European Union

*Alfredo Garcia Prats, Werner Haslehner, Eric Kemmeren, Georg Kofler, Michael Lang, João Félix Pinto Nogueira, Christiana HJI Panayi, Stella Raventós-Calvo, Isabelle Richelle and Alexander Rust**

Compatibility with Fundamental Freedoms of a Municipal Surcharge Distinguishing between Residents and Non-Residents for the Purposes of the Applicable Rate – Opinion Statement ECJ-TF 4/2023 on the Decision of the EFTA Court of 4 July 2023 in *RS* (Case E-11/22)

In this CFE Opinion Statement, submitted to the EU Institutions in December 2023, the CFE ECJ Task Force comments on the CJEU's decision of 4 July 2023 in *RS* (Case E-11/22), which addressed whether or not municipal surcharges are compatible with the fundamental freedoms.

1. Introduction

This is an Opinion Statement prepared by the CFE ECJ Task Force on the decision in *RS* (Case E-11/22), in which the EFTA Court delivered its decision on 4 July 2023.[1]

At issue in the *RS* case was whether, and to what extent, municipal surcharges are compatible with the fundamental freedoms. In Liechtenstein, workers, at the time in question, were subject to an income tax at the national level. In addition, the income of resident workers was also taxable at the level of the municipality in the form of a municipal surcharge. The tax rates for the municipal surcharge varied from municipality to municipality. Non-resident workers were not subject to the municipal surcharge but to a surcharge that was a supplementary national tax. The tax rate for the supplementary national tax was higher than the highest municipal tax rate. The EFTA Court ruled that such a surcharge infringed the fundamental freedoms and that a deferral of the application of the fundamental freedoms was not permissible in that case.

2. Background, Facts and Issues

In this case, RS was an individual taxpayer of German nationality who was resident in Switzerland. During the 2019 tax year, RS worked in the Liechtenstein public service. He was subject to limited tax liability on his employment income in Liechtenstein as permitted by the applicable tax treaty. For the tax year at issue, taxpayers resident in Liechtenstein had to pay a national income tax on their employment income, as well as a municipal surcharge. Municipalities could set the rate between 150% and 250%. However, in that year, the existing municipal surcharges varied between 150% and 180%, depending on the municipality. Non-residents were also subject to the national income tax but did not pay any municipal surcharge. They were instead subject to a supplementary national tax. For income from employment, that supplementary national surcharge for non-residents was fixed at a rate of 200% (which was the mid-point of the rate range allowed by Liechtenstein law).

As a result, RS had to pay a higher tax on his income from employment compared to resident taxpayers. The Constitutional Court of Liechtenstein had already dealt with the question of compatibility of the supplementary national tax with the EEA Agreement.[2,3] It annulled the legal basis

* **The CFE ECJ Task Force is formed by CFE Tax Advisers Europe and its members are Alfredo Garcia Prats (Professor at the University of Valencia), Werner Haslehner (Professor at the University of Luxembourg), Eric Kemmeren (Professor of International Taxation and International Tax Law at the Fiscal Institute Tilburg of Tilburg University), Georg Kofler (Chair of this Task Force and Professor at the Institute for Austrian and International Tax Law of WU Vienna), Michael Lang (Professor at the Institute for Austrian and International Tax Law of WU Vienna), João Felix Pinto Nogueira (Deputy Academic Chairman at IBFD and Professor at Law School, Universidade Católica Portuguesa), Christiana HJI Panayi (Professor at Queen Mary University of London), Stella Raventós-Calvo (President of AEDAF and Vice-President of CFE), Isabelle Richelle (Co-Chair of the Tax Institute, University of Liège, Brussels Bar) and Alexander Rust (Professor at the Institute for Austrian and International Tax Law of WU Vienna). The Task Force is supported by Aleksandar Ivanovski (Director of Tax Policy, CFE) and Brodie McIntosh (Tax Policy Analyst, CFE). Although the Opinion Statement has been drafted by the ECJ Task Force, its content does not necessarily reflect the position of all members of the group. The CFE ECJ Task Force was founded in 1997 and its founding members were Philip Baker, Paul Farmer, Bruno Gangemi, Luc Hinnekens, Albert Raedler†, and Stella Raventós-Calvo. For further information regarding this opinion statement, please contact Prof. DDr. Georg Kofler, Chair of the CFE ECJ Task Force or Dr. Aleksandar Ivanovski, Director of Tax Policy at info@taxadviserseurope.org.**

