Editorial

Most-favoured-nation Clause in European Tax Law?

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In the court hearing on the Schumacker case (C-279/93[2]) on 18 October 1994, Judge Joliet of the European Court of Justice asked all parties present (amongst them five Member States in addition to Germany which was the defendant) two questions:

1. Is it correct that, if Mr. Schumacker had lived in the Netherlands instead of Belgium, there would be no case because of the more favourable provisions for cross-border workers in Germany under a specific German-Dutch agreement?
2. In the affirmative, is such a result acceptable under the principles of European law?

Whereas everybody more or less agreed to the first statement, the representatives of the Member States did their best to evade a clear answer to the second question. The lawyer for the German government replied that Germany and the Netherlands are renegotiating the treaty and that it was quite possible that the new convention will no longer contain this special treatment for Dutch cross-border workers.[3]

Very briefly, the facts of the case are the following: Roland Schumacker, a national and resident of Belgium worked exclusively over the border in Germany as an employed chimney bricklayer. Since, under the German rules, he was not resident in Germany, he did not get family-related benefits including income splitting for husband and wife as a resident taxpayer would do. Altogether these differentials amounted to DM 8.000 p.a. (in the meantime Germany has somewhat adapted its domestic law, which, in his case, reduced the disadvantage roughly by half).

In his quite lengthy report of 22 November 1994 Ph. Léger, the advocate general, did not mention this issue. In the final decision of 14 February 1995 the Dutch-German agreement was not referred to in order to refute the German position that it is administratively not feasible to take into account the non-resident's personal situation.

What does Judge Joliet's second question mean in a wider context? Did he indicate that a Member State may no longer conclude a bilateral agreement with another Member State to the disadvantage of nationals and residents of other Member States?

This quite complicated issue shall be approached by three simple statements:

1. Clearly, there is no general principle in the Treaties of Rome or Maastricht which would require implementation of a full most-favoured-nation principle in tax treaties between Member States. The existence of Article 220 is an excellent argument in that respect.
2. On the other hand, bilateral agreements between Member States may not violate community law. This is particularly true in the area of the fundamental freedoms such as free cross-border flow of goods, services, labour and capital within the Community.
3. Just as well Member States may not conclude tax treaties with third countries which would violate substantial interests of nationals and/or companies resident in other Member States.

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[2] Decision of 14 February 1995 (in favour of Mr. Schumacker).

[3] For more details *see* Rädler, 'EuGH: Mündliche Verhandlung Im Fall Schumacker' – 'Ehegattansplitting bei beschränkt steuerpflichtigen Grenzgängern', *Finanz-Rundschau* 1994, pp. 705–709.

Luc Hinnekens has brilliantly explained these points in the last issue of this journal.[4]

These points should be illustrated by two examples:

1. The withholding tax rates on interest or on royalties paid between an enterprise of a specific Member State and an enterprise of another Member State still may vary from 0 per cent to perhaps 15 per cent. This makes it impossible for an enterprise resident in one of the less advantageous Member States to compete with companies from the more fortunate Member States.
2. Another good example is that French and UK companies get back 50 per cent of the corporation tax paid by an Italian subsidiary, provided there is distribution, whereas companies from other Member States get nothing. In my view, this treatment is a clear violation of Article 52 of the Treaty.

In those instances as well as in the situation of Mr. Schumacker mentioned by Judge Joliet, a solution in line with European law may only treat alike all Union nationals and residents from all Member States. This can only be achieved by extending such privileged treatment automatically to all individuals and companies resident within the Union who are taxpayers. Thus, capital-import neutrality is achieved in those limited areas, i.e. a level playing field for all players from within the Community is created. In my view, achieving a level playing field requires the most-favoured-nation approach.

[4] Hinnekens, 'Compatibility of Bilateral Tax Treaties with European Community Law – The Rules', *EC Tax Review* 1994/4 pp. 146–166.