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The Scope of the Schumacker Doctrine

A case study of thresholds and rules that take
into account the ability to pay

by

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Summary

It has been established by the Schumacker doctrine that the personal and family circumstances of a taxpayer must be taken into account in at least one Member State. Normally the residence state has the obligation to take into account the personal and family circumstances, since that state is in the best position to examine the taxpayer's ability to pay. However, the problem arises when a taxpayer works in two or several Member States, that he usually loses the proportion of personal tax benefits that are attributable to the foreign income. In case all or almost all of his income is received in the source state, he is comparable to a resident and must be granted personal tax benefits. However, in case he only earns part of his income in the source state, it must be examined whether his situation is comparable to that of a resident. It is not clear in which situations the Schumacher doctrine applies.

This thesis is a study of the scope of the Schumacker doctrine. The paper analyses which rules take into account the ability to pay and in which situations a taxpayer is considered to be comparable to that of a non-resident. The findings of the study are that such rules are difficult to identify, since there are considerable differences between countries and the aim of the rules vary. However, rules that take into account the ability to pay generally weigh unspecified on a taxpayer's total income.

It is not possible to set a general threshold for determining the proportion of income that has to be earned in the source state in order for the non-resident to be considered comparable to a resident. The reason is that the treatment in the source state is dependent on whether the income in the residence state is sufficient for that state to take into account the personal and family circumstances of the taxpayer. It may be the case that the taxpayer earns equal amounts of income in the source and the residence state, but the amount earned in the residence state is not taxable there. In such case it is only the source state that has the possibility to take into account personal and family circumstances of the taxpayer. They must be taken into account once somewhere.

1 Introduction

1.1 Background

“It is unfair to treat unequally equal persons and equally unequal persons”¹. This is a principle originating from the Greek philosopher Aristotle from which the non discrimination article², in TFEU stems.³

Ability to pay is a fundamental concept in taxation.⁴ When the ability to pay is taken into account, the taxpayer will contribute to the society in accordance with his consumption power which is determined by his overall income and costs. Since the overall income includes both domestic and foreign income, the residence state is normally in the best position to assess the ability to pay. The progressiveness of taxation is one of the features of the principle, the granting of personal deductions is another, both of which can easily be performed in a situation when only one country is involved. However, difficulties arise when taxing rights are allocated between two or more countries.⁵

Generally ability to pay plays an important role globally when it comes to forming tax policies. In some countries it can be found in the constitution.⁶ Even though globally accepted, it is a principle established in domestic law⁷ and there is no reference to the ability to pay in the EU treaties. Nevertheless, the ECJ has in cases concerning the fundamental freedoms enforced national rules that take into account the ability to pay in cross-border situations.⁸

When different rules are applied to nationals of different EU Member States, resulting in that one of them is worse off, it is considered to be discriminatory only insofar they are in a comparable situation. The ECJ has established that, as a general rule, residents and non-residents are not comparable for direct tax pur-

¹Marco Greggi, “Revisiting “Schumacker”: The Role of Limited Tax Liability in EU Law”, *Allocating Taxing Powers within the European Union* (Springer, 2013) p.43, referring to Aristotle’s *Ethic to Nicomaco*, V, 5. (used version: Natali, “Nicomachean ethics: Symposium aristotelicum”, Oxford (2009)).

²Article 18, “Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union”, *Official Journal of the European Union* C 326 (2012): 1–390.

³Marco Greggi, “Revisiting “Schumacker”: The Role of Limited Tax Liability in EU Law”, *Allocating Taxing Powers within the European Union* (Springer, 2013) pp. 43-44.

⁴Frans Vanistendael, “Ability to Pay in European Community Law”, *EC Tax Review* 23.3 (2014): p 154.

⁵Wolfgang Schön, “International tax coordination for a second-best world (part I)”, *World Tax Journal* 1.1 (2009): pp. 71-72.

⁶Wolfgang Schön, “International tax coordination for a second-best world (part I)”, *World Tax Journal* 1.1 (2009): p 72.

⁷Wolfgang Schön, “International tax coordination for a second-best world (part I)”, *World Tax Journal* 1.1 (2009): p 72.

⁸Frans Vanistendael, “Ability to Pay in European Community Law”, *EC Tax Review* 23.3 (2014): p. 122.

poses,⁹ and different treatment on the basis of residence is the norm.¹⁰ The reason for it is that non residents usually derive only part of their income in the source state. However, the situation is different in cases when the taxpayer derives all, or almost all of his income in the source state; in this case the non resident is in a comparable situation to a resident.¹¹

While most states grant personal tax relief for resident tax payers, non-residents are normally not entitled to such deductions or reductions in the source state.¹² When a taxpayer earns part of his income in the residence state, he is normally only entitled to a proportionate part of personal deductions in this state. However, according to the tax legislation the source state, he is normally not entitled to part of personal deductions there.¹³ Thus, what was established in the *Schumacker*¹⁴ case does not solve the situations when the taxpayer does *not* earn all or almost all of his income in the source state.

One possible solution for avoiding discrimination could be to grant the taxpayer an option to be taxed as a non-resident with a flat tax rate, or as a resident with a progressive tax rate and with the right to make personal deductions, as the possibility is in Sweden. There is currently a pending ECJ case, *Hirvonen*, in which the question referred to the ECJ is whether such provisions are contrary to the free movement of workers.¹⁵

A number of cases have followed the *Schumacker* case and extended taxpayers rights to have their ability to pay taken into account. However, it is not clear under which circumstances the Schumacker doctrine applies as making the distinction between rules taking personal and family circumstances into account and other rules is difficult.¹⁶ There is furthermore a lack of clear benchmarks for assessing discrimination.¹⁷ Case law has recently developed as regards the circumstances that must be at hand¹⁸ and the scope of the Schumacker doctrine needs further clarification.

⁹C-279/93 *Finanzamt Köln-Altstadt v. Schumacker* [1995] paras. 30-31.

¹⁰Richard Lyal, “Non-discrimination and direct tax in Community law”, *EC Tax Review* 12.2 (2003): p 68.

¹¹Richard Lyal, “Non-discrimination and direct tax in Community law”, *EC Tax Review* 12.2 (2003): p. 72.

¹²Kees van Raad, “Non-Residents - Personal Allowances, Deduction of Personal Expenses and Tax Rates”, *Journals IBFD* vt.2 (2010): p. 155.

¹³Peter J Wattel, “Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why Schumacker, Gilly and Gschwind Do Not Suffice”, *European Taxation* 217 (2000): p 210.

¹⁴C-279/93 *Finanzamt Köln-Altstadt v. Schumacker* [1995] paras. 36-38.

¹⁵C-632/13 *Skatteverket v. Hilkka Hirvonen* [].

¹⁶Michael Lang, “Recent Case Law of the ECJ in Direct Taxation: Trends, Tensions and Contradictions”, *EC tax review* 3.2009 (2009): p 101-102.

¹⁷Marco Greggì, “Revisiting “Schumacker”: The Role of Limited Tax Liability in EU Law”, *Allocating Taxing Powers within the European Union* (Springer, 2013) p 47.

¹⁸C-39/10 *European Commission v Republic of Estonia* [2012];, C-181/12 *Yvon Welte v Finanzamt Velbert* [2013];, C-425/11 *Katja Ettwein v Finanzamt Konstanz* [2013];, C-303/12 *Guido Imfeld, Nathalie Garcet v État belge* [2013].

1.2 Aim

The aim with this thesis is to clarify the scope of the Schumacker doctrine and specifically to answer the questions “Which tax rules are considered to take into account the ability to pay?” and “What are the thresholds for determining when a non-resident is in a comparable situation to that of a resident?”.

An article by Frans Vanistendael has recently been published, *Ability to Pay in European Community Law*¹⁹ where the author analyses the way in which the ability to pay principle is applied in cross-border situations. Vanistendael’s article however does not include an analysis of the most recent judgments in the field, *Commission v Estonia*²⁰, *Ettwein*²¹, *Welte*²² and *Imfeld*²³. The author of this thesis is not aware of any other work that has thoroughly altogether analysed the recent cases mentioned. Therefore, the contribution of this thesis will be to analyse the scope of the ability to pay in ECJ case law as regards the most recent cases.