1. LI: ECJ, 4 July 2023, Case E-11/22, *RS v. Fiscal Authority of the Principality of Liechtenstein (Steuerverwaltung des Fürstentums Liechtenstein)*, Case Law IBFD.
2. Agreement on the European Economic Area (2 May 1992), Primary Sources IBFD.
3. LU: Constitutional Court of Liechtenstein, 1 Sept. 2020, StGH 2019/095.

providing for a national surcharge of 200% but deferred the operative date of the annulment by one year to give the legislator enough time to bring the Tax Act in conformity with the EEA Agreement (1992).

RS appealed the tax assessment, arguing that he was discriminated against in comparison to resident taxpayers. The Administrative Court decided to stay the proceedings and requested an advisory opinion from the EFTA Court. It submitted the following question:[4]

> Must Articles 3, 4 and 28(2) of the EEA Agreement be interpreted as precluding the application of a higher tax rate to the taxation of earnings gained by activity in Liechtenstein as an employed person by nationals of an EEA Member State who are not resident for tax purposes on national territory (Liechtenstein), compared to persons liable to tax who are resident for tax purposes on national territory (Liechtenstein), when assessing taxes in respect of the tax years up to 2020, insofar as they have not yet been finally assessed?

3. The Decision of the EFTA Court

The EFTA Court analysed the request, as well as the written observations submitted by the interested parties and referred to the questions asked by the Liechtenstein Administrative Court. In order to realize the purpose of the cooperation between the national Court and the EFTA Court provided for in article 34 of the Surveillance and Court Agreement (hereinafter SCA),[5] the request must be understood as meaning that the referring court seeks an answer to two questions:

– first, whether article 28 of the EEA Agreement and/or article 4 of the EEA Agreement must be interpreted as precluding national legislation pursuant to which an EEA state applies a higher rate of taxation to income gained through an employment activity exercised in that state by non-resident EEA nationals compared to residents of that state; and
– second, if that question is answered in the affirmative, the referring court seeks to determine whether EEA law must prevail irrespective of any deferral required by national law.[6]

With regard to the first question, the EFTA Court held that EFTA states must exercise their competence in the area of taxation consistently with EEA law.[7] Article 4 of the EEA Agreement, constituting the general non-discrimination clause, applies independently only to cases in which no specific rules prohibiting discrimination exist. Such principle is given explicit expression and effect in article 28 of the EEA Agreement. The free movement of workers entails the abolition of any discrimination based on nationality between workers of EU Member States and EFTA states as regards employment, remuneration and other conditions of work and employment. Any EEA national who has exercised the right to freedom of movement for workers and who has been employed in another EEA state falls within the scope of article 28 of the EEA Agreement. This includes the situation of an EEA national who works in an EEA state other than that of their actual place of residence.[8]

Article 28(2) of the EEA Agreement entails the abolition of all discrimination based on nationality between workers of the EEA states, particularly with regard to remuneration. This principle of equal treatment with regard to remuneration would be rendered ineffective if it could be undermined by discriminatory national provisions on income tax.[9]

The EFTA Court then reiterated its prior case law that the non-discrimination rules not only forbid overt discrimination by reason of nationality but also all covert forms of discrimination that, by the application of other distinguishing criteria, lead to the same result. As a consequence, the free movement of workers prohibits an EEA state from adopting a measure that favours workers resident within its territory if that measure ultimately favours that EEA state's own nationals. Such measures mainly operate to the detriment of nationals of other EEA states, since non-residents are, in the majority of cases, foreign nationals.[10] Residence serves as a proxy for nationality and distinctions on the basis of residence lead to indirect discrimination by reason of nationality.

