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THE *WIELOCKX* AND THE *SVENSSON* JUDGMENTS: "FISCAL COHESION" WITH A DIFFERENT FLAVOUR?

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At a few months' interval, the Court of Justice has handed down two judgments which significantly restrict the scope of the "fiscal cohesion" argument as a valid justification, in terms of EC law, for tax discrimination between residents and non-residents in the field of cross-border financial services.

As will be recalled, this issue was first addressed by the Court of Justice in 1992 in its celebrated *Bachmann* judgment.[2] The Court held at the time that a Belgian tax provision restricting the availability of income tax relief for taxpayers resident in Belgium in respect of life insurance premiums or group insurance premiums, to premiums paid to insurers established in Belgium was, among others, a restriction of the freedom of (EC incorporated) insurers established outside Belgium to sell their services on the Belgian market. Yet, it held that this restriction was justified, in terms of EC law, by the need to preserve the "cohesion" of the Belgian tax system.

According to the Court's understanding of the Belgian tax system, this "cohesion" consisted in a strict correlation between (i) the income tax relief granted to resident taxpayers in respect of premiums paid to locally established insurers, and (ii) the taxation in due course of the proceeds of insurance contracts which had benefited from income tax relief (to the exclusion of insurance contracts for which no such relief had been granted).

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2 Case C-204/90, *Bachmann* [1992] ECR I-249.

The *Bachmann* judgment met with mixed reactions at the time. One of the criticisms made was that the Court had failed to take into account the impact of the double tax treaties concluded between Belgium and all other Member States. All such treaties provide that the right to tax "private pensions" (which terms include the proceeds of individual life insurance as well as group insurance policies) belongs to the Member State where the "pensioner" has established his tax domicile at the time he draws his pension. This is the case even if, during the course of his professional career, the (future) pensioner lived in Belgium and deducted the life insurance or the group insurance premiums from his professional income. In other words, the cohesion which the Court had felt the need to protect in the *Bachmann* case is excluded by all double tax treaties entered into by Belgium with other Member States.

The *Schumacker* judgment handed down by the Court on 17th February 1995[3] suggested that the Court might be having second thoughts about the "fiscal cohesion" argument upheld in *Bachmann*. The case concerned the difference in taxation between a Belgian national working in Germany and taxed in Germany as a non-resident, and the taxation of workers residing in Germany.

One of the arguments put forward by the German authorities to justify this difference in tax treatment was the need to preserve the "cohesion" of the German tax system.

The Court set this argument aside: the "cohesion" of the German tax system could not be advanced as a valid justification for the heavier taxation imposed on a Belgian national working in Germany as a non-resident, compared to a German resident, since Germany itself had agreed, pursuant to a bilateral agreement with the Netherlands, to tax Dutch Residents working in Germany and taxed in Germany as non-residents in (substantially) the same way as German residents.[4]

The *Wielockx* case gave the Court a first opportunity to review the scope of the "fiscal cohesion" argument upheld in *Bachmann*. The Court did so in its judgment delivered on 11th August 1995.[5]

Mr Wielockx is a Belgian national, resident in Belgium. He is active as an independent physiotherapist in the Netherlands. All his professional income is derived from — and taxed in — the Netherlands.

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3 Case C-279/93, *Finanzamt Köln-Altstadt v Schumacker*, [1995] ECR I-225.

4 See *Schumacker* judgment, para 46.

5 Case C-80/94, not yet reported in ECR.

Mr Wielockx was refused by the Dutch tax authorities the right to deduct from his professional income a contribution to a "pension reserve". This refusal was justified by the fact that this deduction is only available to taxpayers who are resident in the Netherlands.

