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A FIRST REACTION TO *ASSCHER*

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The Court of Justice's recent decision in *P H Asscher v Staatssecretaris van Financien*[2] adds to the Court of Justice's ever expanding jurisprudence on Articles 48 and 52 of the EC Treaty. Briefly stated, the facts in *Asscher* were as follows. Mr Asscher was a Netherlands national who had lived in Belgium since 1986. The dispute concerned the correct taxation in the Netherlands of Mr Asscher's income for 1990. At that time he held a directorship of a Netherlands company (of which he was the sole shareholder) and also worked in Belgium as a manager for a Belgium company. He paid insurance contributions to Belgium's compulsory social security scheme and was not obliged to contribute to the Netherlands social security scheme. Netherlands tax law provided that, irrespective of nationality, non-Netherlands residents like Mr Asscher who derived less than 90% of their income from the Netherlands and who were not obliged to contribute to the Netherlands social security scheme were subject to wages and income tax at 25%. Had Mr Asscher earned more than 90% of his income in the Netherlands he would only have paid income tax at the rate of 13% (although he would then have been liable to pay into the Netherlands social security scheme at the additional rate of 22.1%).

Mr Asscher appealed against the assessment to tax on his Netherlands income at 25% on the grounds that it constituted indirect discrimination contrary to Articles 7 and 48 of the EC Treaty. His appeal in the lower courts was unsuccessful, but the matter was eventually referred to the Court of Justice by the Netherlands Supreme Court under the auspices of Article 177.

In substance, the questions posed by the Supreme Court to the Court of Justice were as follows:

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2 Case C-107/94 [1996] STC 1027. Once again, the importance of the decision can be seen by the number of governments which felt compelled to make observations to the Court, namely Belgium, France, Germany, the Netherlands and the United Kingdom.

(1) Can a national of a Member State who now works in another Member State rely on Article 48 of the EC Treaty as against his State of origin?

(2) Can Article 48 of the EC Treaty be interpreted as precluding a Member State from applying to a Community national who works within its territory and at the same time works and lives in another Member State, a higher rate of income tax than that applicable to its own residents?

(3) Is the answer to question (2) affected by the fact that the taxpayer earns less than 90% of his earnings in that Member State?

Interestingly, the first point decided by the Court of Justice was that the relevant provision of the EC Treaty was Article 52 not Article 48. This was because the Netherlands company for which Mr Asscher worked was a "one-man company", i.e., Mr Asscher was the sole shareholder and director. The Court disregarded the separate legal personality of the Netherlands company and held that Mr Asscher was not a "worker" within the meaning of Article 48 on the grounds that he did not perform services for and under the direction of another person.[3] Accordingly, Mr Asscher should be considered as self-employed and thus the issue for the Court was whether or not Netherlands legislation was compatible with Article 52 of the EC Treaty.[4]

Taking the questions posed to the Court in order, the Court's answer to the first question was, at first sight, straightforward - Article 52 applies to a Member State's own nationals working within its territory provided that they are attempting to exercise rights guaranteed by the EC Treaty. This prevents Member States from denying their own nationals the "fundamental freedoms" that they must guarantee for non-nationals. However, the *Asscher* judgment is one of the first decisions on the point (previous cases having generally been concerned with the right to rely on trade or professional qualifications acquired in the other Member

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3 "Worker" is not defined in the EC Treaty and is therefore subject to determination by the Court of Justice. The test for employment applied in *Asscher* was established in *Lawrie-Blum v Land Baden-Württemberg* Case 66/85 [1986] ECR 2121, paragraph 17. As a matter of English company law it is possible for a person to both wholly control a company (as principal shareholder and sole director) and be a worker for that company, *Lee v Lee's Air Farming Ltd* [1961] AC 12, although more than mere directorship is required.

4 The Court did, however, hold at paragraph 29 that: "In any event .... a comparison of Articles 48 and 52 ... shows that they are based on the same principles both as regards entry into and residence in the territory of the Member States by persons covered by Community law and as regards the prohibition of all discrimination against them on the grounds of nationality."