Discrimination can arise through the application of different rules to comparable situations or through the application of the same rule to different situations. In general, with regard to direct taxes, the situation of residents and non-residents is not comparable. Citing its prior case law,[11] the EFTA Court stated that a non-resident taxpayer, however, is objectively in the same situation as a resident taxpayer if he receives all or almost all of his income in the state where he works.[12] As a consequence, non-residents, such as the applicant in the main proceedings, who earn all or almost all of their worldwide income in Liechtenstein, are in a comparable situation to those persons who reside and work in Liechtenstein. The fact that the tax for resident taxpayers is levied at the level of the municipality and the tax for non-resident taxpayers is levied at the level of the central government does not make the two situations incomparable.[13]

With regard to differences in the tax rate, it is not even necessary that the non-resident earn all or almost all of his income in the working state. The status of residence, or non-residence of an EEA national, is irrelevant with regard to the calculation of the tax rate. For tax rate distinctions, non-residents and residents are always in a similar situation. If non-residents are taxed at a higher rate compared to similarly situated resident taxpayers, that different treatment constitutes indirect discrimination based on the criterion of residence, which is contrary to article 28 of the EEA Agreement.[14]

4. *RS* (E-11/22), para 18.
5. Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice, OJ L 344 (1994).
6. *RS* (E-11/22), para. 26.
7. Id., para. 27.
8. Id., para. 29.
9. Id., para. 30.
10. Id., para 31.
11. IE: EFTA Court, 27 June 2014, E-26/13, *Íslenska ríkið v. Atli Gunnarsson*, paras. 86 and 87.
12. *RS* (E-11/22), para. 32.
13. Id., para. 33.
14. Id., paras. 34 and 35.

The EFTA Court concluded that article 28 of the EEA Agreement must be interpreted as precluding national legislation that applies a higher tax rate to employment income earned by EEA nationals who are not residents of Liechtenstein compared to the tax rate for employment income earned by EEA nationals who are residents of Liechtenstein.[15]

The EFTA Court then dealt with the consequences of a breach of the EEA Agreement. Although EEA law prevails over national provisions, the Constitutional Court of Liechtenstein deferred the date on which its annulment of the provision contrary to article 28 of the EEA Agreement took effect. The Constitutional Court justified the deferral on grounds of legal certainty.

The EFTA Court held that any provision of national law that contradicts the EEA Agreement must be disapplied if the provision of EEA law in question is unconditional and sufficiently precise. Article 28 of the EEA Agreement meets these requirements. The Court interprets EEA law and clarifies the meaning of EEA rules as they must be understood and applied from the time of their entry into force. As a consequence, an unconditional and sufficiently precise EEA rule must be fully and uniformly applied in all the EEA states from the day on which the respective legal act of the EEA Agreement entered into force.[16]

It is only in exceptional situations that EEA states may temporarily maintain the effects of national rules that are contrary to EEA law in order to conform with the principle of legal certainty. However, such a deferral of the effects of the EEA Agreement is only permissible if two conditions are fulfilled simultaneously: first, the persons concerned must have acted in good faith and, second, there must be a risk of serious difficulties. The first criterion requires the risk of serious economic repercussions because individuals and national authorities had been led to adopt practices in good faith that did not comply with EEA law by reason of objective, significant uncertainty regarding the implications of provisions of EEA law, to which the conduct of other EEA states, the EFTA Surveillance Authority or the Commission may even have contributed. As for the second criterion, mere budgetary and administrative problems that might arise from the immediate annulment of the contested provision are not sufficient to fulfil the requirement of serious difficulties. If the cumulative criteria are not fulfilled, the temporal effects of article 28 of the EEA Agreement may not be limited.[17]