1.3 Method and material

For the purpose of this thesis, the traditional legal method is used, which in the EU context is founded on principles of interpretation where rules to a large extent are interpreted in the light of their objective.²⁴ Since the aim of the thesis is to analyse the law as it stands today, *de lege lata*, the traditional legal method is the only one that can fulfil this purpose.

As stated in section 1.1 there is no reference to the principle of ability to pay in the EU treaties. The law as it stands today follows from the judgments of the ECJ, which consequently constitute the most important material, accompanied by the ancillary, but important, Opinions of the Advocate Generals. While the judgments rarely makes references to legal doctrine, such references are often found in the AG’s Opinions.²⁵ Article 252 of the TFEU requires the Advocate General to act independently and to make reasoned submissions on cases. Independence can be understood in more than one aspect; independence from political interference and independence from previous judgments of the ECJ are two of them. Further, the opinions are not subject to negotiation or amendments.²⁶

¹⁹Frans Vanistendael, “Ability to Pay in European Community Law”, *EC Tax Review* 23.3 (2014): 121–134.

²⁰C-39/10 *European Commission v Republic of Estonia* [2012].

²¹C-425/11 *Katja Ettwein v Finanzamt Konstanz* [2013].

²²C-181/12 *Yvon Welte v Finanzamt Velbert* [2013].

²³C-303/12 *Guido Imfeld, Nathalie Garcet v État belge* [2013].

²⁴Jörgen Hettne and Ida Otken Eriksson, *EU-rättslig metod: teori och genomslag i svensk rättstillämpning* (Norstedts juridik, 2011) p. 36.

²⁵Bernitz Ulf et al., *Finna rätt–juristens källmaterial och arbetsmetoder* (Norstedts Juridik AB, 2012) p. 72.

²⁶Iyiola Solanke, “Diversity and Independence in the European Court of Justice”, *Colum. J. Eur. L.* 15 (2008): p. 98-101.

The opinion of the Advocate General is in most cases followed. Even when the ECJ does not follow the opinion, it can be used to influence future case law.²⁷ The analysis of and opinions on case law in doctrinal articles are also important material that this thesis is built upon.

1.4 Delimitation

This thesis only concerns direct taxation of individuals. The prohibition of different treatment of taxpayers in objectively same situations is also applicable for companies²⁸ but company taxation and its implications on the fundamental freedoms is beyond the scope of this thesis. Since the subject has been extensively analysed, the thesis is focused on recent case law that has not yet been subject to thorough doctrinal analysis. Further, it is not the aim of this thesis to analyse which double tax credit rule that would be the most suitable for solving the problems in a Schumacker situation. However, for a better understanding of the problem, the methods and their consequences will shortly be presented.

Taxes that, according to Vanistendael, can take the taxpayers ability to pay into account is income-, wealth-, inheritance- and gift taxes.²⁹ Most of the cases found relating to the ability to pay concerns income tax, but *Welte*³⁰ is a case concerning inheritance tax. The choice of cases includes all types of tax features that has been identified as related to the ability to pay.³¹ The first category of cases concerns personal deductions and family circumstances, *Schumacker*³², *Wielockx*³³, *Gilly*³⁴, *Gschwind*³⁵, *Zurstrassen*³⁶, *Wallentin*³⁷, *Lakebrink*³⁸, *Commission v Estonia*³⁹, *Ettwein*⁴⁰ and *Imfeld*⁴¹. One case fits in both the second category concerning the progressiveness of tax rates and the third category concerning deduction of

²⁷Iyiola Solanke, “Diversity and Independence in the European Court of Justice”, *Colum. J. Eur. L.* 15 (2008): p. 102-103.

²⁸See for example Case 270/83 Commission of the European Communities v French Republic [1986].

²⁹Frans Vanistendael, “Ability to Pay in European Community Law”, *EC Tax Review* 23.3 (2014): p 121.

³⁰C-181/12 *Yvon Welte v Finanzamt Velbert* [2013].

³¹Frans Vanistendael has identified five tax features relating to the ability to pay, see Frans Vanistendael, “Ability to Pay in European Community Law”, *EC Tax Review* 23.3 (2014): p 122.

³²C-279/93 *Finanzamt Köln-Altstadt v. Schumacker* [1995].

³³C-80/94 *G. H. E. J. Wielockx v Inspecteur der Directe Belastingen* [1995].

³⁴C-336/96 *Mr and Mrs Robert Gilly v Directeur des services fiscaux du Bas-Rhin* [1998].

³⁵C-391/97 *Frans Gschwind v Finanzamt Aachen-Außenstadt* [1999].

³⁶C-87/99 *Patrick Zurstrassen v Administration des contributions directes* [2000].

³⁷C-169/03 *Florian W. Wallentin v Riksskatteverket* [2004].

³⁸C-182/06 *État du Grand Duchy of Luxembourg v Hans Ulrich Lakebrink and Katrin Peters-Lakebrink* [2007].

³⁹C-39/10 *European Commission v Republic of Estonia* [2012].

⁴⁰C-425/11 *Katja Ettwein v Finanzamt Konstanz* [2013].

⁴¹C-303/12 *Guido Imfeld, Nathalie Garcet v État belge* [2013].

business expenses, *Gerritse*⁴². The fourth category concerning the structure of the tax scale includes the *Asscher*⁴³ case. The fifth category concerns deductions of losses and includes *Lakebrink*⁴⁴. The case law referred to in this thesis consists of judgments available at the 30th of March 2014.

1.5 Outline

An explanation of the concepts of discrimination and comparability will first be provided. In order to understand how problems arise regarding tax rules taking into account the taxpayer's ability to pay when he derives income from other states than the residence state, a presentation methods for eliminating double taxation follows. Then a presentation of the Schumacker case and related doctrine follows. Thereafter, the recent case law will be analysed, taking into account the historical application of the Schumacker doctrine and its objective. In the conclusion the benchmarks and the tax rules that take into account the ability to pay, that has been derived from the recent case law, will be presented and serve as clarifications of the scope of the Schumacker doctrine.

2 Tax discrimination and comparability

In this section two concepts that are directly linked to each other will be presented. An explanation of the concepts *tax discrimination* and *comparability*, on which tax discrimination is dependent on, will be provided.

2.1 Tax Discrimination

Although direct taxation falls within the exclusive competence of the Member States, they must exercise their powers in consistence with EU law.⁴⁵ The ECJ has, on the basis of the fundamental freedoms and the freedom of establishment granted by the TFEU, stated that tax discrimination on the basis of nationality is prohibited.⁴⁶ Since there is no definition of discrimination in the Treaty, the ECJ has formed an approach of its own mainly in the *Schumacker* case and following case law.⁴⁷ Discrimination in this context can arise when different rules applies

⁴²C-234/01 *Arnoud Gerritse v Finanzamt Neukölln-Nord* [2003].

⁴³C-107/94 *P. H. Asscher v Staatssecretaris van Financiën* [1996].

⁴⁴C-182/06 *État du Grand Duchy of Luxembourg v Hans Ulrich Lakebrink and Katrin Peters-Lakebrink* [2007].

⁴⁵See for example Case C-279/93 *Schumacker* [1995] ECR I-225 para. 21.

⁴⁶Ruth Mason and Michael S Knoll, "What is Tax Discrimination", *Yale LJ* 121 (2011): p. 1025.

⁴⁷Marco Greggi, "Revisiting "Schumacker": The Role of Limited Tax Liability in EU Law", *Allocating Taxing Powers within the European Union* (Springer, 2013) p. 46.

to nationals of different Member States in an objectively comparable situation, resulting in that one of them is placed in a less favourable situation.⁴⁸

Source taxation⁴⁹ generally differs from residence taxation⁵⁰ in that source taxation is levied on the gross income at a flat tax rate, whereas residence taxation is levied on the net income progressively. The gross taxation of non residents can be motivated by the aim to reduce the burden of filing a complete tax return in the source state. Further, the imposition of a flat tax rate on the income in the source state can be motivated with the fact that it is only applied on a fraction of the total income; the taxpayer would with a progressive taxation gain an unfair tax advantage.⁵¹

Personal tax benefits related to the civil status of the tax payer, such as the opportunity to file a joint tax return for couples or receiving a personal allowance, take into account the taxpayer's ability to pay.⁵² Such benefits and personal tax reliefs, for example deduction of social welfare costs or costs for home mortgage and childcare, are often not granted to non-residents.⁵³

2.2 Comparability

One argument for different treatment of non residents is the lack of information about the taxpayer in the source country.⁵⁴ Another argument is that it is the responsibility of the residence state to take into account the tax payer's ability to pay. If the source state would also grant personal tax benefits, the tax payer could end up with double benefits.⁵⁵ However, when a tax payer derives most of his income from the source state, and the income is exempt in the residence state, the problem arises that he is unable to benefit fully from the personal tax benefits available in that state. Therefore, since the *Schumacker* judgment, non-residents deriving at least 90% of their total income from the source state must be treated as residents in respect of personal tax benefits.