> "In order to justify the fiscal disadvantage suffered ... by non-resident taxpayers, the Netherlands Government relies on the principle of fiscal cohesion laid down in [*Bachmann*], according to which there must be a correlation between the sums which are deducted from the taxable income and the sums which are subject to tax. If a non-resident could set up a pension reserve in the Netherlands and thus secure a right to a pension, that pension would not be taxed in the Netherlands since, by virtue of the double-taxation convention between Belgium and the Netherlands ... such income is taxed in the State of residence.
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> As the Advocate General observed [in] his Opinion, the effect of double-taxation conventions which ... follow the OECD model is that the State taxes all pensions received by residents in its territory, whatever the State in which the contributions were paid, but, conversely, waives the right to tax pensions received [by a private pensioner resident] abroad even if they derive from contributions paid in its territory which it treated as deductible [at the time the future pensioner was a resident in its territory]. Fiscal cohesion has not therefore been established in relation to one and the same person ... but is shifted to another level, that of the reciprocity of the rules applicable in the Contracting States.
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> Since fiscal cohesion is secured by a bilateral convention concluded with another Member State, that principle may not be invoked to justify the refusal of a deduction such as that in issue."[6]

The *Svensson* judgment handed down by the Court a few months[7] after the *Wielockx* judgment gave the Court the opportunity to go one step further. The case concerned the compatibility with EC law of the refusal by the Luxembourg authorities to grant to two Swedish nationals resident in Luxembourg, who had taken out a loan with a bank in Belgium, the interest rate subsidy available under Luxembourg law for the construction of a dwelling. The refusal was justified by

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6 See *Wielockx* judgment, para 23 to 25.

7 Judgment of 14th November 1995, Case 484/93 - *Svensson*, not yet reported in ECR.

the fact that, under Luxembourg law, the interest rate subsidy is only available if the loan is taken out with a locally established credit institution.

The Luxembourg Court, apprised of the dispute, requested a preliminary ruling from the Court of Justice regarding the compatibility of the residence requirement imposed on the loan provider with the freedom of cross-border services guaranteed by the Treaty.

One of the arguments put forward by the Luxembourg authorities to justify the residency requirement was — unsurprisingly — the need to preserve the "cohesion" of the Luxembourg tax system.

This cohesion would, arguably, be at risk if one forced the Luxembourg authorities to grant the interest rate subsidy in respect of loans taken out with a credit institution established in another Member State since the profits of that "foreign EC" credit institution are not subject to (corporation) tax in Luxembourg.

This argument was formally rejected by the Court:[8]

> "Admittedly, the Court held in two judgments [in *Bachmann*] that the rules liable to restrict both free movement of workers and freedom to provide services could be justified by the need to maintain the integrity of the fiscal regime.
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> That is not the case here, however.
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> In those cases there was a direct link between the deductibility of the contributions and the tax on the sums payable by the insurers ..., a link which had to be preserved in order to preserve the integrity of the relevant fiscal regime, whereas there is no direct link whatsoever in this case between the grant of the interest rate subsidy to borrowers on the one hand and its financing by means of the profit tax on financial establishments on the other.
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> [Thus], it is not compatible with [the freedom of cross-border services and the freedom of capital payments] to make the grant of a housing benefit, in particular an interest rate subsidy, subject to the requirement that the loans intended to finance the construction, acquisition or improvement of the housing which is to benefit from the subsidy have been obtained from a credit institution [which] must be established [in that Member State]."

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[8] See *Svensson* judgment, para 16 to 19.

Whilst avoiding a *volte-face* by formally abandoning the "tax cohesion" argument upheld in *Bachmann*, the Court's recent judgments thus appear to give to the concept a very different content.

The question is no longer whether, in the absence of the national tax regulation at issue, the Member State concerned could continue to ensure "a strict correlation between the deductibility ... and the taxation."[9] Instead, "fiscal cohesion is secured [if there exists] a bilateral convention concluded with another Member State[10] ... even if [as a result] a strict correspondence between the deductibility ... and the liability to tax ... cannot be achieved".[11]

This evolution is certainly to be welcomed and comes none too soon.

Indeed, as pointed out by Advocate General Elmer in his Opinion in the *Svensson* case,[12] continued adherence to the concept of "strict cohesion" upheld in *Bachmann* could lead to a situation totally at odds with a single market: why not, for example, invoke the need of tax cohesion to restrict the benefit of home improvement grants by a condition that the contractor carrying out improvements be resident in the same Member State (and hence liable to tax in that Member State in respect of the profits derived from the grant given to his customer)? Certainly, if one goes down that route, the sky is the limit.

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9 See *Wielockx* judgment, para 24.

10 See *Wielockx* judgment, para 25.

11 See *Wielockx* judgment, para 27.

12 See Opinion at para 32 and 33.