed" the source state to levy a (withholding) tax in a tax treaty does not relieve the latter from scrutiny under the fundamental freedoms.[63]

From this it also becomes clear that a "neutralization" argument is in vain if a treaty-based credit limitation, which also forms part of both jurisdictions that are linked through a tax treaty, has effect and does not require the residence state to grant any further relief.[64] If, therefore, a credit is, either legally or factually, not available in the residence state, the source state is still under an obligation to tax the shareholder in a non-discriminatory manner.[65] A credit limitation may exclude the crediting of a withholding tax and, therefore, "neutralization" in a number of factual or legal situations, for example, because of a participation exemption;[66] depending on tax rates because of net-taxation of the dividend on which a gross-withholding tax is levied;[67] due to overall losses;[68] or where the residence state provides, in principle, both an indirect tax credit for underlying corporate tax and a treaty-based direct credit for withholding tax, but the indirect tax credit has already "sucked up" the residence state's tax on the dividends.[69] It is, however, unclear as to whether or not and when "neutralization" can occur if the residence state grants a carry-forward of any excess credit.[70]

Another substantive issue is whether or not "partial neutralization" is possible. For instance, in 2009, Austria amended its corporate tax act to comply with *Denkavit Internationaal* and *Amurta* and provide for a refund of (discriminatory) Austrian dividend withholding tax to certain non-resident corporate recipients "insofar as" no treaty credit for the withholding tax is available in the other state.[71] If, depending on the foreign level of taxation, (only) part of the withholding tax may be credited in the shareholder's residence state, Austria (only) refunds the remaining portion. This approach was also adopted by the Austrian Supreme Administrative Court (*Verwaltungs-gerichtshof*).[72] In addition, this position is supported in parts of the literature[73] and appears to be sensible, as the disadvantage to the taxpayer is removed through a combination of a treaty credit in the residence state and a refund in the source state. The ECJ[74] and the Commission,[75] however, appear to require a "full neutralization", i.e. a set-off in the full amount of the disadvantage, and, therefore, adopt an "all-or-nothing" approach. Indeed, not only in infringement cases, but also in respect of the facts in *Secilpar*,[76] has the ECJ stated that the difference in treatment "does not disappear unless the tax withheld at source under national legislation can be set off against the tax due in the other Member State in the full amount of the difference in treatment arising under the national legislation".[77]

It is not immediately clear why the ECJ would favour such "all-or-nothing" approach, given that, from an overall perspective, the disadvantage is also removed in cases of "partial neutralization" combined with a source state refund. Just as with the "all-or-nothing" approach regarding personal and family benefits in *Schumacker* and *De Groot*, where it is either the source or the residence state that must grant all of its domestic personal and family benefits, the ECJ might have taken this position under the impression of (supposed) simplicity.

Finally, from a procedural perspective, it is unclear as to whether the taxpayer or the source state should bear the burden of proof as to whether "neutralization" has (not) occurred via a treaty credit in the residence state. As the source state's tax is, in principle, discriminatory, it has been argued that the source state should bear that