State).[5] And it must be said that the Court's conclusion in *Asscher* is not immediately apparent from the strict wording of Article 52 of the EC Treaty:

> "... restrictions on the freedom of establishment of nationals of a Member State *in the territory of another Member State* [emphasis supplied] shall be abolished by progressive stages in the course of a transitional period. Such progressive abolition shall also apply to restrictions on the setting up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.
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> Freedom of establishment shall include the right to take up and pursue activities as self-employed persons, and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 58, under the conditions laid down for its own nationals by the law of the country where such establishment is effected subject to the provisions of this Chapter relating to capital."[6]

It is clear from this that the framers of the EC Treaty had discrimination by a Member State against nationals of another Member State in mind. Although the Court has in the past held that Article 52 prohibits a Member State from restricting its own nationals from leaving its territory in order to set up an establishment in another Member State,[7] the Court's application of the Treaty to a Member State's own nationals working within its territory represents a potential increase in the Court's powers. The decision stands in direct factual contradiction to *Werner v Finanzamt Aachen-Innenstadt*[8] in which the Court held that Article 52 did not preclude a Member State from taxing its nationals carrying on business within its

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5 See *Knoors v Secretary of State for Economic Affairs* Case 115/78 [1979] ECR 399, *Bouchoucha* Case C-61/89 [1990] ECR I-3551 and *Kraus v Land Baden-Württemburg* Case C-19/92 [1993] ECR I-1663. These cases can be contrasted with *Ministere Public v Vincent Auer* Case 136/78 [1979] ECR 437, [1979] 2 CMLR 373. It was, of course, accepted that the EC Treaty could not be applied to matters which are purely internal to a Member State - see paragraph 32 of the Court's judgment in *Asscher*.

6 Further EC legislation in the context of Article 48 makes it clear that the principle of free movement of workers requires that nationals of a Member State working in *another* Member State enjoy the same taxation treatment as nationals of that other Member State working there, Article 7 of Council Regulation EEC No. 1612/68 15 October 1968 on the freedom of movement of workers within the Community, OJ English Special Edition 1968, (II) p 475.

7 *R v HM Treasury and Commissioners of Inland Revenue ex parte Daily Mail and General Trust plc* Case 81/87 [1988] ECR 5483, [1988] 3 CMLR 713, paragraph 16.

8 Case C-112/91 [1993] ECR I-429.

territory more heavily if they were non-resident. Although the Court justified its decision in *Werner* by claiming that the taxpayer was not exercising any of the rights guaranteed by the EC Treaty (a point picked up by Advocate General Léger[9] in *Asscher* who argued that Mr Asscher, unlike Mr Werner, had exercised his rights under the EC Treaty by emigrating to Belgium to carry on an economic activity there) - the weakness of this reasoning has been noted by commentators.[10] *Werner*, it is submitted, is unlikely to be upheld in the future.

The Court's introductory remarks in answer to the second and third questions put to it were both predictable and paradoxical. The Court re-iterated the now settled law that national tax legislation which lays down a distinction in tax treatment founded on residence can constitute indirect discrimination on the grounds of nationality for the purposes of both Article 48 and Article 52 of the EC Treaty.[11] The Court was untroubled by the fact that the usual justification for this statement - that legislation which discriminates on the grounds of residence is likely to operate to the disadvantage of *non*-nationals - was patently untrue in the specific case of Mr Asscher who was disadvantaged because of his tax residence not his nationality.

The Court then went on to state the "*Schumacker*" test that such discrimination would only exist if (a) different rules were applied to comparable situations or (b) the same rule was applied to different situations.[12] However, the subsequent application of this test may cause readers some surprise. The Court considered that it was concerned with aspect (a) of the *Schumacker* test, so the question for decision was whether non-resident taxpayers working in the Netherlands like Mr Asscher were in a comparable situation to Netherlands resident taxpayers pursuing the same economic activity there. In making such comparisons, the Court recognised that:

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9 Paragraph 44.

10 See, inter alia, Farmer and Lyal, *EC Tax Law* (1994) at pp 323-324, Flynn and Brannan *Tax Journal* 21st July 1995 at p 75 and Knobbe-Keuk [1993] *CML Rev* 1229 at pp 1233-1234. Advocate General Léger commented in *Asscher* (paragraph 41) that the Court will eventually have to rule on this aspect - see Directive 90/364 on the right of residence which was not in force when *Werner* was decided.