A judicial decision that temporally limits the effects connected with a declaration of nullity deprives EEA taxpayers of the right to obtain a refund of the taxes unduly levied. The right to a refund of taxes levied by an EEA state in breach of EEA law is the consequence and complement of the rights conferred on individuals by provisions of EEA law prohibiting such taxes. EEA states are, in general, required to refund taxes levied in breach of EEA law. An effective remedy also includes interest on the refund.[18]

Taxpayers whose tax assessments have been finally concluded must also be able to benefit from remedies for breaches of the rights under EEA law, to the extent that such remedies are available to them under national procedural law. An EEA state has to respect the principles of equivalence and effectiveness. If a refund plus interest is not possible, the EEA state is obliged to provide compensation for loss and damage in accordance with the principle of state liability.[19]

4. Comments

The decision of the EFTA Court gives guidance on the compatibility of municipal and national surcharges with the fundamental freedoms of the EEA Agreement. It is equally applicable to the design of regional or state surcharges. The reasoning of the EFTA Court on the basis of the EEA Agreement is also relevant to the application of the fundamental freedoms of the Treaty on the Functioning of the European Union (TFEU) (2007).[20]

The Liechtenstein Constitutional Court should be supported in its decision to directly apply EEA Law. However, by deferring the application of EEA law by one year, and thereby granting the legislator a grace period of one year to implement an EEA compliant solution, it has not ensured the full application of EEA law. The EFTA Court made it clear that there are no reasons to grant such a deferral under EEA law.

The wording of the fundamental freedoms of the EEA Agreement and of the TFEU is nearly identical, for example, the provisions for the free movement of workers (article 28 of the EEA Agreement and article 45 of the TFEU), the freedom of establishment (article 31 of the EEA Agreement and article 49 of the TFEU), the freedom to provide services (article 36 of the EEA Agreement and article 56 of the TFEU) and the free movement of capital (article 40 of the EEA Agreement and article 63 of the TFEU). Both the EFTA Court and the Court of Justice of the European Union (CJEU) interpret the fundamental freedoms of the EEA Agreement in light of its purpose to promote a continuous and balanced strengthening of trade and economic relations between the contracting parties under equal conditions of competition with a view to creating a homogeneous European Economic Area.[21]

The EEA Agreement contains provisions on the fundamental freedoms and State aid. However, secondary EU law is not binding on non-EU Member States. For that reason, it is no longer obvious that the normative framework of the EU and EEA situations is always identical.

15. Id., para. 36.
16. Id., paras. 41 and 42.
17. Id., paras. 45-49.
18. Id., paras. 52 and 53.
19. Id., para. 59.
20. Treaty on the Functioning of the European Union of 13 December 2007, OJ C115 (2008), Primary Sources IBFD.
21. *See* AT: ECJ, 23 Sept. 2003, Case C-452/01, *Margarethe Ospelt and Schlössle Weissenberg Familienstiftung*, Case Law IBFD and NO: ECJ, 23 Nov. 2004, Case E-1/04, *Fokus Bank ASA v. The Norwegian State*, Case Law IBFD.

The EFTA Court did not hesitate to rule on the case, which was "triangular": The applicant was a German national (an EEA state), residing in Switzerland (not an EEA state) working in Liechtenstein (an EEA state). Hence, the EEA Agreement clearly applied to the applicant subjectively, but he was not discriminated against because of his residence in an EEA state, but rather because he was a non-resident of Liechtenstein. The EFTA Court hence observed "that the applicant, a German national, was resident during the relevant 2019 tax year in Switzerland, rather than in an EEA State", and noted that the "question raised does not relate solely to the applicant's situation but more generally to the compatibility with EEA law of an item of national legislation, as described by the referring court".[22] It therefore seems that the EFTA Court answered the preliminary questions for two distinct reasons and did not discard them as hypothetical: first, the Court found that the EEA free movement of workers applies in the case at issue and prohibits discrimination of non-resident EEA nationals, wherever residing (i.e. whether resident of an EEA state, such as Germany, or a non-EEA state, such as Switzerland).[23] Second, referring to *Cilevičs* (Case C-391/20),[24] the EFTA Court took into account the broader implications of its findings on all EEA nationals not residing in Liechtenstein, which justifies the Court giving an answer to the questions put to it in relation to the EEA fundamental freedoms.