Personal tax benefits are in many countries attributed to the proportion of the worldwide income earned by the resident taxpayer. In such situation, the tax treatment of a cross-border is neutral only if the source state(s) provide(s) per-

⁴⁸Marjaana Helminen, *EU tax law: direct taxation* (IBFD, 2012) sec. 2.1.2.

⁴⁹Taxation in the state from where the income derives.

⁵⁰Taxation in the state where the taxpayer resides.

⁵¹Ruth Mason and Michael S Knoll, "What is Tax Discrimination", *Yale LJ* 121 (2011): p. 1025-1027.

⁵²Kees van Raad, "Non-Residents - Personal Allowances, Deduction of Personal Expenses and Tax Rates", *Journals IBFD* vt.2 (2010): p. 155.

⁵³Ruth Mason and Michael S Knoll, "What is Tax Discrimination", *Yale LJ* 121 (2011): p. 1028.

⁵⁴Ruth Mason and Michael S Knoll, "What is Tax Discrimination", *Yale LJ* 121 (2011): p. 1028.

⁵⁵Ruth Mason and Michael S Knoll, "What is Tax Discrimination", *Yale LJ* 121 (2011): 1104.

sonal tax benefits to the other proportion of the income.⁵⁶ The problem with the proportional personal tax benefits, as has been pointed out by Wattel, is that they are usually only available for resident tax payers. Following the *Schumacker* doctrine, the source state only has to make available personal tax benefits in case the tax payer earns all or almost all of her income in that state.⁵⁷ This solution has not been sufficient; if the tax payer derived less than 90% of the his total income from the source state, only the residence state is obliged to grant personal tax reliefs, and in this case not more than for the fraction of income earned in the residence state.⁵⁸ However, in case the taxpayer earns income from several states, and none of them take personal and family circumstances into account, the residence state cannot be free from this obligation. In such case, the residence state cannot apply exemption with progression and apportionment for personal deductions without without failing to fulfil its obligations in the Treaty.⁵⁹

2.3 Summary

As has presented, there are a variety of reasons for applying different tax rules to non-resident taxpayers. However, in cases where the non-resident taxpayer is in a situation objectively comparable to that of a non-resident, and is treated differently, discrimination arises, as established in the *Schumacker* case. That judgment does not however solve the cases where the taxpayer earns only part of his income in one or several source states. As the effect of such discrimination depends on the method applied for the elimination of juridical double taxation⁶⁰, it is appropriate to shortly present the different methods in the following section.

3 Methods for elimination of double taxation - consequences and solutions

Juridical double taxation arises when the source state taxes the person according to the source principle and the state where the person is resident taxes her according to the residence principle simultaneously. In order to eliminate double taxation, the residence state uses either the exemption method or the credit

⁵⁶Kees van Raad, “Non-Residents - Personal Allowances, Deduction of Personal Expenses and Tax Rates”, *Journals IBFD* vt.2 (2010): p. 157-158.

⁵⁷Peter J Wattel, “Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why Schumacker, Gilly and Gschwind Do Not Suffice”, *European Taxation* 217 (2000): p. 210.

⁵⁸Peter J Wattel, “Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why Schumacker, Gilly and Gschwind Do Not Suffice”, *European Taxation* 217 (2000): p. 217.

⁵⁹C-385/00 *F.W.L. de Groot v Staatssecretaris van Financiën* [2002] paras. 100-102,116.

⁶⁰Nils Mattsson, “Does the European Court of Justice Understand the Policy behind Tax benefits Based on Personal and Family circumstances?”, *European Taxation-Amsterdam*- 43.6 (2003): p. 186.

method.⁶¹

3.1 Credit and Exemption

With full exemption, the residence state does not tax the income from the source state. If exemption with progression is used, the residence state takes into account the foreign income for determining the tax rate, but does not tax the income. Alternatively, the residence state taxes the worldwide income, but deducts the foreign paid tax.⁶²

When using ordinary credit, the deductible tax in the residence country is the lowest amount of the tax paid in the source country and the tax calculated in the residence state. The ordinary credit method allows the deduction of the foreign paid tax from the tax calculated on the worldwide income.⁶³

3.2 Consequences and solutions

The problem for a person in a Schumacker situation arises when the residence state disregards the foreign income. As Wattel observes, a cross-border worker usually loses the same proportion of personal allowances in the residence state as the proportion of foreign income he earns. Wattels opinion is that non-residents, at least in the situation described, do not differ from residents to the extent that the host state should not grant proportional allowances. As the non-resident has a progression benefit, he argues that this should be removed and proportional tax benefits be granted.⁶⁴

In Wattels opinion, the purpose of personal allowances is to take into account a taxpayer's personal ability-to-pay and they are not linked to specific items of income.⁶⁵ Furthermore, he states that personal tax advantages should be proportionally divided between the countries that have taxing powers.⁶⁶

⁶¹Nils Mattsson, "Does the European Court of Justice Understand the Policy behind Tax benefits Based on Personal and Family circumstances?", *European Taxation-Amsterdam- 43.6* (2003): p. 186.

⁶²Nils Mattsson, "Does the European Court of Justice Understand the Policy behind Tax benefits Based on Personal and Family circumstances?", *European Taxation-Amsterdam- 43.6* (2003): p. 186.

⁶³Nils Mattsson, "Does the European Court of Justice Understand the Policy behind Tax benefits Based on Personal and Family circumstances?", *European Taxation-Amsterdam- 43.6* (2003): p. 186.

⁶⁴Peter J Wattel, "Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why Schumacker, Gilly and Gschwind Do Not Suffice", *European Taxation* 217 (2000): p. 214.

⁶⁵Peter J Wattel, "Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why Schumacker, Gilly and Gschwind Do Not Suffice", *European Taxation* 217 (2000): p. 214.

⁶⁶Peter J Wattel, "Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why Schumacker, Gilly and Gschwind Do Not Suffice", *European Taxation*

In order to remove the progression advantage and the allowance disadvantage, Wattel suggests worldwide taxation of non-residents. Thus, non-residents should be taxed as if they were residents and be granted exemption with progression taxation relief and a proportionate share of allowances. Further, the residence state should grant proportionate personal allowances when calculating the double taxation relief.⁶⁷

Avery Jones agrees with Wattel on that the host state should grant a proportionate share of personal allowances. However, he believes the problem of losing part of the personal allowances in the residence state when working in another state can be removed with the tax credit system. Avery Jones suggest that the residence taxes the worldwide income and grants the personal allowances *before* calculating the tax credit on the foreign income.⁶⁸

Furthermore, Avery Jones suggest that the credit for the foreign tax paid should be available against the highest tax rate in the residence state, in order to minimise the risk of a credit that does not cover the tax paid, in case the residence state has a lower tax than the host state. He also believes that this risk is reduced when the taxpayer is not taxed progressively in the host state.⁶⁹

3.3 Summary

In this section different methods for eliminating double taxation and their consequences in relation to personal allowances for persons deriving income from several countries has been presented. The presentation is important for the understanding of how the problem with loss of personal allowances and deductions is created. The aim with this thesis is to clarify the scope of the Schumacker doctrine. Thus, it is outside of the scope of this thesis to further investigate whether source or worldwide taxation of non-residents is the best solution and which double taxation credit method is the most suitable one. In section 4 the Schumacker doctrine and its development in case law is presented.

217 (2000): 214-215.