11 See, inter alia, *Biehl v Administration des Contributions* Case C-175/88 [1990] ECR I-1779, [1990] 3 CMLR 143, paragraph 12, *R v Inland Revenue Commissioners ex parte Commerzbank* Case C-330/91 [1993] ECR I-4017, [1993] 3 CMLR 457, paragraph 15, and *Finanzamt Köln-Altstadt v Roland Schumacker* Case C-279/93 [1995] STC 306, paragraphs 28 and 29.

12 See paragraph 30 of the *Schumacker* judgment, affirmed *Wielockx v Inspecteur der Directe Belsatingen* Case C-80/94 [1995] STC 876, paragraph 17.

> "...a Member State in which a non-resident taxpayer works may be justified in refusing him ... [tax] benefits where he does not receive all or almost all of his income in that State, since comparable benefits are granted in the State in which he resides and which is responsible, under international tax law, for taking personal and family circumstances into account."[13]

The taxpayer won his case in *Schumacker* because he had insufficient taxable income in his State of residence to take account of his family and personal circumstances with the result that, in the State in which he worked, there was no objective difference between him and a resident taxpayer engaged in comparable employment. It had been hoped that when deciding *Asscher* the Court of Justice would take the opportunity to resolve some of the questions posed by its decision in *Schumacker* (and the subsequent application of that decision in *Wielockx*) such as the level of income at which a non-resident risked discriminatory treatment.[14] Unfortunately, the Court in *Asscher* did not address the issue in that way. Thus the case of a non-resident taxpayer receiving "all or almost all" of his income in a Member State is only *one example* of residents and non-residents of a Member State being comparable for the purposes of the EC Treaty.

In *Asscher*, the Court assessed "comparability" in a different way. It considered the assertion by the Netherlands government that the higher rate of tax applicable to non-residents earning less than 90% of their world-wide income in the Netherlands was necessary to offset the fact that non-residents escaped the progressive nature of Netherlands tax by only paying tax on income received in the Netherlands. It then went on to comment that non-resident and resident taxpayers were in a comparable situation because under Article 24(2)(1) of the Belgium/Netherlands double tax treaty Belgium could take Mr Asscher's taxed Netherlands income into account in determining the rate of tax to be applied to the balance of his income. Thus residents and non-residents were in comparable situations with regard to the "rule of progressivity" and the application of a higher rate of tax by the Netherlands government to the income of non-residents constituted indirect discrimination in breach of Article 52 of the EC Treaty.[15] Quite how the Court would have decided the point if the Belgium income tax regime was proportional or regressive remains an open question. Those who are uneasy with the Court's increasing involvement in the field of direct taxation may feel that the fact that Belgium could take Mr Asscher's taxed Netherlands income into account in determining the rate of Belgium tax to be applied to the balance of his income shows precisely why Mr Asscher was *not* in a comparable situation to

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[13] See paragraph 44 of the *Asscher* judgment.

[14] See the articles in *ECTJ* Volume 1 Issue 2 1995/96 pp 109-144.

[15] See paragraphs 46 - 49 of the *Asscher* judgment.

a Netherlands resident taxpayer who, after all, was subjected to Netherlands tax on his or her world-wide income.

Further, at first blush, the use of double tax agreements to determine whether non-residents and residents are in a comparable situation for the purposes of determining the question of discrimination sits somewhat uneasily with the Court's earlier decision in *EC Commission v France*.[16] In that case, the Court rejected the French Government's argument that the existence of double taxation agreements with other Member States should be borne in mind in assessing whether or not France's denial of tax credits on dividends paid by French companies to branches of insurance companies registered outside France (while allowing credits on dividends paid to French incorporated companies, including the subsidiaries of parent companies registered outside France) was discriminatory. The Court held that:

> "... the rights conferred by Article 52 of the Treaty are unconditional and a Member State cannot make respect for them subject to the contents of a [double tax] agreement concluded with another Member State. In particular, that Article does not permit those rights to be made subject to a condition of reciprocity imposed for the purpose of obtaining corresponding advantages in other Member States."[17]

Presumably the point is that even if the resident and non-resident taxpayers are in objectively different situations as far as the domestic revenue raising capacity of the Member State is concerned, the Court can examine the issue more widely and their situations can become comparable by application of the relevant double tax agreement. This is the case notwithstanding that, in the reverse situation, Member States governments cannot rely on their network of double tax agreements in mitigation of any discrimination inherent in their national system. However the Court has not adequately explained the precise criteria to be taken into account when assessing "comparability" at the domestic level. Advocate General Léger's suggestion that any differences in the situation of resident and non-resident taxpayers must be "fiscally relevant", i.e., "sufficiently closed linked to the field of taxation in issue",[18] is not particularly helpful.