The EFTA Court generally followed the interpretation of the fundamental freedoms of the CJEU. Article 6 of the EEA Agreement requires that the provisions of the Agreement be interpreted, in so far as they are identical in substance to the provisions of the TFEU, in conformity with the decisions of the CJEU rendered prior the entry into force of the EEA Agreement (2 May 1992). According to article 3(2) of the SCA,[25] the EFTA Court shall pay due account to the principles laid down by the relevant decisions of the CJEU given after the date of signature of the EEA Agreement. In fact, the EFTA Court tries to interpret the provisions of the EEA Agreement in line with CJEU case law decided prior to and after 2 May 1992 in order to establish a common interpretation.[26]

It can be assumed that the CJEU would have decided this case in a similar way. A higher tax liability on non-resident employees compared to resident employees would not be compatible with the free movement of workers enshrined in article 45 of the TFEU.[27] If a supplementary national tax for non-residents exceeds the amount of a municipal surcharge for resident taxpayers, the free movement of workers is being infringed.

EU law requires the higher supplementary national tax to be disregarded and to apply instead the lower municipal surcharge. Unless a new ground of justification is found, if different municipalities have different tax rates, the non-resident taxpayer is entitled to be taxed in accordance with the lower of the municipal tax rates. This would be in line with the CJEU's decision in *Commission v. Spain* (Case C-127/12).[28]

It is a different question, however, how a Member State should remedy this discrimination from a tax policy perspective, where several options are feasible. If a municipality, region or state in a federal tax system wants to apply different tax rates to non-resident/out of state taxpayers, it is advised not to choose residence as a nexus for taxation. Equal treatment between resident and non-resident taxpayers could be achieved by choosing the location where the income arises as a nexus. This way, taxpayers resident in a specific municipality and working in this municipality would be treated in the same way as non-resident taxpayers who are working in the same municipality. In practice, the implementation of such a solution could prove difficult.

5. The Statement

The CFE ECJ Task Force welcomes the decision of the EFTA Court in the *RS* case. Although the EFTA Court had to interpret the EEA Agreement, the case is equally relevant to the interpretation of the fundamental freedoms of the European Union. The EFTA Court clarified the compatibility of municipal surcharges with the fundamental freedoms. In essence, non-resident taxpayers may not be taxed at a higher rate than resident taxpayers in a similar situation. If the tax rate of municipal surcharges varies between municipalities, the maximum tax rate for the non-resident taxpayer is the lowest municipal tax rate. The CFE ECJ Task Force agrees with the findings and the reasoning of the EFTA Court. It believes that the decision can be equally applied in an EU context.

22. *RS* (E-11/22), para. 21, referring to LV: ECJ, 7 Sept. 2022, C-391/20, *Boriss Cilevičs and Others*, EU:C:2022:638, para. 32.
23. *See also RS* (E-11/22), para. 59 ("individuals such as the applicant in the main proceedings").
24. *Boriss Cilevičs and Others* (C-391/20).
25. *Supra* n. 5.
26. NO: EFTA Court, 9 July 2014, Joined Cases E-3/13 and E-20/13, *Fred. Olsen and Others v. the Norwegian State*, para 110.
27. *See* NL: ECJ, 27 June 1996, Case C-107/94, *P.H. Asscher v. Staatssecretaris van Financiën*, Case Law IBFD and DE: ECJ, 12 June 2003, Case C-234/01, *Arnoud Gerritse v. Finanzamt Neukölln-Nord*, Case Law IBFD.
28. ES: ECJ, 3 Sept. 2014, Case C-127/12, *European Commission v. Kingdom of Spain*, Case Law IBFD.