⁶⁷Peter J Wattel, "Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why Schumacker, Gilly and Gschwind Do Not Suffice", *European Taxation* 217 (2000): p. 227-228.

⁶⁸JF Avery Jones, "A Comment on Progressive Taxation of Non-residents and Intra-EC Allocation of Personal Tax Allowances", *European Taxation-Amsterdam* 40.8 (2000): p. 375.

⁶⁹JF Avery Jones, "A Comment on Progressive Taxation of Non-residents and Intra-EC Allocation of Personal Tax Allowances", *European Taxation-Amsterdam* 40.8 (2000): p. 375.

4 The Schumacker doctrine

4.1 C-279/93 Schumacker

The *Schumacker* case⁷⁰ from 1995 is a landmark case in which the ECJ established the “once somewhere” principle.⁷¹ Mr. Schumacker who lived in Belgium was subject to limited taxation in Germany where he worked. Due to the principle applied by the German tax law, that the personal and subjective situation was to be taken into account by the residence state, Schumacker was denied the benefit of the splitting tariff available for married couples. Such taxation would mitigate the progressive effect of the tax rates by aggregating the income of the spouses and tax each of them on 50% of that income. Also other personal tax benefits were denied or reduced for Mr. Schumacker because he was a non-resident in Germany.⁷²

In the proceedings that Mr. Schumacker had brought against the tax authorities, the court referred to the ECJ and brought the question whether rules applying a higher tax rate on non resident workers in Germany, who were in a comparable situation to resident workers except for their residence, violated the principle of free movement of workers. The question was also what impact it might have that the non-resident derived all or almost all of his income in Germany.⁷³

AG Léger concluded that even though direct taxation is not harmonised and falls in the exclusive competence of the member states, the Community must establish an internal market in which all obstacles to the free movement of goods, services, persons and capital must be abolished. AG Léger also referred to previous case law in which the ECJ had held that “The principle of equal treatment with regard to remuneration would be rendered ineffective if it could be undermined by discriminatory national provisions on income tax”⁷⁴. Further, AG Léger held that there is a logic behind the distinction between residents and non residents: the choice of residence is also a choice of in which state the taxpayer will contribute to the public administration costs, and that state will provide the personal tax benefits.⁷⁵

The reason for drawing a distinction between resident and non-resident taxpayers is that they are not objectively in the same situation; AG Léger cited previous case law and stated “As we know, ‘discrimination consists solely in the application of different rules to comparable situations or in the application of the same rule to

⁷⁰C-279/93 *Finanzamt Köln-Altstadt v. Schumacker* [1995].

⁷¹Ruth Mason and Michael S Knoll, “What is Tax Discrimination”, *Yale LJ* 121 (2011): p. 1031.

⁷²Opinion of mr Advocate General Léger delivered on 22 November 1994 in Case C-279/93 *Schumacker* paras.1-7.

⁷³Opinion of mr Advocate General Léger delivered on 22 November 1994 in Case C-279/93 *Schumacker* para. 14.

⁷⁴Opinion of mr Advocate General Léger delivered on 22 November 1994 in Case C-279/93 *Schumacker* para 29.

⁷⁵Opinion of Mr Advocate General Léger delivered on 22 November 1994 in Case C-279/93 *Schumacker* paras. 19-21; 36.

differing situations’⁷⁶. When a national of a Member State exercises his right to free movement while residing in another state than the state from where he derive all his income and pay taxes, he is discriminated if his personal circumstances and family responsibilities are not taken into account there.⁷⁷

One possible solution for determining to place a non resident on the same footing as a resident, is to do so if he does not derive *sufficient* income in his state residence to benefit from the personal tax benefits available there. As regards the splitting regime, which in the Schumacker case was available for couples residing simultaneously in Belgium and Germany, there would be no justification for denying a non resident in Schumaker’s situation this benefit, even when the income of the spouse was not taxable in Germany.⁷⁸ The judgment of the ECJ was in line with the AG’s opinion.

Before proceeding to discuss the Schumacker doctrine as applied today, it seems appropriate to shortly present case law that have followed until *Commission v Estonia*. As will be shown in Section 2.4, the Schumacker doctrine has been extended.

4.2 Evolution of the Schumacker Doctrine in the ECJ Case Law

In this section, case law following the Schumacker judgment is shortly presented. That case law has already been extensively analysed.⁷⁹ As will be shown, a variety of tax rules can be referred to such rules that aim to take into account the taxpayer’s ability to pay.

4.2.1 C-80/94 Wielockx - Deduction of Pension Reserves

In August the same year as the Shumacker case had been delivered, the ECJ gave its judgment in Case C-80/94 *Wielockx*. Mr Wielockx, resident in Belgium, was self-employed and derived all his income in the Netherlands. Unlike national taxpayers, Wielockx was only taxed on his national taxable income and was refused to deduct payments to pension reserves. The ECJ stated that a non-resident receiving all or almost all of his income in the source state is objectively comparable to a resident of that state. In such situation, where only the non-resident taxpayer is refused to deduct pension payments, he suffers discrimination. Since the

⁷⁶Opinion of Mr Advocate General Léger delivered on 22 November 1994 in Case C-279/93 Schumacker para. 53

⁷⁷Opinion of Mr Advocate General Léger delivered on 22 November 1994 in Case C-279/93 Schumacker paras. 38-71.

⁷⁸Opinion of Mr Advocate General Léger delivered on 22 November 1994 in Case C-279/93 Schumacker paras. 91-96.

⁷⁹See for example Michael Lang, “Recent Case Law of the ECJ in Direct Taxation: Trends, Tensions and Contradictions”, *EC tax review* 3.2009 (2009): and the literature referred to there.

discrimination in this case could not be justified by the need for fiscal cohesion, it was precluded by the freedom of establishment.⁸⁰

4.2.2 C-107/94 Asscher - Higher Tax Rate for Non-Residents

After *Wielockx* came *C-107/94 Asscher*. As a non resident, Mr Asscher had to pay higher tax at a higher rate than residents earning income from the same economic activity in the Netherlands. While residents were taxed at a rate of 13% even if they received less than 90% of their worldwide income, non residents had to meet that threshold; otherwise the applicable tax rate was 25%.⁸¹ Mr Asscher had moved to Belgium from the Netherlands where he received remuneration from his company, and due to the tax treaty that income was only taxable in that country. In Belgium, that income was exempt but taken into account for determining the progressive tax rate.⁸² Thus, the difference in treatment in the Netherlands could not be explained by the fact that a non resident escaped the progressiveness of the tax in there, since Belgium had the right to take into account the worldwide income when determining the progressive tax rate.⁸³ Consequently, the ECJ concluded that resident and non-residents were comparable with regard to that rule.⁸⁴

4.2.3 C-336/96 Gilly - Right to Tax, Obligation to Make Available Benefits

In *C-336/96 Gilly* the ECJ established that when countries have allocated the powers of taxation using nationality as a connecting factor, and all income of a taxpayer is derived in the source state, that state is not obliged to take into account personal and family circumstances, if the residence state has been given the right to tax the total income of the taxpayer and therefore also grants the available tax advantages and deductions in that state.⁸⁵

4.2.4 C-391/97 Gschwind - Threshold for Joint Taxation

The threshold applicable for non-residents, that 90% of a couple's total income had to be derived in Germany in order for the joint taxation to apply, was questioned in *Case C-391/97 Gschwind*.⁸⁶ The circumstances in the case were that over 40% of the household's income was earned in the state of residence, and in any case where that income exceeded 10% the ECJ concluded that the legislation at issue maintained the possibility for the personal and family circumstances to be taken

⁸⁰C-80/94 *G. H. E. J. Wielockx v Inspecteur der Directe Belastingen* [1995].

⁸¹C-107/94 *P. H. Asscher v Staatssecretaris van Financiën* [1996] para. 45.

⁸²C-107/94 *P. H. Asscher v Staatssecretaris van Financiën* [1996] para.15.

⁸³C-107/94 *P. H. Asscher v Staatssecretaris van Financiën* [1996] paras. 47-48.

⁸⁴C-107/94 *P. H. Asscher v Staatssecretaris van Financiën* [1996] para. 45.

⁸⁵C-336/96 *Mr and Mrs Robert Gilly v Directeur des services fiscaux du Bas-Rhin* [1998].