62. *Commission v. Italy* (C-540/07), at para. 38 and *Commission v. Spain* (C-487/08), at para. 62. See also Opinion of AG in *Commission v. Italy* (C-540/07), at paras. 58-59.
63. See also P. Pistone, *Expected and Unexpected Developments of European Integration in the Field of Direct Taxes*, 35 Intertax 2, p. 73 (2007). For a possibly contrary position, see DE: BFH, 22 Apr. 2009, I R 53/07, 18 *Internationales Steuerrecht* 15, p. 551 (2009), with comments by F. Wassermeyer and W. Schön (rejecting the right to a refund of the German treaty-reduced dividend withholding tax that only burdens outbound distributions irrespective of how Switzerland as the shareholder's residence state avoids double taxation). The taxpayers in this case subsequently initiated proceedings before the German Constitutional Court (*Bundesverfassungsgerichtshof*), as the issue was not referred to the ECJ, but the Constitutional Court declined to hear the case (see DE: BverfG, 15 Oct. 2010, 2 BvR 1807/09). Explicitly contra is the decision of the Federal Tax Court (*Bundesfinanzhof*) DE: BFH, 9 Dec. 2009, *FG Berlin-Brandenburg*, 2 K 8172/06 B. The German rules on outbound dividends are now before the ECJ. In this regard, see Pending Case, *Commission v. Germany* (C-284/09) and the analysis by J. Englisch, Germany v. Commission. *Commission refers Germany to the ECJ over its discriminatory taxation of outbound dividends. Press release. European Commission*, 2 Highlights & Insights Eur. Taxn. 5, pp. 62-63 (2009).
64. *Denkavit Internationaal* (C-170/05), at para. 53.
65. It has been argued against the "treaty-based overall approach" that credit and exemption are only two different methods to eliminate juridical double taxation. Nevertheless, both methods work in quite different ways leading to different results for taxpayers. It is, for example, clear that a final withholding tax in the source state becomes a real cost factor if the residence state exempts such foreign income (and possibly tries to achieve capital import neutrality). It, therefore, appears to be the wrong approach to assess the effects of both relief mechanisms based on a hypothetical equalization of the involved tax systems, as it is exactly the tax treaty that links the effectively different systems involved. For a different viewpoint, see Weber, *supra* n. 41, at pp. 603-604.
66. For this situation, see *Denkavit Internationaal* (C-170/05), for example.
67. Fortuin, *supra* n. 52, at p. 62.
68. T. Pons, *The* Denkavit Internationaal *Case and Its Consequences: The Limit between Distortion and Discrimination?*, 47 Eur. Taxn. 5, secs. 4. and 5. (2007), Journals IBFD.
69. See Austrian Independent Fiscal Senate, 13 July 2011, RV/1271-L/10 (2011).
70. For a critical discussion, see Bellingwout, *supra* n. 43, at sec. 4.5.2.2.
71. For discussion of AT: Corporate Income Tax Law (*Körperschaftsteuergesetz*), sec. 21(1)(1a), National Legislation IBFD, see G. Kofler, *Austria: Changes to Austria's Tax Treatment of Outbound Inter-Company Dividends*, 18 EC Tax Rev. 6, pp. 313-314 (2009) and, for an analysis including the most recent changes to Austrian tax law, see G. Kofler & E. Marschner, *Die Quellensteuerrückzahlung bei grenzüberschreitenden Portfoliodividenden nach § 21 Abs 1 Z 1a KStG*, 9 *Zeitschrift für Gesellschaftsrecht und angrenzendes Steuerrecht (GES)* 6, p. 289 et seq. (2011).
72. AT: VwGH, 23 Sept. 2010, 2008/15/0086 (holding that the Austrian withholding tax on outbound inter-company dividends infringes primary EU law "insofar as" no tax treaty credit has been given by the shareholder's residence state).
73. See Van Sprundel, *supra* n. 43.
74. *Commission v. Italy* (C-540/07) , at para. 35 et seq. and Opinion of AG in *Commission v. Italy* (C-540/07), at para. 48 et seq.
75. See the Commission's arguments regarding Pending Case, *Commission v. Germany* (C-284/09).
76. *Secilpar* (C-199/10), at para. 40.
77. *Commission v. Italy* (C-540/07), at para. 37; *Commission v. Spain* (C-487/08), at para. 59; and *Secilpar* (C-199/10), at para. 40.

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burden and prove that the disadvantage is neutralized.[78] This would, however, be very impracticable, as the taxpayer is much closer to the relevant information[79] and it also appears that the ECJ, for example, in *Haribo and Salinen v. Finanzamt Linz* (Joined Cases C-436/08 and C-437/08),[80] and *Meilicke v. Finanzamt Bonn-Innenstadt* (Case C-262/09),[81] has no objections to reasonable procedural burdens on taxpayers in cross-border situations.

3. Conclusions

Beginning with *Denkavit Internationaal* and *Amurta*, the ECJ has introduced a "treaty-based overall approach" to allow for the neutralization of an apparently discriminatory dividend withholding tax in the source state via a treaty-based tax credit in the taxpayer's residence state. This perspective is sensible for a number of reasons, for example, because it honours the treaty allocation of taxing powers between the Member States and it provides for an effective tie breaker that prevents the residence state from denying a credit based on the argument that the source state's withholding tax violates EU law and is, therefore, not compulsory. Whether or not such "neutralization" exists depends on the full neutralization of a discriminatory withholding tax, which can also occur under an "ordinary credit" (with a credit limitation) system, depending, of course, on the fact that dividends are sufficiently taxed in the other Member State. The ECJ also appears to take an "all-or-nothing" approach so that a (potential) "partial neutralization" does not remove the source state's obligation to grant exemption from, or a refund of, the full amount of the discriminatory withholding tax. However, this is the much bigger issue and it is as yet unclear as to whether or not the ECJ is willing to extend the "treaty-based overall approach" beyond dividend withholding taxes to all other income.[82]

78. See, for this position, Fortuin, *supra* n. 52, at p. 62.
79. This appears to be the approach of Austria (see *supra* n. 71), under which the taxpayer must prove that no credit was available to receive a refund of dividends withholding tax that is, in principle, discriminatory.
80. AT: ECJ, 10 Feb. 2011, Joined Cases C-436/08 and C-437/08, *Haribo Lakritzen Hans Riegel BetriebsgmbH, Österreichische Salinen AG v. Finanzamt Linz*, ECJ Case Law IBFD.
81. DE: ECJ, 30 June 2011, Case C-262/09, *Wienand Meilicke, Heidi Christa Weyde, Marina Stöffler v. Finanzamt Bonn-Innenstadt*, ECJ Case Law IBFD.
82. For instance, the potential effect of a tax treaty was not even referred to in *Royal Bank of Scotland* (C-311/97) (concerning a tax rate discrimination of a Greek branch of a UK bank). Likewise, in *Centro Equestre* (C-345/04), at paras. 33-35, the ECJ did not evaluate whether or not a discriminatory disallowance of deductions in the source state may be neutralized by a treaty credit in the home state, but, rather, noted (at para. 35) that the credit method is "appropriate for preventing the double counting of costs since, where it is applied by the first State, that State can check the operating expenses that have been taken into account in calculating the tax paid in the second State".

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