Nevertheless, having identified discrimination, the Court of Justice then considered whether it could be justified. Given the limited number of instances in which national governments have successfully justified discrimination, it is perhaps not surprising that in this case the Netherlands government was unable to justify its tax

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16 Case 270/83 [1986] ECR 273, [1987] 1 CMLR 401.

17 Ibid paragraph 26.

18 Advocate General Léger's Opinion paragraph 74.

treatment. Its argument that a higher tax rate for non-residents was necessary because they would otherwise be treated more favourably than residents (since non-residents did not have to contribute to the Netherlands compulsory social security scheme) was swiftly dismissed.[19] The Court noted that Netherlands residents were "disadvantaged" because the Netherlands government did not allow such taxpayers to deduct social security payments from their taxable income. Having decided to deny this deduction as part of its internal tax policy, the Netherlands government could not then penalise non-residents for not paying into (and hence not being insured by) the Netherlands social security fund by imposing a higher rate of tax on their Netherlands source income.

The Court then discussed whether the Netherlands tax treatment was justified by the need to ensure cohesion of its tax system in line with its earlier judgment in *Bachmann v Belgium*.[20] Oddly, the Court did not allude to its recent judgment in *Wielockx* in which it purported to clarify its decision in *Bachmann*. As Marc Quaghebeur put it in an earlier issue of this *Journal*:

> "...[In *Wielockx*] the Court gave two important clarifications. The Court pointed out that the principle of coherence is shifted to a higher level. Fiscal coherence must, in the first place, be examined at a general level, and not just at the level of one and the same person. Moreover, one must not consider the coherence at the level of the domestic tax legislation but at an even higher level, i.e., that of reciprocity of the rules applicable in the Contracting States."[21]

In *Asscher* the Court retreated to the position that in *Bachmann* there was a direct link between the right to deduct contributions and the taxation of sums payable by insurers under pension and life assurance contracts and it was necessary to preserve that link in order to safeguard the cohesion of the tax system in

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19 This argument has overtones of *R v IRC ex parte Commerzbank AG* Case C-330/91 [1993] ECR I-4017, [1993] 3 CMLR 457 in which the UK Government's argument that the award of repayment supplement to a non-resident company exempt from tax would place it at a greater advantage to a resident company was said by Advocate General Darmon to be misplaced.

20 Case C-204/90 [1992] ECR I-249 and see also *Commission v Belgium* C-300/90 [1992] ECR I-305.

21 *ECTJ* Volume 1, Issue 2, 1995/96, at 129.

question.[22] It then determined in *Asscher* that, at the level of domestic tax legislation, there was no such link. Resident taxpayers liable to pay social security contributions paid a higher overall rate of tax than non-resident taxpayers like Mr Asscher but then they derived benefits from the scheme which non-residents did not.[23] *Wielockx* was not cited.

Conclusion

Bachmann apart, the decision in *Asscher* shows the Court of Justice in bullish, policy making mood. The Court was less concerned by the specific details of the case before it than by the need, at a more general level, to eradicate discrimination between residents and non-residents who are not in comparable situations. This widening in the Court's view is bound to cause concern to national tax legislators who will face increasing difficulty in marrying national tax legislation based on residence with the non-discrimination Articles in the EC Treaty.

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22 The Court has recently re-iterated this interpretation of *Bachmann* in a non-tax case *Svensson and Gustavsson v Ministre du Logement de l'Urbanisme* [1995] ECR I-3955 at paragraph 18. In *Bachmann* taxpayers had a choice between being able to deduct the assurance premiums and being taxed on the capital and pensions received when the contract matured and not being able to deduct the premiums but in that case not being taxed on the capital and pensions received at maturity. It was argued by Marc Quaghebeur (*op cit* in note 21) that this correlation was tenuous.

23 The Court noted that the exclusion of non-residents from the Netherlands social security scheme could only be justified by reference to Council Regulation (EEC) No. 1408/71 of 14 June 1971. Since Member States are under an obligation to comply with Community law, the Netherlands could not use tax measures to compensate for the fact that a taxpayer did not pay contributions to its social insurance scheme.