⁸⁶C-391/97 *Frans Gschwind v Finanzamt Aachen-Außenstadt* [1999] para. 14.

into account in the state of residence and thus was compatible with the freedom of movement for workers.⁸⁷

4.2.5 C-87/99 Zurstrassen - Residence Requirement for Joint Taxation

Also in Case C-87/99 *Zurstrassen* conditions for applying joint taxation for a couple was questioned in relation to the freedom of movement for workers. The ECJ stated that such tax advantage can not be denied only because one of the spouses is not resident in the state, in case the other (resident) spouse derives almost all the income of the household in that state.⁸⁸

4.2.6 C-385/00 de Groot - Apportionment for Allowances

In C-385/00 *de Groot*⁸⁹ the Netherlands applied progression with exemption and apportionment for allowances relating to the personal and family circumstances of the taxpayer.⁹⁰ The tax rules aimed to distribute personal allowances over the worldwide income, and allowances were deducted proportionally from the tax payable in Netherlands on the income from that state.⁹¹

De Groot, resident in the Netherlands, received income from the Netherlands and several other Member States and was obliged to pay maintenance payments to the woman he was no longer married to.⁹² In none of the source states his personal and family circumstances were taken into account, while they were proportionally taken into account in the residence state.⁹³ The ECJ stated that the residence state could be free from the obligation to fully take into account the personal and family circumstances of a taxpayer in case the source states take into account his ability to pay.⁹⁴ However, as this was not the case, the legislation created an obstacle to the free movement of worker and was precluded.⁹⁵

4.2.7 C-234/01 Gerritse - Flat Taxation and Allowance

Application of a flat tax rate for non-residents without allowing deduction of a basic allowance, whereas residents was granted the allowance and were taxed at a progressive scale, was questioned in Case C-234/01 *Gerritse*. The ECJ held that where the non-resident also is subject to progressive taxation in his state of residence, he is in a comparable situation to a resident of the host state. In

⁸⁷C-391/97 *Frans Gschwind v Finanzamt Aachen-Außenstadt* [1999] paras 29, 32.

⁸⁸C-87/99 *Patrick Zurstrassen v Administration des contributions directes* [2000] para.27.

⁸⁹C-385/00 *F.W.L. de Groot v Staatssecretaris van Financiën* [2002].

⁹⁰C-385/00 *F.W.L. de Groot v Staatssecretaris van Financiën* [2002] paras. 21, 25.

⁹¹C-385/00 *F.W.L. de Groot v Staatssecretaris van Financiën* [2002] para. 26.

⁹²C-385/00 *F.W.L. de Groot v Staatssecretaris van Financiën* [2002] paras. 29,30.

⁹³C-385/00 *F.W.L. de Groot v Staatssecretaris van Financiën* [2002] para. 47.

⁹⁴C-385/00 *F.W.L. de Groot v Staatssecretaris van Financiën* [2002] para. 100.

⁹⁵C-385/00 *F.W.L. de Groot v Staatssecretaris van Financiën* [2002] para. 100.

case a flat taxation leads to a higher tax payable for the non-resident taxpayer, the legislation constitutes discrimination.⁹⁶ ⁹⁷ As regards the basic allowance the ECJ held that “[...]it has a social purpose, allowing the taxpayer to be granted an essential minimum exempt from all income tax[...].”⁹⁸

4.2.8 C-169/03 Wallentin - Basic Allowance

Again in Case C-169/03 *Wallentin* the denial of deduction of a basic allowance for non-residents was questioned. The ECJ held that in cases where the non-resident taxpayer receives no significant taxable income in his state of residence, denial of a basic allowance constitutes discrimination.⁹⁹ The same reasoning applies where the taxable payment is a retirement pension, as established in Case C-520/04 *Turpeinen*.¹⁰⁰

4.2.9 C-182/06 Lakebrink - Deduction of Negative Rental Income

Legislation allowing only for resident taxpayers to take into account negative rental income relating to a house when determining the applicable tax rate constitutes discrimination in case the non-resident taxpayer receives almost all of his income in the source state.¹⁰¹ The ECJ held in *Lakebrink* that “[...]the ability to pay tax may indeed be regarded as forming part of the personal situation of the non-resident within the meaning of the judgment in *Schumacker*.¹⁰² The same reasoning was applied in Case C-527/06 *Renneberg*.¹⁰³

⁹⁶C-234/01 *Arnoud Gerritse v Finanzamt Neukölln-Nord* [2003] para. 53.

⁹⁷Interestingly, the calculation when applying the progressive scale in this case resulted in a higher tax!, see para. 54.

⁹⁸C-234/01 *Arnoud Gerritse v Finanzamt Neukölln-Nord* [2003] para. 48.

⁹⁹C-169/03 *Florian W. Wallentin v Riksskatteverket* [2004] para. 24.

¹⁰⁰C-520/04 *Pirkko Marjatta Turpeinen* [2006] para. 39.

¹⁰¹C-182/06 *État du Grand Duchy of Luxembourg v Hans Ulrich Lakebrink and Katrin Peters-Lakebrink* [2007] paras. 30, 35.

¹⁰²C-182/06 *État du Grand Duchy of Luxembourg v Hans Ulrich Lakebrink and Katrin Peters-Lakebrink* [2007] para. 34.

¹⁰³C-527/06 *R. H. H. Renneberg v Staatssecretaris van Financiën* [2008] paras. 61 and 84.

5 The Scope of the Schumacker Doctrine in Recent Case Law

5.1 C-39/10 Comm. v Estonia - Allowance on Retirement Pensions

The Estonian income tax law granted non-resident taxpayers allowances on pensions in case their income from Estonia exceeded 75% of the worldwide income.¹⁰⁴ A person resident in Estonia received pension from both Estonia and Finland of equal amounts. The total amount of income was so low that there was no liability to tax in Finland and in Estonia it was slightly above the allowance threshold.¹⁰⁵

The Commission was of the opinion that The Estonian tax law placed taxpayers having received less than 75% of the total income in Estonia in a less favourable situation because they had exercised their right of freedom of movement of workers.¹⁰⁶ The Republic of Estonia held that this category of taxpayers was not in a comparable situation to that of a person who reached that threshold.¹⁰⁷

The ECJ referred to previous case law and stated that discrimination can arise between residents and non-residents only in case they are in a comparable situation. That would be the case when the non-resident receives no significant taxable income in the residence state because that state would in such situation not be in position to take into account the personal and family circumstances of the taxpayer.¹⁰⁸

Even though the residence state in principle should be able to take into account the personal and family circumstances of the taxpayer in a case where he receives more than 50% of his total income in that state, this was not the case at hand. The circumstances was that the taxpayer had no taxable amount in the residence state which could therefore not take into account the personal and family circumstances of the taxpayer.¹⁰⁹

Thus the ECJ concluded that the tax legislation at issue created an obstacle to the free movement of workers that could not be justified.¹¹⁰

5.2 C-425/11 Ettwein - Splitting Regime

Case C-425/11 *Ettwein* from February 2013 concerned, as in the Schumacker case, denial of the splitting regime for non resident tax payers. The self-employed work-

¹⁰⁴C-39/10 *European Commission v Republic of Estonia* [2012] para. 35.

¹⁰⁵C-39/10 *European Commission v Republic of Estonia* [2012] para. 15.

¹⁰⁶C-39/10 *European Commission v Republic of Estonia* [2012] para. 32.

¹⁰⁷C-39/10 *European Commission v Republic of Estonia* [2012] para. 40.

¹⁰⁸C-39/10 *European Commission v Republic of Estonia* [2012] paras. 51-53.

¹⁰⁹C-39/10 *European Commission v Republic of Estonia* [2012] paras. 54-55.

¹¹⁰C-39/10 *European Commission v Republic of Estonia* [2012] para. 68.

ers, Mr and Mrs Ettwein, were of German nationality, lived in Switzerland, but derived all their income from Germany. German tax law required, for applicability of the splitting regime, that the tax payers had their residence within the territory of a Member State in the European Union or in an EEA state. However, the agreement between the European Member States and Switzerland granted no less favourable treatment for self-employed persons in the host state than the benefits applied for its own nationals. Thus, the treaty conferred to Mr and Mrs Ettwein the same tax advantages as applied to nationals in Germany.¹¹¹

The Advocate General Jääskinen argued that discrimination on the ground of nationality could not be the case, as Mr. and Mrs. Ettwein were German nationals. Hence, since there was no such discrimination in the context of the EU, the corresponding rules in the EC-Switzerland agreement could not be applied.¹¹² Thus the Schumacker doctrine was not considered relevant and Jääskinen concluded that the Agreement did not preclude the denial of split taxation in Germany for Mr and Mrs Ettwein.¹¹³

Contrary to the AG's opinion, the Court examined the situation of Mr and Mrs Ettwein in the light of the ECJ case law, namely *Schumacker* and *Asscher*, and stated that even though the residence state usually has the best possibility to take into account the tax payer's ability to pay, the situation is different in case this state cannot do so because the tax payer derives all or almost all of his income from the source state.¹¹⁴ The ECJ concluded that a non-resident pursuing business activity in the source state and earns all or almost all of his income there is in a comparable situation to that of a resident pursuing the same activity there. Thus, personal and family circumstances would in this case have to be taken into account by the source state. The free movement of persons established in the agreement thus precluded the denial of the splitting regime in Germany for Mr and Mrs Ettwein.¹¹⁵

As O'Shea has pointed out, the ECJ applied the Schumacker doctrine in the Ettwein case when determining the comparability of residents and non residents in situations regarding personal tax benefits. Further, the Court confirmed previous case law establishing the national treatment principle applicable in both a host and an origin member state. In this case, Germany was considered the host state and at the same time the origin state, to which the German nationals Mr and Mrs Ettwein could claim to benefit from the national treatment principle.¹¹⁶

¹¹¹C-425/11 *Katja Ettwein v Finanzamt Konstanz* [2013] paras. 22-27.

¹¹²Opinion of Advocate General Jääskinen delivered on 18 October 2013 in Case C-425/11 *Katja Ettwein v Finanzamt Konstanz* para. 35.

¹¹³Opinion of Advocate General Jääskinen delivered on 18 October 2013 in Case C-425/11 *Katja Ettwein v Finanzamt Konstanz* paras. 54 and 68.

¹¹⁴C-425/11 *Katja Ettwein v Finanzamt Konstanz* [2013] para. 27.

¹¹⁵C-425/11 *Katja Ettwein v Finanzamt Konstanz* [2013] paras. 47-53.

¹¹⁶Tom O'Shea, "ECJ Determines Applicability of German Tax Advantages for Swiss Residents", *Tax Notes International* 72 (2013): p. 259.

5.3 C-181/12 Welte - Allowance for Calculation of Inheritance Tax

In *Welte* the question was whether the free movement of capital precluded legislation in a Member State providing less allowance for the calculation of inheritance tax in case both the deceased and the heir, at the time of the death, were resident in a third country.¹¹⁷

Mr Welte, resident and a national of Switzerland, was his wife's sole heir and had inherited real estate located in Germany with a value of EUR 329 200 comprising 60% of the value of the total inheritance. The applicable amount of allowance, calculated against the value of the real estate, was determined by the tax authority to be EUR 2000. The inheritance tax for non residents was payable only on immovable property but not on bank receivables. Had Mr Welte or his wife been resident in Germany, the applicable allowance would have been EUR 500 000 and he would not have to pay any tax.¹¹⁸

The Court referred to the ECJ in order to seek clarification on whether the different treatment of residents and non residents as regards the amount of allowance applicable for the calculation of inheritance tax was compatible with the free movement of capital.

AG Mengozzi examined the compatibility of the legislation on inheritance tax with the free movement of capital which precludes restrictions that are likely to deter non residents from investing in a Member State and rules with the effect of reducing the value of inheritance. Since the effect of the German inheritance tax was that non residents were taxed more heavily than residents, that could deter them from investing in the Member State. Thus the AG concluded that the legislation resulted in a restriction on the movement of capital.¹¹⁹

If the restriction is a result of different treatment to persons who are not objectively comparable, it can be accepted under EU law. The Belgian and the German Government argued that residents and non residents in this case were not objectively comparable, since in this case Germany only had limited tax powers, an argument that had been rejected by the ECJ in previous case law. The reason therefore was that Member States normally apply identical tax for residents and non residents and the residency of the taxpayer is in such case no justification for denying a tax advantage such as an allowance. Also in those previous cases the Member States only had powers to tax immovable property located within their jurisdiction.¹²⁰

¹¹⁷C-181/12 *Yvon Welte v Finanzamt Velbert* [2013] para. 17.

¹¹⁸Opinion of Advocate General Mengozzi delivered on 12 June 2013 in Case C-181/12 *Yvon Welte v Finanzamt Velbert* paras. 3-9.

¹¹⁹Opinion of Advocate General Mengozzi delivered on 12 June 2013 in Case C-181/12 *Yvon Welte v Finanzamt Velbert* paras. 28-30.

¹²⁰Opinion of Advocate General Mengozzi delivered on 12 June 2013 in Case C-181/12 *Yvon Welte v Finanzamt Velbert* para.31-33

Mengozzi proceeded and stated that even if the ECJ would conclude that residents and non-residents are generally not comparable, as established in the *Schumacker* case, the state in which the immovable property was situated was the only state that had the possibility to take into account the taxpayers personal and family circumstances. AG Mengozzi meant that since that part of the inheritance was only taxable in the source state, the residence state had no possibility to take into account the ability to pay.¹²¹

In a case similar to *Welte*, but where the value only consisted of immovable property, the ECJ had held that if heirs of deceased persons who were resident and heirs of persons who were non-resident were put on the same footing as regards taxing the immovable property, the law has established that there was no objective difference between them. Since there was no objective difference between those taxpayers, different treatment as regards the deductibility of debts relating to that property would constitute discrimination.¹²²

As regards one of the possible justifications for the restriction, maintenance of fiscal cohesion, AG Mengozzi rejected the argument that a lower basis of assessment could be set of by a lower allowance, because in a transfer of a single asset limited and unlimited taxation are not apparently different. Furthermore, AG Mengozzi stated emphasized that the allowance granted to German residents was not connected to the value of the real estate, thus the direct link was missing.¹²³

Neither could the need to ensure the effectiveness of fiscal supervision be considered valid as justification for the restriction, and thus AG Mengozzi found the legislation at issue to be precluded by the free movement of capital.¹²⁴

The ECJ came to the same conclusion as AG Mengozzi. It is interesting to note that the Court concluded that the basis of assessment for tax on inheritance *in principle* was less for a non resident than for a resident. However, the Court put emphasis on the fact that the German tax legislation placed non-resident and resident heirs on the same footing for the purposes of taxing immovable property, thus the legislation accepted that there was no objective difference between those two.¹²⁵

In contrary to what had been held in the cases *Shumacker*¹²⁶ and *Ettwein*¹²⁷ the Court in this case did not require that the non resident was taxed on all or almost all of his income in the source state in order to be considered comparable to a resident. Although the real estate of the inheritance comprised no more than 60%

¹²¹Opinion of Advocate General Mengozzi delivered on 12 June 2013 in Case C-181/12 Yvon Welte v Finanzamt Velbert para. 39

¹²²C-43/07 *D. M. M. A. Arens-Sikken v Staatssecretaris van Financiën* [2008] para. 57.

¹²³Opinion of Advocate General Mengozzi delivered on 12 June 2013 in Case C-181/12 Yvon Welte v Finanzamt Velbert para.71.

¹²⁴Opinion of Advocate General Mengozzi delivered on 12 June 2013 in Case C-181/12 Yvon Welte v Finanzamt Velbert para.73 and 86.

¹²⁵C-181/12 *Yvon Welte v Finanzamt Velbert* [2013] para.70-72.

¹²⁶C-279/93 *Finanzamt Köln-Altstadt v. Schumacker* [1995] paras. 36 and 37.

¹²⁷C-425/11 *Katja Ettwein v Finanzamt Konstanz* [2013] paras.46 and 47.

of the value of the total inheritance, the relevance in *Welte* was put on the fact that the legislation put residents and non residents on the same footing for taxing immovable property.¹²⁸

5.4 C-303/12 *Imfeld* - Allowance for Dependent Children

In *Imfeld* the question was whether the income tax law having the effect of making unavailable the some personal tax benefits to a resident couple in case one of them derives all of his income in another Member State is compatible with EU law. The question was further what impact it may have that this person benefits partly from the equivalent tax advantage in the source state.¹²⁹

Mr. Imfeld, practising as a self employed lawyer in Germany, and his wife Ms Garcet were resident in Belgium and had two children.¹³⁰ The larger part of the household's income was earned by Mr Imfeld and taxable only in Germany due to the applicable tax treaty. Even when taxable only in Germany, the income of Mr Imfeld was taken into account for calculation of the payable Belgian tax at a progressive rate and the applicable tax deductions.¹³¹

The problem was that the “supplementary allowance for dependent children” was to be set against the highest income earned by one of the spouses. Since Mr Imfeld earned the highest income on which the allowance was calculated, and the income was not taxable in Belgium, the result was that the couple could not effectively benefit from the deduction. However, Mr Imfeld was taxed separately in Germany where he did receive an allowance for dependent children.¹³²

The question to be examined was if the Belgian tax law was compatible with the freedom of establishment. The AG observed that, according to settled case law, the allowances relating to personal and family circumstances is in principle to be taken into account by the residence state which can normally assess the ability to pay. Only in case the taxpayer derives no significant income in the residence state, the source state is required to take into account personal and family circumstances.¹³³

The “supplementary allowance for dependent children” was granted for Mr Imfeld and Ms Garcet as a couple. However, since the allowance was set against the income of Mr Imfeld that was not taxable in Belgium and deducted from the

¹²⁸C-181/12 *Yvon Welte v Finanzamt Velbert* [2013] paras 70-72.

¹²⁹Opinion of Advocate General Cruz Villalón delivered on 13 June 2013 in Case C-303/12 *Guido Imfeld, Nathalie Garcet v État belge* paras. 1-2

¹³⁰Opinion of Advocate General Cruz Villalón delivered on 13 June 2013 in Case C-303/12 *Guido Imfeld, Nathalie Garcet v État belge* para. 9.

¹³¹Opinion of Advocate General Cruz Villalón delivered on 13 June 2013 in Case C-303/12 *Guido Imfeld, Nathalie Garcet v État belge* para. 40.

¹³²Opinion of Advocate General Cruz Villalón delivered on 13 June 2013 in Case C-303/12 *Guido Imfeld, Nathalie Garcet v État belge* paras. 41-42.

¹³³Opinion of Advocate General Cruz Villalón delivered on 13 June 2013 in Case C-303/12 *Guido Imfeld, Nathalie Garcet v État belge* paras. 59-60.

taxable amount, the couple could not benefit from the allowance. The AG concluded that this result was a real disadvantage for the couple, as they would have been able to benefit from the allowance had they received all their income, or the major part of their income, in Belgium. The difference in tax treatment was according to AG Villalón, likely to discourage citizens from exercising the freedom of establishment.¹³⁴

The reason for setting of the allowance to the higher of the couple's income was to maximise the effect of the tax advantage, but in this cross-border situation the effect was the opposite. AG Villalón stated that the obstacle to the freedom of establishment was not "an inevitable consequence of the disparity of the national legislations", contrary to what the Belgian Government had argued.¹³⁵ AG Villalón further dismissed the argument that the Belgium would be free from its obligations since Mr Imfelds personal and family circumstances were taken into account in Germany: "a Member State cannot rely on the existence of an advantage granted unilaterally by another Member State".¹³⁶

As AG Villalón pointed out, the reason why Mr Imfeld and Ms Garcet were denied the tax benefit was not because Mr Imfeld was granted the equivalent benefit in Germany; there was no correlation in this regard. Thus, the freedom of establishment precluded the Belgian tax legislation in question.¹³⁷

The ECJ came to the same conclusion as the AG but emphasised that the restriction of the freedom of establishment in this case was a consequence of the disadvantageous treatment of Ms Garcet's income, fully subject to Belgian tax, without her being able to benefit from the tax advantage.¹³⁸

A problem that can arise is how to distinguish tax advantages such as the allowance for dependent children from social security benefits. This has been pointed out by Bruno Peters as he analyses the *Imfeld* case in relation to the *Lachheb*¹³⁹ case in which a tax rebate for children was classified a social security benefit. Social security rights are governed by EU regulations establishing that such rights shall not be conferred to persons on the basis of their residency. Generally it is the state in which a person works that has the obligation of making available social security benefits. In the case *Lachheb* the ECJ classified the advantage as a social security benefit because the granting of that benefit had no relation the income earned or tax to be paid by the person.¹⁴⁰

¹³⁴Opinion of Advocate General Cruz Villalón delivered on 13 June 2013 in Case C-303/12 *Guido Imfeld, Nathalie Garcet v État belge* paras. 65-67.

¹³⁵Opinion of Advocate General Cruz Villalón delivered on 13 June 2013 in Case C-303/12 *Guido Imfeld, Nathalie Garcet v État belge* para. 71

¹³⁶Opinion of Advocate General Cruz Villalón delivered on 13 June 2013 in Case C-303/12 *Guido Imfeld, Nathalie Garcet v État belge* para. 76

¹³⁷Opinion of Advocate General Cruz Villalón delivered on 13 June 2013 in Case C-303/12 *Guido Imfeld, Nathalie Garcet v État belge* para. 86 and 89.

¹³⁸C-303/12 *Guido Imfeld, Nathalie Garcet v État belge* [2013] paras 76 and 81.

¹³⁹C-177/12 *Caisse nationale des prestations familiales v. Salim and Nadia Lachheb*. [2013].

¹⁴⁰Bruno Peeters, "Mobility of EU Citizens and Family Taxation: A Hard to Reconcile Combination", *EC Tax Review* 23.3 (2014): pp. 119-120.

6 Discussion and conclusion

The aim with this thesis is to seek clarification on what type of tax rules that are considered as taking into account the taxpayer's ability to pay/his personal and family circumstances. The thesis also aim to clarify the applicable thresholds determining when a taxpayer is in a Schumacker situation. These factors determine the scope of the Schumacker doctrine.

6.1 Which Tax Rules Take Into Account the Taxpayer's Personal and Family Circumstances?

Tax rules taking into account the personal and family circumstances of a taxpayer vary among the Member States in their character and function.¹⁴¹ From *Lakebrink* we know that “[...]the ability to pay tax may indeed be regarded as forming part of the personal situation of the non-resident within the meaning of the judgment in *Schumacker*.¹⁴²

As Mattson observes the ECJ considers a basic allowance a tax benefit relating to the personal and family circumstances of the taxpayer, he points out that there are considerable differences between countries regarding the size and function of allowances. As he explains, the allowance in one country may have the function of being equal to an amount that should be available for basic consumption, whereas in another country it serves the purpose of relieving a taxpayer with incidental income of administrative filing burdens. Mattson therefore argues that it is problematic to categorise basic allowances as benefits related to personal and family circumstances.¹⁴³ As shown in section 4.2, benefits allowing for deduction of pension reserves, joint taxation for couples and allowances are included in the tax rules for which the Schumacker doctrine applies.

In C-425/11 *Ettwein* the taxpayers income was exclusively derived in the source state, Germany. As they were also German nationals, the AG found that the non-discrimination principle on the grounds of nationality could not be applies. The ECJ however established in this case that also *nationals* of a Member State, resident in another Member State, are protected from discrimination in the first state. When they are in a comparable situation to residents in that state, it is responsible for taking into account personal and family circumstances. In this case, the tax rule at issue was the splitting regime. Thus, the ECJ applied the Schumacker doctrine as regards comparability of residents and non-residents doctrine

¹⁴¹Nils Mattsson, “Does the European Court of Justice Understand the Policy behind Tax benefits Based on Personal and Family circumstances?”, *European Taxation-Amsterdam*- 43.6 (2003): p. 186.

¹⁴²See section 4.2.9.

¹⁴³Nils Mattsson, “Does the European Court of Justice Understand the Policy behind Tax benefits Based on Personal and Family circumstances?”, *European Taxation-Amsterdam*- 43.6 (2003): p. 193.

and stated that the denial of the splitting regime in this case was a restriction of the free movement of persons.¹⁴⁴

In case C-181/12 *Welte* however, the taxpayer did not receive all or almost all of the value of inheritance from the source state; it constituted approximately 60% of the total value.¹⁴⁵ Mr Welte was denied the higher amount of tax free allowance and the Belgian Government argued that the legislation at issue was in line with the Schumacker doctrine. According to the Government residents and non-resident taxpayers were in objectively different situations because the latter were only taxed on their domestic part of the assets, whereas residents were subject to unlimited taxation.¹⁴⁶ Furthermore, since Mr Welte only received part of the inheritance from the source state, the Government argued that the residence state in principle had the obligation to make available tax-free allowances in view of the taxpayer's personal personal situation".¹⁴⁷

According to the above reasoning, even though Welte was only subject to limited taxation on the inheritance and the taxable in Germany value only constituted part of the inheritance, Weltes situation was by the ECJ considered to be comparable to a heir of a deceased person who had been resident in Germany.¹⁴⁸

The reason for this was that the German legislation placed non-residents and residents on the same footing for determination of the inheritance tax on immovable property, whereas the amount of allowance was only dependent on the heir's capacity as a taxable person but not the value of the property.¹⁴⁹

Thus, while the Government argued that Mr. Welte was not in a comparable situation ECJ did not accept this argument because the law put residents and non-residents *on the same footing* for the purpose of taxing immovable property. Clearly there was no objective difference between residents and non residents, irrespective of the ratio of the value of inheritance derived from the source state.¹⁵⁰

The reasoning applied in Welte goes back to *Avoir Fiscal* in which tax rules placed companies with registered offices in the jurisdiction and branches with registered offices outside the jurisdiction on the same footing for profit taxation. Where persons are placed on the same footing, different treatment as regards tax advantages constitutes discrimination.¹⁵¹

The Schumacker doctrine did not apply in *Welte*. If it had applied, Mr. Welte would not have been comparable to a resident, since he did not derive most of his income from the source state. There must be a difference between the tax

¹⁴⁴See section 5.2.

¹⁴⁵C-181/12 *Yvon Welte v Finanzamt Velbert* [2013] para. 15.

¹⁴⁶C-181/12 *Yvon Welte v Finanzamt Velbert* [2013] 45-46.

¹⁴⁷C-181/12 *Yvon Welte v Finanzamt Velbert* [2013] para. 46.

¹⁴⁸C-181/12 *Yvon Welte v Finanzamt Velbert* [2013] para. 56.

¹⁴⁹C-181/12 *Yvon Welte v Finanzamt Velbert* [2013] para. 51-55.

¹⁵⁰See section 5.3.

¹⁵¹270/83 *Commission of the European Communities v French Republic* [1986] para. 20.

rule granting the allowance for calculation of the inheritance tax on immovable property and tax rules that are considered as taking into account the taxpayer's ability to pay that can explain why the Schumacker doctrine was not applied.

What is the difference between the allowance in *Welte* and tax rules taking into account personal and family circumstances of a taxpayer? In order to answer that question the characteristics of tax rules taking into account the ability to pay must be identified. As has been said in section 3.2 Wattel explains that “[p]ersonal allowances and non-income-related deductions weigh unspecified on a taxpayer's total income”¹⁵². This was the case also in *de Groot* and was used as an argument for allocating them proportionally.¹⁵³ In *Welte* the allowance was related to a specific type of income. However, it is worth noting that AG Mengozzi was of the opinion that *if* the case would fall within the scope of the Schumacker doctrine, the source state would be the only state having the possibility of taking into account personal and family circumstances, since the real estate was not taxable in the residence state.¹⁵⁴

Further, there was no direct link between the allowance and the tax levied on the real estate, as AG Mengozzi pointed out.¹⁵⁵ That is, the allowance did not vary, but constituted a fixed amount irrespective of the tax on the real estate. This amount was considerably higher if neither the heir was resident nor the deceased had been resident in Germany. Indeed, there is normally such a link between personal allowances and taxation of income in the residence state, since residents are taxed progressively, see section 2.1.

From the reasoning above, one can draw the conclusion that deductions and allowances taking into account the ability to pay are not attributable to specific sources of income, as the case was in *Wette*, since only the total income of a taxpayer gives information about the ability to pay. This is in line with the approach taken by Wattel but contrary to the opinion of Vanistendael who has held that inheritance tax can take into account the ability to pay. Furthermore, from the *Welte* case one can conclude that the residency of a taxpayer does not motivate different treatment (even if they are in principle not comparable) in cases when the tax legislation put them on the same footing.

The case *Imfeld* concerned the granting of a “supplementary allowance for dependent children” to a couple resident in Belgium. The couple were in *principle* granted this allowance, but in *practice* they could not benefit from the tax advantage due to the fact that one of the spouse's income that this allowance was calculated on was not taxable in the residence state. That spouse however, was

¹⁵²Peter J Wattel, “Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why Schumacker, Gilly and Gschwind Do Not Suffice”, *European Taxation* 217 (2000): p. 227-228.

¹⁵³See section 4.2.6

¹⁵⁴Opinion of Advocate General Mengozzi delivered on 12 June 2013 in Case C-181/12 Yvon Welte v Finanzamt Velbert para. 39

¹⁵⁵Opinion of Advocate General Mengozzi delivered on 12 June 2013 in Case C-181/12 Yvon Welte v Finanzamt Velbert para.71.

granted a similar advantage in the source state. First, one can conclude that the ECJ considers the real outcome when examining whether a taxpayer suffers a disadvantage. Secondly, one can conclude that the residence state cannot be free from its obligation because a similar advantage is granted unilaterally by the source state. The problem remains though how to distinguish between tax advantages and social security advantages, which is very important as it is the state in which a person works that is responsible for granting the latter type of advantage, as opposed to personal tax advantages which is mainly the residence state's responsibility.

6.2 What is the Threshold for Applying the Schumacker Doctrine?

Concerning rules that take into account personal and family circumstances of the taxpayer, it has been established by the Schumacker doctrine that 1) it is in principle the residence state that has the responsibility to take into account personal and family circumstances for tax purposes, 2) only when the tax payer does not derive sufficient income in the residence state in order to take into account personal and family circumstances, the source state is required to do so. The second situation occurs when the taxpayer derives all or almost all of her income in the source state.¹⁵⁶

When the taxpayer derives income from various member states not taking into account her personal and family circumstances, the residence state cannot be free from the obligation to fully grant advantages taking into account the taxpayer's ability to pay.¹⁵⁷ From the *de Groot case* one can conclude that the *result* in a cross-border situation is required to be that the taxpayer has his ability to pay taken into account *completely* and not only partially.

It was established in *Gschwind* that EU law does not preclude legislation setting the threshold of 90% of the total income to be earned in the source state for allowing joint taxation for non-resident couples. However, such legislation is only permitted in case the taxpayer maintains the possibility of having her personal and family situation taken into account by the residence state. Thus, the ECJ has established that there is a requirement to be fulfilled when the source state applies a threshold.

Furthermore, it follows from the case *Commission v Estonia* that even if the taxpayer earns 50% his income in the residence state, the source state cannot always refuse to grant tax advantages linked to the taxpayer's personal and family circumstances. It may be the case that the only *taxable* income is earned in the source state, which in such case must take into account the personal and family circumstances of the taxpayer. Thus, it is not possible to set a threshold establishing that a certain percentage of income earned in the source state makes a

¹⁵⁶See section 4.

¹⁵⁷See section 4.2.6.

non-resident comparable to a resident and gives the right to tax advantages taking into account his ability to pay. The personal and family situation has to be taken into account once somewhere.

One can conclude from the above reasoning that the ECJ enforces the principle of ability to pay in cases concerning the fundamental freedoms and aims to reach the result that the taxpayer's personal and family circumstances shall be fully taken into account. In some cases, however, the taxpayer can get the advantage of both a flat tax rate and personal tax advantages, as the case was in *de Groot* and *Wallentin*. The question remains, to be answered by the ECJ in *Hirvonen*, whether that problem can be solved with a system in which a taxpayer can choose between being taxed as a resident and a non-resident.

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